

Pensions & Divorce

History

Matrimonial Causes Act 1973

This Act gave courts in England and Wales the power to take the value of Personal and Occupational Pensions into account when settling the matrimonial estate via offsetting, although this was not compulsory.

Matrimonial Causes (Northern Ireland) Order 1978

This Order gave similar provisions to courts in Northern Ireland as those introduced above.

Family Law (Scotland) Act 1985

Pension rights to be treated as part of the matrimonial property to be divided between the divorcing parties.

In Scotland, the value of pension benefits had to be offset (though the ex-spouse had no direct access to the pension) as part of the financial settlement. There was no such compulsion to allow for the pension value in sharing the assets for England, Wales or Northern Ireland.

Pensions Act 1995

This Act gave the courts in England, Wales, Scotland and Northern Ireland the power to earmark pensions. This can be used for divorces petitioned (i.e. started) on or after 1 July 1996 (England and Wales), 19 August 1996 (Scotland) or 10 August 1996 (Northern Ireland).

The Act also made it compulsory for courts to take pension rights into account when determining the value of the matrimonial estate, thus effectively bringing England and Wales into line with Scotland.

Welfare Reform & Pensions Act 1999

Brought in pension sharing in divorce and nullity of marriage cases where the petition was filed with the court on or after 1 December 2000.

Earmarking (now termed attachment order in England and Wales) and offsetting are available for those couples who do not want to use Pension Sharing.

To help simplify the explanations, we have assumed that the member is male and the ex-spouse is female or a Civil Partner. Also, where we refer to England and Wales this includes Northern Ireland. Pension sharing in Northern Ireland is implemented under a specific statutory instrument: The Pensions (Northern Ireland) Order 1995.

The options for pensions

Offsetting

Prior to the Pensions Act 1995, the only way of taking account of the value of pension benefits was by "offsetting". This involved getting the value (usually the cash equivalent or transfer value) of the pension benefits as at the date of divorce (or date of official separation in Scotland). This value would then be included in the total value of the matrimonial estate to be divided on divorce.

As the courts were unable to compel the pension holder to set aside any of his pension benefit for his ex-spouse, the courts took account of the value of the pension by offsetting this against other assets. Effectively, they substituted the proportion of the pension that the ex-spouse would be entitled to for another asset (or part of) of similar value. Normally, this involved the ex-spouse gaining a larger share of the matrimonial home.

Example:

Angus and Agnes are divorcing. Angus has a Personal Pension worth £150,000 and the family home is worth £200,000. There are no other assets of the marriage, therefore the total assets are worth £350,000. If the courts awarded each of them a settlement of 50% of the matrimonial estate, Agnes would get £175,000 of the equity in the home and Angus would keep his pension and get £25,000 of the equity in the home.

Attachment orders – earmarking

Earmarking was introduced by sections 166–167 of the Pensions Act 1995. It is now known as an attachment order, and is effectively deferred maintenance. The terminology still refers to earmarking order with regard to Scotland.

Earmarking could be used for divorces started on or after 1 July 1996 (England and Wales), 19 August 1996 (Scotland) or 10 August 1996 (Northern Ireland).

The sequence of events leading up to an earmarking/attachment order is as follows:

- The court instructs the member to get a valuation of his pension benefits.
 - **In Scotland**, this would be the Cash Equivalent Transfer Value (CETV) of the benefits as at the date of petition or when the divorcing couple separated, if earlier. The court usually only take into account **benefits earned during the marriage**.
 - **Outside Scotland**, the courts will use the same CETV basis, but there will be **no proportioning** by the courts for the period of the marriage. This means that all pension benefits, including those earned before marriage, are taken into account (except any already earmarked from an earlier divorce).
 - The pension scheme provider/trustees must provide this valuation within 3 months of the request.
 - The court issues an order to be served on the pension provider/trustees. Under the terms of the **Family Proceedings Rules**, the provider/trustees can object to the terms of an order within 14 days of its receipt. Due to the short timescale, providers/trustees have to act on these orders immediately on receipt to avoid accepting an order by default – which could conflict with their policy terms/scheme rules.
- **For divorces in England and Wales and Northern Ireland**, the court can direct that:
 - A specified percentage of the pension benefits must be paid to the ex-spouse when the member starts to draw his benefits.
 - The member may have to commute part of his pension for the maximum lump sum available when benefits are taken, and pay part of that lump sum to his ex-spouse.
 - A specified percentage of any lump sum death benefit must be paid to the spouse in the event of the death of the member before retirement.
- **In Scotland**, the court does not earmark the pension income of the member. Only the tax-free cash sum and lump sum death benefits would be earmarked.
- Administrator's/trustees' normal discretion on selection of beneficiaries for death benefits can be over-ridden by an earmarking order. The order can compel the inclusion of the ex-spouse as a beneficiary for any lump sum death benefit. This power does not extend to the redirection of dependant's pensions on the member's death.
- If the pension benefits are subsequently transferred, the receiving scheme or provider must be given a copy of the earmarking order by the transferring scheme. The ex-spouse should be informed of the transfer within 21 days.

The options for pensions – continued

Attachment/earmarking provides an avenue for an ex-spouse, who may have no "own-right" pension provision, to access the pension built up during the marriage, or in England and Wales before the divorce. Unfortunately, the provisions are somewhat limited by various disadvantages:

- Attachment orders automatically lapse on remarriage of the ex-spouse, in relation to any periodical payments (i.e. pension payments) due. Any tax free retirement lump sum earmarked when the planholder takes benefits would still be payable to the ex-spouse unless the Court Order specified otherwise. Similarly attachment orders automatically lapse on the member's death, except where the Order has made provision for any lump sum death benefit to be paid to the ex-spouse. In these cases the terms of the Order, on payment of benefits on death, would still apply on the member's death. This is the case even if the pension is already in payment.
- Subject to normal HM Revenue and Customs rules, the member can opt to take benefits whenever he/she wishes. This may mean that he/she will defer taking benefits as long as possible in the hope that the ex-spouse will remarry or die first.
- The ex-spouse has no control over the investment of the pension fund. The member could deliberately invest in poorly performing funds to diminish the value of the fund.
- Contracted-out rights cannot be earmarked.

- The pension is taxed as the member's income and earmarked payments are paid after tax. For this reason, pension providers are likely to require the Order to specify that the member (not the provider) is responsible for the actual payments to the ex-spouse. This may, conveniently, be arranged through a joint bank account with appropriate ongoing payments to individual accounts.
- The method of valuation for divorces outside Scotland could have serious consequences for those who marry late in their working life or for those who have been divorced more than once.
- Earmarking does not allow a clean break divorce.

Care needs to be taken in drafting such orders as some have been submitted which are unworkable, such as orders setting out:

- lump sum retirement fund greater than the maximum amount allowed by pensions legislation,
- that the ex-spouse's share is be transferred to a Personal Pension/Stakeholder.

These are examples of where the 14 day limit for reviewing court orders is useful.

Pension Sharing

Pension Sharing was introduced by the Welfare Reform and Pensions Act 1999 for divorces petitioned (started) on or after 1 December 2000. As with the earmarking provisions, pension sharing is available to couples divorcing throughout the UK.

Pension sharing is not compulsory.

It is one of three options available to the courts settling benefits in respect of pension entitlement where the couple is unable to reach an agreement. Couples divorcing in Scotland can reach a pension share/earmarking agreement by a court order or by completing a registered Minutes of Agreement; however, in both England and Wales, this can only be achieved by a court order.

The process to be followed in Pension Sharing is as follows:

- Court instructs the member to get a valuation of his pension benefits (the valuation method is the same as that used under Earmarking) along with certain other information about his benefits. If a CETV has been provided within the last 12 months, no CETV will be required.
- The provider or trustees of the pension scheme must provide the valuation within 3 months (or no later than 6 weeks before the divorce hearing if the provider/trustees had prior notice of the impending hearing). If there is no request for a CETV, the scheme must provide the requested information within one month.
- Court will decide how much of the pension rights should be allocated to the ex-spouse and the member's pension rights will be reduced by a corresponding amount. This reduction is known as a "Pension Debit".
- **In Scotland**, the order may instruct a monetary amount or a percentage of the pension benefit to be subject to a debit. Outside Scotland, the debit amount must be a percentage. This debit amount may include contracted-out rights.

- › The rights allocated to the ex-spouse are known as a "Pension Credit".
- › The existing pension scheme can choose to allow the ex-spouse to join the scheme in her own right OR to take the transfer value to another registered pension scheme. In practice, however, it is likely that most schemes (other than those where assets cannot be readily cashed in, e.g. unfunded schemes, public sector schemes or SSASs where the majority of the assets are in property) will allow only a transfer out.
- › The scheme is also able to nominate a "default option" – for instance where the ex-spouse is unable, or unwilling, to make a decision on where to transfer her pension share.

Pension Schemes are allowed to pass on the costs of implementing Pension Sharing orders to divorcing couples. The Regulations do not specify limits on the charges, but the National Association of Pension Funds (NAPF) had previously recommended the adoption of an index-linked flat fee in the range of £1800 to £2200. In addition, NAPF suggested that schemes should be able to pass on any third party costs. *However, if there are charges to be paid, the scheme must notify the couple of these charges before the order/agreement is made.*

Once the pension provider/trustees get a Pension Sharing order, there are requirements:

- › they have 21 days from receipt to appeal against any order/agreement.
- › they can delay the start of the implementation period until charges are paid or whilst relevant information is outstanding (or whilst an appeal is being decided).

- › they have 4 months in which to implement the Pension Sharing Order. This implementation period involves discharging the Pension Debit/Credit by way of an internal or external transfer.

Effects of Pensions Simplification

The Pensions Simplification legislation changed the effect on the treatment of pension benefit entitlement on divorce. The legislation came into force on 6 April 2006, referred to in this document as A Day.

Offsetting

Where "Offsetting" applies the 2006 legislation has no direct impact as these sharing arrangements are outside the pension scheme. However it should be noted that the value and basis of the benefits taken into account may be affected by the 2006 benefit rules.

Attachment Orders/Earmarking

Testing against the Lifetime Allowance:

The scheme member will be responsible for testing total benefits, including the pension and tax-free cash to be paid to the ex-spouse against the Lifetime Allowance (LTA). This approach has to be taken despite the fact that a portion of the benefits will be paid to the ex-spouse.

Pension sharing

Pensions simplification has a more significant effect on pension sharing arrangements.

The basic principles of pension sharing remain the same. However, from A Day, there are a number of ways in which the legislation will affect how pension credits and debits are treated.

The impact on the member and the ex-spouse are considered separately below.

Effects on the member

- › **Checking Benefits against the Lifetime Allowance (LTA).**
After A-Day the value of any pension debit will not count against the member's LTA.
- › **Protection – Effect of Divorce Post A Day**
If the member has registered for Primary or Enhanced Protection and pension sharing arrangements have been agreed after A-Day, the protected LTA will be reduced. The reduction will be in the same proportion as the percentage shared with the ex-spouse. The member must notify HMRC of this change. See www.hmrc.gov.uk/pensionschemes for further details.

Effects on the ex-spouse

From 6 April 2006 the pension credit can be invested in all types of registered pension.

- › **The Annual Allowance**
A pension credit will not be treated as a contribution when checking against the Annual Allowance
- › **Pension Credits received after A-Day and the Lifetime Allowance**
The value of any pension credits received after A-day will count against the LTA unless the source of the credit is a pension which is already in payment. In this case the ex-spouse can register the pension credit for an additional LTA, as this will already have counted against the member's LTA. This registration must be completed within 5 years after the 31 January following the tax year in which the pension sharing order was made.

The options for pensions – continued

- › Subject to legislation, once the ex-spouse has received the Pension Credit, he/she has control over the investment and timing of when benefits are taken.
- › Pensions in payment which originated from a pension credit are taxed as the individual's own income, (i.e. the ex-spouse pays the tax on the part he/she has been given).

Note – Safeguarded Rights were abolished from 6 April 2009 under the Pensions Act 2007.

Pension Sharing – Your Questions Answered

What happens once a pension sharing order is finalised?

To enable us to take action for the pension sharing, we need certain information for the ex-spouse and copy documentation for the divorce. In broad terms details required are:

- › For the ex-spouse, their full name (and details of all names by which they have been known), date of birth and National Insurance Number.
- › Copy of the final pension sharing order.
- › Copy divorce papers including decree absolute. In Scotland there is a one stage divorce decree, called a decree of divorce (or decree nisi). It is also possible to finalise pension sharing in Scotland by the completion of Minutes of Agreement.
- › Confirmation there is no appeal pending on the pension sharing order.

We have 4 months (known as the "implementation period") from the time we receive all the necessary documentation to implement the terms of the pension sharing order.

What is the next stage?

Once we have all the documentation and information required, we will arrange for the pension credit to be released. Following the payment of the pension credit, the client and ex-spouse will receive a discharge notice confirming the amounts involved and the valuation date for the CETV – see next question.

How is the value of the pension credit calculated?

The pension credit share is based on a valuation CETV of the member's policy or scheme benefits. Once the pension share is agreed by the court, this is applied to an updated CETV to obtain the value of the pension credit. The eventual CETV may be more or less than the original CETV valuation.

The legislation allows the pension arrangement's administrator to decide the valuation day for actual implementation of the pension share within the implementation period.

NOTE: Any benefit earned or contributions paid after the date of the Court Order should be excluded from the valuation.

What options are available to the ex-spouse for a pension credit?

To help ensure a clean break the ex-spouse will probably prefer to transfer their pension credit to another plan, either with us or another provider:

- › Transfer to a personal or stakeholder pension in their own name.
- › Transfer to a pension scheme of which the ex-spouse is already a member, but only if the scheme rules allow.
- › Transfer to a buy out policy (from occupational scheme only).

Before making any decision on what to do with a pension credit we would recommend that financial advice is taken.

Can the ex-spouse join the occupational scheme of which the client is a member?

Membership of the client's existing Prudential occupational scheme will not normally be offered to the ex-spouse. Even if the ex-spouse is an existing member – the pension credit cannot remain in the scheme.

Pension Sharing – Your Questions Answered – continued

What if the ex-spouse does not make a decision about their pension credit?

We would normally expect the ex-spouse to want to make a decision about their pension credit soon after the divorce is finalised. If we have not received a decision on the receiving arrangement for the pension credit within two months of the other requirements being met we will contact the ex-spouse and their solicitor for a decision.

What if the policy is already subject to an earmarking/attachment order?

Only one attachment/earmarking or pension sharing order can be applied to any one policy or pension arrangement.

What happens where the policy subject to the pension share, contains With-Profits investments?

If the policy (or any part of the policy) to be disinvested contains With-Profits funds, then money withdrawn from this fund may require an adjustment to the claim value. This only applies if, at the policy claim date, the value of the underlying assets is less than the value of the policy (including all bonuses). This adjustment is known as a Market Value Reduction (MVR).

What charges are made for a pension sharing order to be implemented?

Due to the complex nature of the calculations Prudential currently make a charge for work carried out for a pension share involving a defined benefit occupational scheme. Details of any charges due to be paid are provided when a pension sharing order is initiated. Full payment is requested before the pension share can be implemented.

Summary

To summarise, for divorce settlements, the following options are available:

Pension Offset –

where other assets of similar value are substituted for the Pension Sharing portion – **this is likely to remain the preferred choice for the majority of couples.**

Earmarking –

the ex-spouse is allocated a portion of the pension benefits once they come into payment. The ex-spouse has no control over them until the member decides to take benefits – **earmarking orders**

have been relatively rare since the provisions were introduced – it is likely to remain that way, but may still be used for death benefits.

Pension Sharing –

a portion of the member's pension fund is deducted and allocated to the ex-spouse, as her own pension fund. The ex-spouse's share can either stay in the existing scheme or be transferred to another registered (tax approved) pension scheme. **Transferring to another scheme/arrangement will probably be the preferred choice (over earmarking). However, the trustees may not allow a transfer**

out if there are insufficient realisable assets to facilitate a Pension Sharing Transfer (for example, in a Small Self Administered Scheme where assets may not be readily encashable, or may be cashable subject to investment penalties).

The information in this document is based on our understanding, as at October 2011, of current taxation, legislation and HM Revenue & Customs practice, all of which are liable to change without notice.

The impact of taxation (and any tax relief) depends on individual circumstances.



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