

Pension Options on Divorce



INTRODUCTION

Often, in the past, pensions were deemed 'too complicated' and 'overlooked' in divorce settlements. They are indeed complex but increasingly they can form the largest asset, alongside the matrimonial home. Whilst the house can be sold or transferred, a pension cannot simply be sold and distributed.

DIFFERENT TYPES OF PENSION ARRANGEMENTS

In addition to the State Pensions, there are two main types of pension arrangement:

- A **Defined Benefit** (pension) also known as a **final salary** arrangement whereby the pension receivable is determined amongst other things by the scheme rules, your length of service and your final salary and
- A **Money Purchase** arrangement. Put simply; the pension you receive in retirement is determined not by your final salary but mainly by the value of your pension funds, your age and interest rates at the time you take your benefits.

Whilst **State Pensions** are, currently, paid at age 65 for males and 60 for females, other pension benefits can be drawn between the ages of 50 and 75. (From 6th April 2010 between ages 55 and 75). This can be important in the decision making process if one party wants to take their pension benefits earlier than the scheme type will normally allow. A forecast of the Basic and Additional State Pension benefits can be obtained from <http://www.thepensionservice.gov.uk>

HOW TO VALUE PENSION BENEFITS

There are a number of ways of valuing pension benefits. For **Money Purchase** arrangements it is often the current value. For **Defined Benefit** schemes it is often the cash equivalent transfer value. However, this is not the only way to value accrued scheme benefits and can be undervaluing the real benefits of the scheme.

CONSIDERATIONS

Can the pension be used in the financial settlement? Is it appropriate to use the pension in the settlement? Are there other ways of accounting for the pension? Which option is best?

OPTIONS

- Offsetting
- Attachment Orders
- Sharing

Offsetting

Offsetting involves taking a global view of the matrimonial assets, including the value of the pension rights, and compensating for the loss of pension rights by redistributing or balancing against the value of other assets, such as investments or property. For example; if the value of pension benefits were calculated as being £100,000 a similar amount would be transferred from say investments to 'offset' that. Offsetting is usually immediate and avoids the complications of attachment orders and sharing. However, there may be cases where the value of the pension rights represents such a proportion of the matrimonial assets that offsetting becomes impractical.

If other assets of the marriage are to be offset against pension rights, it should also be borne in mind that there is no single correct or consistent method of comparing the respective values.

Attachment Orders

Attachment Orders are a direction by the Court to the pension trustees to pay part or all of the member's benefit to the ex-spouse on retirement or death. For example, an Order to pay 50% of the pension in payment to the ex-spouse would be 'attached' to the scheme in order that it is recognised when the scheme member takes his/or her retirement benefits. It is crucial to remember that an attachment order does not in itself operate to transfer legal ownership of all or part of the benefits from the member to the ex-spouse.

Attachment orders must be worded precisely, so as to make clear whether it is the benefit of pension income, retirement tax-free cash or lump sum payment on death (or any combination of these) which is to be attached. It is important to note that an order made against pension income benefits (but not lump sum benefits) would cease on the re-marriage of the recipient ex-spouse (but not on the re-marriage of the member), as attachment orders are a form of deferred spousal maintenance.

It is not possible to obtain an attachment order against either the Basic State Pension or SERPS/ S2P benefits.

There is general agreement that the problem with attachment orders, and the reason they have proven unpopular, is that they do not transfer ownership or control of the proportion of benefits to the ex-spouse. However, it should not be dismissed without careful consideration of the facts.

Sharing

When a pension sharing order is granted, benefits are divided between the couple at the time of divorce and a legal transfer of ownership of the agreed proportion of the benefits is made from member to ex-spouse.

For **private sector schemes**, there are essentially two ways in which such a transfer can be arranged:

- The scheme must offer the ex-spouse an external transfer value, which may be placed in a pension arrangement of their choice, and
- The scheme may, in their discretion, offer the option of an internal transfer value, whereby the ex-spouse becomes a 'shadow' member of the scheme in their own right.

If the private sector scheme is under-funded, then 'shadow' membership must be offered unless the former spouse has rejected the offer or the scheme trustees are prepared to pay the full cash equivalent transfer value, rather than a lower one which reflects the under-funding position.

Public sector schemes are not obliged to offer external transfers and are therefore expected only to offer internal transfers.

It is possible to obtain a sharing order against SERPS / S2P benefits. The DWP will provide a notional capitalisation of the value of SERPS benefits for use in the calculation of matrimonial assets on submission of Form BR20 to the Pensions Service in Newcastle.

It is worth remembering that many people have more than one source of pension benefits, and not all pension arrangements need be treated in the same way. For example, where one party had three pension contracts, it would be permissible to offset the first, attach the second and to share the third. Equally, where there are several sources of private pension it may make sense to transfer all of one or more contracts to the ex-spouse rather than arranging for a partial share in more than one contract.

COSTS

In order to minimise administration and implementation costs, which are understandably charged by each scheme, it is often advantageous for the member to consolidate his or her various pension 'pots' before a pension sharing order is applied. Consideration should also be given to whether guaranteed annuity rates or benefits are available, before any final decision is made.

CONCLUSION

There is no one size fits all solution. Each case is different because elements other than just the pensions will need to be taken into account in reaching a decision. Individual advice is essential.

Once the financial settlement is completed, it is essential that both parties review their new individual financial positions and amend to suit their own financial and personal circumstances.

NB. This is only a summary of the options available. Individual advice is essential prior to taking any action as this area is complicated and requires highly personalised advice.

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No responsibility can be accepted for the accuracy of the information in this facts sheet and no action should be taken in reliance on it without advice.
Please remember that past performance is not necessarily a guide to future returns.

The value of units and the income from them may fall, as well as rise. Investors may not get back the amount originally invested

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