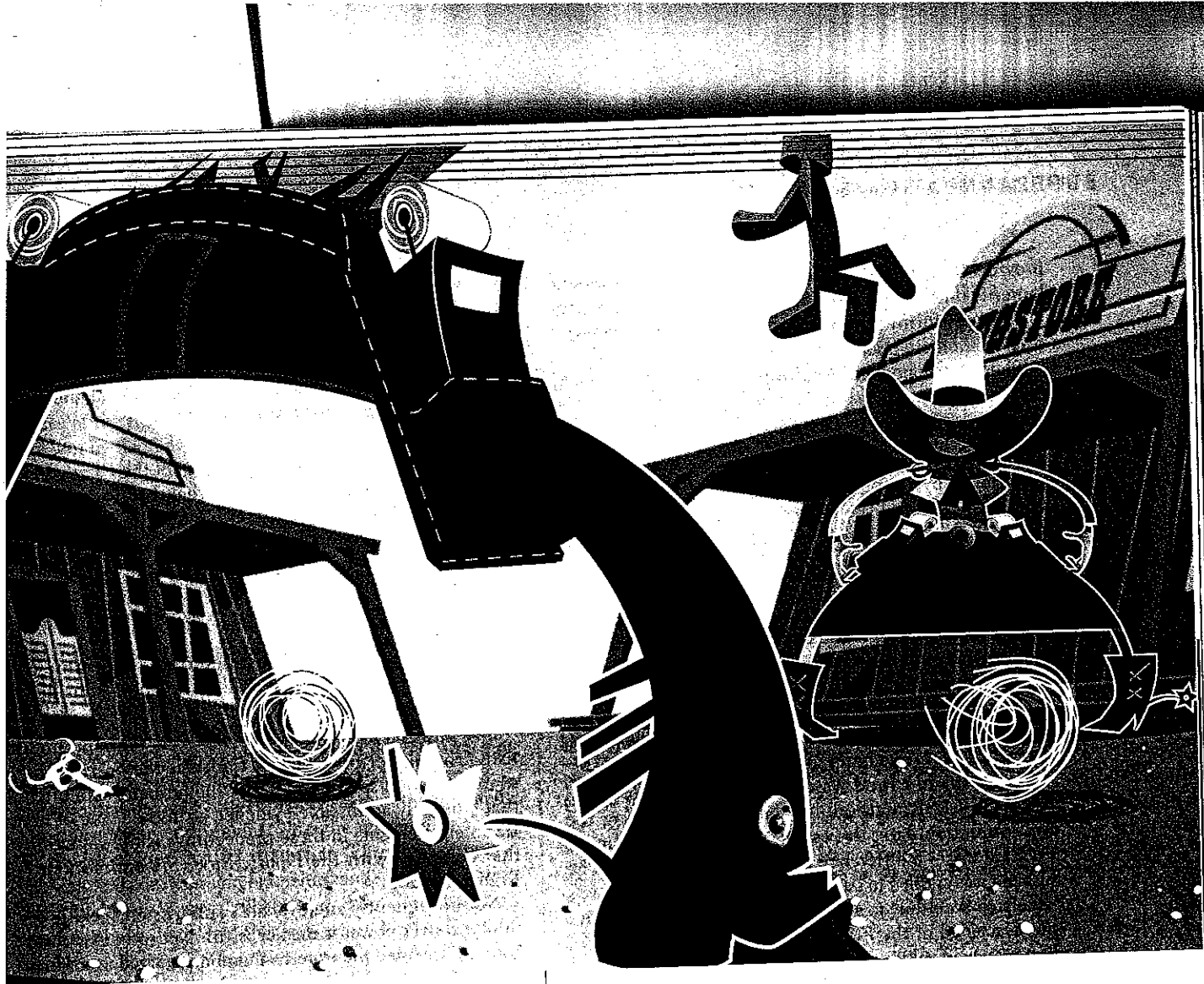


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DUAL FORMULAS CAUSE DISSENSION IN DIVISION OF SUPERANNUATION FUNDS

The Family Court has taken a “wait and see” approach to the division of superannuation benefits held in defined benefit funds.

By Shane Williams and Jacqueline Campbell



As surely as barbecues bring flies, the changes to the manner in which superannuation was treated for family law purposes have brought problems. And one of the bigger problems for the family lawyer has proved to be superannuation funds with defined benefit structures.

The family law superannuation scheme introduced in December 2002 requires superannuation interests which are to be split to be valued in accordance with the *Family Law (Superannuation) Regulations 2001 (FLSR)*.

Often, a big difficulty with defined benefit funds is valuation. This difficulty occurs if the amount the fund trustee says it will pay to the member at a given time differs substantially from the amount the fund is "worth" using the *FLSR* valuation mechanism. Same fund and same valuation date, but different values.

Background to defined benefit funds

Defined benefit superannuation funds are a relatively small proportion of the total superannuation funds in Australia.

The normal "accumulation" style fund operates similarly to a bank account, with an identifiable pool of money available to each member at any given time. Defined benefit funds are more complex. There is no specific sum of money for the member and no account balance. Instead, there is a promise to pay a benefit at a future date calculated in accordance with a formula.

The payment formula used by the fund can vary according to different member triggering events: retirement, resignation, death, etc. It also changes from fund to fund.

Usually the payment formula includes such variables as years of fund membership, the member's salary and a factor called a "benefit multiple". Again, the benefit multiple varies from fund to fund.

How can there be two different values?

The difference in values arises because the *FLSR* uses a standard formula to estimate the value of the interests of individual fund members in a range of defined benefit funds. It is effectively a "one size fits all" approach to valuation.

As an example, if the fund being valued pays its benefit 100 per cent as a lump sum, the *FLSR* approach is to estimate the member's current retirement benefit (that is, what they would be entitled to if they retired as at the date being valued) then reduce this figure due to the fact that the member will receive this sum many years hence – usually on retirement at age 65. The basis for the discount is that a dollar received now is worth more than a dollar received in the future.

So, if the member has an estimated current benefit of \$200,000 at age 45, the legislative model will assume that this \$200,000 amount will not be received by the member until retirement age (say, 65). The intervening period of 20 years will lessen its value, and a discounting factor is therefore applied to the \$200,000 figure to give the valuation.

Compare this approach with what the fund itself would estimate as being payable in member benefits at any given time. The fund may pay a retirement benefit using its own retirement benefit formula. Alternatively, the fund may

provide a resignation benefit (rather than a retirement benefit) until the member reaches a certain age, using a different formula to the fund's retirement formula. There are other options.

There is the possibility of large discrepancies between the two values.

Dealing with the anomalies

A thorough consideration of the valuation problem was undertaken by Young J in the 2005 case of *BAR v JMR*.¹ That case involved the husband's defined benefit fund interest in the Emergency Services Superannuation Scheme (ESSS). The husband had joined the predecessor to this fund in 1974 and transferred to the ESSS in 1987. The parties separated in 1997 and the husband ceased making regular contributions to the defined benefit interest in the ESSS in 1998.

The husband was aged 51 and the wife 44. The superannuation interest was in the growth phase.² Except for retirement due to disability, fund members receive a benefit paid 100 per cent as a lump sum.

The husband's fund was valued shortly before trial using the FLSR methodology at \$403,810. Using the same valuation date, the estimated fund payout figure was \$534,085 – a difference of more than \$130,000. The husband was entitled to receive a retirement benefit that was calculated according to a different formula to the legislative one described in the FLSR – giving rise to a significant discrepancy in value.

The husband offered the wife the benefit of a splitting order in the growth phase using \$37,782 as the base amount. The wife sought 50 per cent of the husband's entitlement in the ESSS upon vesting of his interest – that is, once his superannuation was in the payment phase.

Young J carefully considered the benefit structure of the ESSS and evidence concerning the retirement intentions of the husband.

His Honour, in a 90-plus page judgment, took time to assess the likely future payout figures of the fund. Noting that the valuation of the husband's interest in the ESSS had increased from \$359,369 in January 2004 to \$403,810 in February 2005 (both FLSR valuations), Young J commented as follows:

"That is almost a \$45,000 increase in one year. That increase I find to be a very significant fact in evidence. The calculation can easily be done as to what would be, on a like basis, the increase in the husband's superannuation interests over five, 10 or even 14 years until retirement. On one view the husband's interests could more than double in value. This comparative analysis of this increase in value in the superannuation interests, in a period less than one year, demonstrates a strong reason for there to be a splittable payment, as a percentage interest, in the payment phase. The wife should be entitled, as a matter of justice and equity, to share in any sustained growth in value of her allocated base amount or percentage split relevant to any splittable payment in her favour in this Fund".

His Honour went on to make a splittable payment in the payment phase. As the future value of the husband's

defined benefit interest was so uncertain, he believed that the appropriate way to deal with the problem was to give the wife a fixed percentage of what was available to the husband when he took his retirement benefit.

Effects of the Family Law Act Section 90MT

If a splitting order is sought, s90MT(2) of the *Family Law Act* is relevant. That section states that, before making a splitting order, "the court must make a determination under paragraph (a) or (b) as follows:

- (a) if the regulations provide for the determination of an amount in relation to the interest, the court must determine the amount in accordance with the regulations;
- (b) otherwise, the court must determine the value of the interest by such method as the court considers appropriate".

The husband relied on s90MT to prevent the court from using the higher fund payout figure as the basis of the superannuation split. Counsel for the husband submitted that "the only admissible evidence as to the value of his ESSS entitlements in these proceedings is the valuation that complies with the *Family Law (Superannuation) Regulations 2001*".³

Not infrequently an advocate's submission seeking to limit a court's power is unsuccessful. Not so in this case. Young J accepted the expert valuation prepared according to the FLSR. He did, however, question whether an FLSR valuation would bind a court in all circumstances:

"Notwithstanding that acceptance [of the FLSR valuation evidence], the question that I posed to counsel and which remains worthy of further consideration is whether a trial Judge should, in all cases and without discretion, be bound to adopt a valuation produced in accordance with the Superannuation Regulations and Schedule 2. Alternatively, is it the overwhelming requirement of the Court to achieve a just and equitable result even if it be necessary to reject or vary a Schedule 2 valuation?"⁴

Valuation difference and s75(2)

Although accepting the FLSR valuation, Young J noted that the husband would receive considerably more as a payout from his superannuation fund than the valuation under the FLSR suggested. He characterised this "extra" amount as a s75(2) factor:

"The expert valuation evidence in this case can be seen to highlight the inadequacy of the Schedule 2 valuation method. I am wholly satisfied that on his elected retirement date the husband will receive a more substantial superannuation payout than a lump sum calculation on a formulae basis... I conclude that, on the facts of this case, I can and should evaluate this future increased capital payment and the apparent inadequacy of the methodology contained within the Superannuation Regulations as relevant s75(2)(f) and (o) factors".⁵

Analysis and conclusions

Splitting a defined benefit interest in the growth phase will almost certainly be unfair to one party, since it is

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not known with certainty what the member will receive until the benefit is paid.

The Court decided that the wife should receive 35 per cent of the husband's interest upon vesting.

Young J was concerned about the possible range of future values of the husband's superannuation. He resolved this problem by flagging the husband's interest and ordering a percentage split when the interest became payable – though at the expense of the "clean break" principle. The wife will receive a fixed portion of the superannuation pie, whatever size that may be. But the husband must be entitled to take his benefit before the spoils can be shared: the date of that event is uncertain and could be many years away.

The husband appealed the decision, but did not challenge the correctness of the approach. Rather, the appeal related to the assessment of contributions and s75(2) factors. The appeal was unsuccessful.


It is tempting to view this case as being one that returns full circle to pre-December 2002 decisions such as *O'Shea's case*,⁵ where the court adjourned the case for 23 years so that the wife could obtain a share of the husband's superannuation entitlements when he retired. But Young J's decision goes further than that. The level of curial analysis and consideration of the husband's superannuation interest in this case is substantial. The super splitting changes have deepened the level of understanding and debate on superannuation. It is not simply a case of "back to the future".

There are also implications in this decision for the role of valuation evidence in superannuation matters. The Court indicated it was looking for guidance – not just on the calculation of an amount using the *FLSR* method, but also for wider expert input as to a "just and equitable approach" to valuing a particular interest. This will presumably involve a greater consideration of the special characteristics of the fund in question and the personal circumstances of the member. For example, Young J spent some time considering when the member was likely to retire, and the effect that would have on his superannuation payout from the ESSS.

Defined benefit funds present particular problems to the family law process. This case gives a careful analysis of difficult defined benefit issues and produces a solution that is both old and new. ●

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1. (2005) FLC 93-231.
2. A superannuation interest will either be in growth or payment phase. Growth phase is that part of the superannuation cycle in which the member is still accumulating benefits, usually via employer or employee contributions. Payment phase is reached when the member receives their superannuation benefit.
2. *FLSR* (para 236, p70).
3. Schedule 2 valuation (para 238, p70).
4. *FLSR* s75(2)(f) and (o) factors (pp74-75).
5. (1988) FLC 91-964.



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