Our Guide to Pensions & Divorce

Overview

Pensions are becoming increasingly complex despite the Government's attempts to introduce greater simplicity and access through the Pensions Freedom regime. Pension funds can have a huge impact on divorce settlements and it is not unusual to see the value of these funds far outweighing the value of the matrimonial home!
New pension flexibility means you have options, but with choices comes the need for advice on the advantages and disadvantages of each option and how they will impact upon the final settlement. Advice should be sought at the earliest possible stage, even before formal negotiations begin as pensions are often a large part of the divorcing couple's accumulated wealth. In the formal split of assets much consideration needs to be taken in dealing with the pensions.
Explaining the complex issues in layman's terms is not easy and this guide helps to give some valuable pointers and to explain a few of the options that are available to you. But it is only a guide and we urge you speak with an independent Chartered Financial Planner who is experienced in this specialist area of financial advice.

There are the 3 basic options

Offsetting

This is where the benefits within a pension are "offset" against other assets. For example if the husband's pension is worth £500,000 and there is a jointly owned matrimonial home worth £1,000,000 the pension could be offset against the house, which means that the husband keep his pension and the wife has the house in totality (or other assets of equal value). The wife will have no future claim on the husband's pension in the future.

√ Simplicity – exchanging assets of equal value

√ A fairly straightforward administration process

√ No Court order requirement

X One party may be left without pension benefits

X Possible loss of death benefits from the pension

Earmarking

This agreement means that when a pension becomes payable at some point in the future, a % of the pension will be paid to the ex-spouse and the pension provider will be instructed by the Court to ensure that this is done. Earmarking also applies to lump sum death in service benefits. However there are a number of disadvantages to the Earmarking option and it is rarely used except in certain circumstances which will be explained by your lawyer.

√ Both spouses will receive pension benefits in the future

√ Death in Service benefits can be earmarked

√ Existing pension annuity payments can be earmarked.

X Earmarking ceases on remarriage

X Earmarking ceases on the death of a scheme member

X Pension income will be taxed at the pension member's income tax rate which may be higher than that of the ex-spouse and this can lead to an unwanted tax liability.

X The ex-spouse has almost no control over the pension award and can be left high & dry if the spouse with the pension decides to defer his pension date.

X Even in an acrimonious divorce, earmarking means that there is no "clean break" and a certain amount of contact between the ex-spouses is inevitable.

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Sharing

A Pension Sharing Order, known as a Pension Credit, will be issued by the Court at the time of divorce awarding an agreed % of the pensions transfer value to be given to the ex-spouse. The recipient will generally transfer the amount into a pension scheme of their own. Or, there may be the option that the existing scheme will allow the recipient to become a member of their scheme

√ Both parties will have a pension that allows them to control their own pension and this achieves a clean break.

√ No need for any consultation or contact with ex-spouse regarding investment decisions, retirement dates or contributions. Once done, you have your own pension with no ex-spouse interference.

√ If either of the ex-spouses re-marries it has no effect on the pension.

√ Any income taken from the pension is taxed at the recipients own rate.

X There are possible Lifetime Allowance issues for high earners - one area where advice is vital.

Is there a “best option”?

Each option carries advantages and disadvantages and circumstances will dictate the best way forward. If there is a situation where different options might favour one or the other party, the lawyers will help you to achieve a settlement that is palatable for both parties through a period of negotiation which will often involve the input of a qualified IFA.

Decisions must be made with the technical input of a qualified pension adviser and the descriptions above are a guide as opposed to advice.

Valuing a pension

Asking a pension provider for a current valuation of a pension may appear to be a simple task, but it very much depends if the pension to be valued is a Defined Contribution (Personal) pension or a Defined Benefit (Final Salary) scheme as these are very different and only a small number of qualified IFAs are able to advise on Defined Benefit schemes.

Defined Contribution Pensions – The most common of these are “personal pensions” or Group Personal Pension (provided by employers) and are usually administered by an insurance company. Another common plan is a SIPP (Self Invested Personal Pension). Valuing these plans is straightforward, but there may be early encashment penalties and other benefits that could be lost on transfer. Once again a pension specialist will have much experience in this area and will be able to identify any other negative factors that may apply.

Defined Benefit Pensions - These are also commonly known as “final salary” or “company pension” schemes and are much more complex. It is therefore vital to ensure that the financial adviser is one of the small number of experts who are qualified to give advice on this type of pension. The main difference between a “Company” and “Personal” pension is that the “Company/Defined Benefit” scheme has an entitlement to future pension benefits as opposed to a value, and normally this entitlement will be based on a % of salary paid on retirement and dependent upon the length of service. As an example someone may be entitled to 1/60th of their final salary for each year worked. So someone with 40yrs service would retire on 40/60ths (or 2/3) of their salary upon retirement. These schemes are becoming less common as they are a huge financial burden on companies and more and more are closing to new members or falling into the Pension Protection Fund “lifeboat”.

If the pension entitlement is being valued for a divorce settlement it will be converted into a Cash Equivalent Transfer Value (CETV). Often this might involve the services of an actuary as the scheme may have specific variables that need to be considered. Once again you need to be guided by a qualified pension expert who has the technical qualifications and experience to undertake this type of analysis.

Death Benefits

Any death benefits attached to a pension need to be looked at very carefully and the consideration of replacing this valuable benefit needs to be carefully undertaken. Factors that have to be considered are the cost of implementing traditional life or term assurance, the health of the person requiring the cover. Clearly this is an area that needs to be consideration when looking at the 3 basic pension “options” described earlier.

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Older age divorces.
Where a divorce occurs at an older age and once a pension is already being drawn, there is even more technical input required in order to deal with this situation, and clearly expert advice is vital.

The State Pension
The **basic** State Pension is not a consideration in Sharing or Earmarking, however the additional State Pension CAN be shared in a settlement. The Form E which is the financial declaration of assets which has to be completed by both parties will normally show if there is an additional State Pension that needs to be considered.

Other Financial Assets
As mentioned previously the pensions are often the largest financial assets within a marriage, but this does not mean that other financial assets should be treated lightly. Whilst the value of things such as ISAs, endowments and other financial instruments may be small in comparison to the pension and house, they still need to be looked at as one asset can be more advantageous to one party than the other. Another are where an expert is required.
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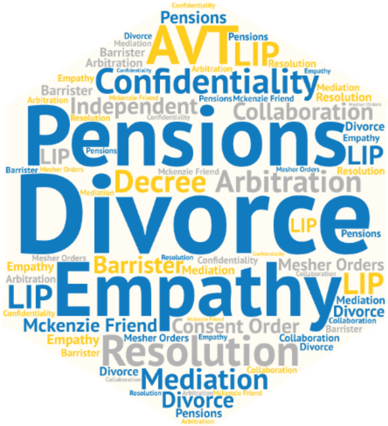
Scottish Law
There are certain critical differences in the way pensions are dealt with under Scottish law and the details above relate to England & Wales.

In conclusion
Divorce can be a confusing and traumatic time, but an expert IFA will work with you and your legal team to advise you with clarity, sensitivity and discretion.

A suitably qualified Chartered Independent Financial Adviser with the appropriate skills will help you with the following during a divorce;

- Deciding which of the three pension options is best for your particular circumstances.
- Maintaining a relationship with your solicitor or barrister to ensure that a palatable settlement is achieved
- Dealing with and checking the valuation of Personal and Company pensions
- Helping to rebuild the pension benefits for the spouse who has had to give away benefits as decreed by a financial order
- Dealing with the possible replacement of death benefits that have been lost as a result of a financial order
- The implementation of a post-divorce pension "share". Only an independent expert will be able to find you the best option for your particular circumstances
- Becoming your post-divorce adviser for both pensions and cash settlement investment strategies.



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