

Duxbury revisited

Is Duxbury a dinosaur?

This was the key question at the Brewin Dolphin inaugural family law and wealth management conference 2017.

To help answer that question, family law partners from over 70 firms were taken through the financial ramifications of the Duxbury formula, by George Mathieson of Mathieson consulting and Lee Clark, a Chartered Financial Planner from Brewin Dolphin. Afterwards, the legal issues were collaboratively debated by Christopher Wagstaffe QC and Laura Heaton both of 29 Bedford Row Chambers. This article summarises the pros and cons of using the Duxbury tables compared to the newer approach of cash flow forecasting.

Duxbury v Duxbury: The facts

Although most practitioners are familiar with using the Duxbury tables, the facts of the case are not so easily recollected.

The parties had been married for 22 years before they divorced in 1984; the wife was 45 years old at the time and the parties had three children. Mr Duxbury was the Chair of a public company and his income provided the family with a luxurious lifestyle during the marriage. Although Mrs Duxbury lived with another man, he had a modest income and she had no intention to marry him. The court ignored the new partner's income for the purpose of the case.

It fell to Mr Duxbury to provide his ex-wife with an income. He earned £145,000 per annum and had assets in excess of £2 million. The court made a capital award in her favour of £600,000 instead of awarding her periodical payments. Of that sum, £51,000 was needed to clear her overdraft and £9,000 was used to replace her car. She retained £540,000; a sum intended to last her 35 years, until she reached the age of 80. It was expected that she would derive a net income of £28,000 per annum, "the assumption being, and it is all theoretical, that at the

end of the 35 years the whole of that fund will have been spent", Ackner LJ, Court of Appeal.

Underlying financial assumptions of Duxbury

Anyone familiar with the notes to the Duxbury tables will know that there are a number of assumed financial assumptions built into the formula, which are:

1. a uniform income yield;
2. a uniform rate of capital growth;
3. a uniform rate of inflation;
4. a consistent tax regime, with bands and allowances increasing in line with inflation;
5. a constant level of drawdown;
6. a consistent rate of churn;
7. the recipient will survive to the average of her contemporaries (Note: 50% of people live beyond the average life expectancy!);
8. the recipient will be entitled to the full state pension;
9. the state pension will increase in line with prices, and
10. the age that the state pension will be drawn will not change.

With such narrow assumptions it is unlikely that these could achieve real yields. Notably, Duxbury does not include the cost of investing money which is a real expense often estimated at 2% of the money invested.

Duxbury v Real Life

Table A, compares the assumptions used in the Duxbury tables against the current financial position using more accurate ('real') assumptions supplied by Brewin Dolphin.

It can be seen that the rate of inflation is higher and both income and capital yields are lower. In addition, the life expectancy of a 45 year old woman according to the ONS is now almost 10 years longer than the Duxbury table.

Cash Flow Forecasting

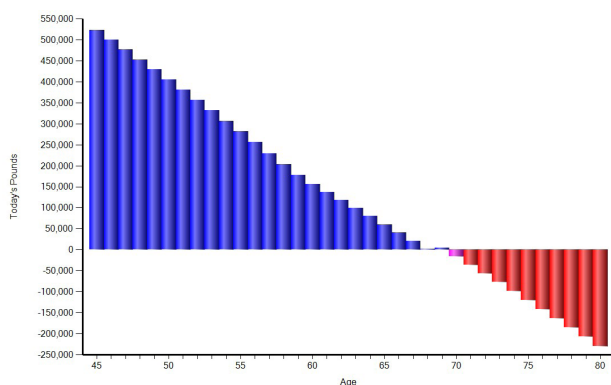
It is possible to predict more closely the long term financial needs of one of the parties by using the “real” figures seen below in a cash flow forecast. The forecast is prepared using specialist software adopted by financial planners, such as Lee Clark of Brewin Dolphin, to assess a more accurate financial picture in cases where a lump sum might be needed.

To explore the merit of such a forecast, at the conference, the speakers considered whether Mrs Duxbury would really have had enough capital to draw out her required annual income sum of £28,000 (net) until her 80th birthday.

Table A

| Assumption | Duxbury (1985) | Real Life (2017/2018) |
|-----------------------------|-------------------------------|--|
| Inflation | 3% | Average 3.4% (RPI average over 30 years) |
| Income yield | 3.5% | 3.1% *(assuming a blended low-moderate portfolio) |
| Capital yield | 3.75% | 3.4% * |
| Life expectancy 45 year old | 35 years – (Average age - 80) | 44.8 years (Average age – 89.8) Chance of reaching 100: 16.9% |

Table B



The above table reflects the real rates of inflation, tax rates and current maximum state pension entitlement, from the year that Mrs Duxbury received her lump sum.

It takes into account the fact that she would have drawn a flat net income of £28,000 per annum.

The forecast shows that using real figures, it is likely that she ran out of funds aged 69. If she lived to 80 years old, her expected average life expectancy at the time of the case, she would have had 11 years without any capital or an income. It is more likely that she would have had to draw much less from the fund per annum for it to last until the target age of 80, with the expectation she would not outlive this date. The table assumes that she didn't remarry and her other circumstances remained the same, for example, she didn't inherit money, start working or win the lottery!

The Real Clean Break Settlement

More importantly, cash flow forecasting can be used to forecast how much money Mrs Duxbury would have needed in 1984 to create a fund that would allow her to draw a net income of £28,000 to the end of her then life expectancy of 80 years.

The forecasting software confirms that Mrs Duxbury needed £745,626

Table C

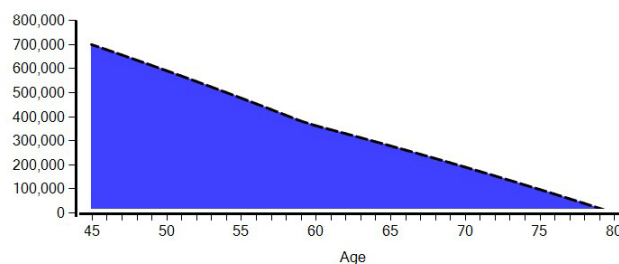


Table C shows that if she had been awarded an additional £145,626 she would have run out of money, as expected, aged 80. This would have been useful information to have had in 1984 when the parties were at court or trying to negotiate a clean break!

Cash flow forecasting can work in both directions. It is easy to look to the past on a decided case, as demonstrated at Table C. Using cash flow forecasting to look forward, to predict the sum required for a new client is possible and can be done with a greater degree of accuracy than by using the Duxbury assumptions but relevant facts, figures and assumptions will be required to make it meaningful.

What happens when the stock market crashes?

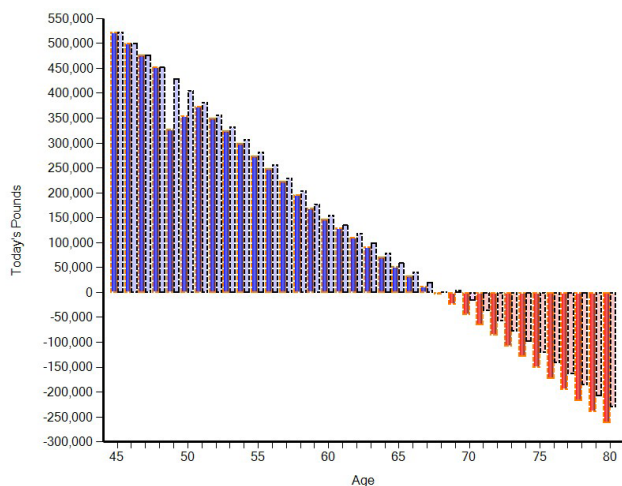
Table D, shows that cash flow forecasting can be used to estimate the impact of a stock market crash on Mrs Duxbury's investments. Lee Clark explained that since Mrs Duxbury had received her lump sum in 1984 there had been 3 significant 'crashes' which would have eroded the value of her fund. It is assumed that she continued to draw money at the fixed rate of £28,000 per

annum for her expenses, despite the fact that the markets had fallen and taken many months for her funds to recover in value per crash. The act of taking money when the markets have fallen is known as ‘pound cost ravaging’.

Table D shows that Mrs Duxbury’s fund would have taken 2 years to recover from the losses caused by the three market crashes.

Pound Cost Ravaging

Table D



Think:

- 1987: -23% in a day (recovery 456 days)
- Tech bubble: 2000 -9.1%, 2001 -12%, 2002 -22.3% (1015 days)
- 2008 financial crisis: -30% (230 days)

The conference debate

Christopher Wagstaffe QC and Laura Heaton took to the floor to discuss the usefulness of the Duxbury tables instead of, or as well as, using real assumptions in modern cash flow forecasting.

They began by asking the audience a simple question: “Imagine you are 45 years old and you win £550,000 in the lottery. Instead of the lump sum, you are offered a net income of £28,000 for the rest of your life, no matter how long you live. What would you do?” The audience voted were 60/40 in favour of taking the capital lump sum now rather than the secure lifetime income.

The barristers were keen to point out, that the financial information publicly available shows that it is difficult to guarantee a net income of £28,000 from a lump sum of £550,000. This in their view was most likely due to the uncertainty of any stock market’s performance; difficulty

in knowing how long you will live and the investment criteria permutations (Table A). Knowing that information, the majority of people demonstrated that they preferred to have the lump sum in hand rather than the guaranteed income.

The issue of income or capital can be a thorny one in the context of matrimonial proceedings. Although the financial calculations form part of the equation, the other part of the equation is about risk and which of the parties to the marriage should bear risk and to what extent that risk is manageable.

The real question for Mrs Duxbury must be this: what is the value to her today, of an income stream of £28,000 for life. There are risks to both parties of paying/receiving a lump sum rather than paying/receiving periodical payments.

For example, if Mrs Duxbury took the lump sum instead of periodical payments and then remarried after 5 years, Mr Duxbury might feel that he paid too much as a lump sum. In this scenario he has “lost”. On the other hand, had he paid periodical payments, his liability would have ended upon his ex-wife’s remarriage.

Likewise, if Mrs Duxbury took the periodical payments order rather than a lump sum, and Mr Duxbury was made redundant after 5 years, she might have preferred in retrospect to take the lump sum payment. She “loses” in this scenario.

The notes to the Duxbury tables in At A Glance provide that: *“the capitalisation of a periodical payments award should therefore aim to achieve as fair a balance as possible between ensuring that the payer does not pay too much and that the payee receives enough but no less”.*

Conclusion

In concluding their observations, both barristers agreed that in certain cases it would be worth the parties paying for a bespoke cash flow forecast calculation to be carried out. The court might take the pragmatic view that up to FDR it would be sensible to use a Duxbury approach. If the matter doesn’t settle at the FDR hearing, it might be proportionate to go ahead with cash flow forecasting for use at the final hearing.

As a final word, Christopher Wagstaffe QC said, “beware the danger of using the wrong tool for the wrong job!”.

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