

Pensions and Divorce



Latest statistics

In 2009, the divorce rate in England and Wales decreased by 6.3 per cent to 10.5 divorcing people per 1,000 married population, compared with 11.2 in 2008. The 2009 divorce rate is the lowest since 1977, when there were 10.3 divorcing people per 1,000 married people.

Compared with 2008, divorce rates in England and Wales fell across all age groups in 2009 for both men and women. (Office for National Statistics, 2011).

Divorce legislation

Pension benefits within divorce settlements are set out in the following legislation:

Matrimonial Clauses Act 1973

This deals with the provision of a 'clean break' wherever possible.

Pensions Act 1995

This requires courts to take pension rights into account when assessing assets on divorce. It introduced the concepts of earmarking pension benefits as well as the basis for cash equivalent transfer values (CETVs) for assessing the value of a pension on divorce.

Welfare Reform and Pensions Act 1999

This brought in the option of pension sharing on divorce. The thrust of the legislation is to attempt a 'clean break' settlement for pension funds on divorce. It states that pension benefits will still be taken into account in divorce settlements. Offsetting and earmarking will still be options to consider, however, a new option was introduced which allows the pension benefits to be shared or split between the parties at the time of the divorce.

Offsetting

This simply means that the pension funds are valued, and the spouse with the greater benefits provides the other spouse with additional funds elsewhere in the settlement to compensate them for the loss in pension rights. In an ideal world this system would be by far the simplest solution, however many people do not have sufficient assets to enable offsetting to be applied.

Earmarking

Earmarking applies to all private pensions (including those in payment), but not state benefits. It entails the court issuing an attachment order to the pension scheme, which requires the trustees of the pension scheme to pay a proportion of the member's benefits directly to the ex-spouse when the benefits are taken. The court can also earmark a proportion of the member's death in service lump sum and widow(er)'s pension benefits for the protection of their ex-spouse.

Earmarking has many problems, not least of which is that the pension remains under the control of the member. If he or she decides not to retire, to invest riskily, or take any other action prejudicial to the ex-spouse there is nothing that they can do about it. Furthermore, if it is likely that the petitioner will remarry prior to the respondent's retirement age, then except for some safeguard on the life cover side, this procedure is probably a costly waste of time.

Pension Sharing

Pension sharing applies to all pensions excluding the basic state pension. All pension benefits are valued (see CETV below) and the petitioner with the lower funds is then granted a share of the member's benefits so as to equalise pension provision at the date of divorce. The share can be transferred to the petitioner's own scheme or the petitioner may become a 'paid up' member of the respondent's company pension scheme.

The option of a paid up benefit is less often used as the retaining scheme will not wish to have the increased costs and disclosure requirements associated with additional members who are not employees. Pensions in payment can be 'unbought', split and 'rebought' using the annuity rates for the member and petitioner at the date of divorce. If the petitioner is much younger, they can use the lump sum as a pension contribution, choose pension fund withdrawal or many other alternatives.

The biggest problem with pension sharing is the cost. Schemes are entitled to charge for the calculations and administration involved in splitting the benefits. As many divorces are Legal Aid based, money may not be available to pay for good advice, which means that the recipient will either lose substantial sums via commission payments, or transfers will be uneconomic.

Cash Equivalent Transfer Value

The CETV is the basis for valuing the pension benefits held by a divorcing member. This value can either be used to calculate an offset against other assets of the marriage, or as a measure to divide the pension between the member and the former spouse. The date of valuation is the divorce date.

In many cases, the CETV is unfair to the petitioner as it is the minimum valuation of the member's fund. For example, on a final salary scheme the valuation is done assuming the member is divorced, hence the CETV takes no account of the widow(er)'s benefits.

In the case of a money purchase scheme it will probably be the external transfer value, which frequently includes a charge against the fund for the accrued costs of the scheme between the date of transfer and the retirement date of the plan.

For more information please contact your financial planner or investment manager, or alternatively call us on 01223 720 208.