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Sharing pensions - the ins and outs

Pension rights in divorce or dissolution settlements can often amount to the largest asset after the equity in the family home. Professional advisers therefore need to pay close attention to this aspect of the “family estate”.

The options in broad terms for most couples are (i) to offset the value of pension rights against other assets in a settlement, e.g. one party retains the pension rights but the other party takes a greater share of the equity in the family home, or (ii) to divide the pension rights, either by “earmarking” or pension sharing.

“Earmarking” has been possible since July 1996. This allows a pension attachment order to be made now against pension income arising on retirement. The Court may also order that part of any lump sum arising should be paid on retirement. Earmarking is not, however, a “clean break” in relation to pension rights since a proportion of one party’s benefits is in effect attached to the other party after retirement. Moreover, a party may cease to be entitled to “earmarked” benefits on remarriage or entering a new civil partnership, and the pension income will cease when the party with the pension rights dies.

Pension sharing was introduced by the Welfare Reform and Pensions Act 1999. Since December 2000, it has been possible to apply pension sharing to almost any pension arrangements including occupational pension schemes, personal pension plans, stakeholder pension plans and the Additional State Pension. Pension sharing arrangements give parties on divorce or on the dissolution of a civil partnership retirement benefits in their own right, as opposed to rights over one party’s pension income.

The following factors may be important in assessing the value of a couple’s pension rights:

- the “cash equivalent transfer value” (CETV), which is the prescribed method of valuing pension rights for pension sharing purposes, does not take into account aspects of pension rights such as death in service benefits and future pensionable service, e.g. there are certain public sector schemes in which the rate at which benefit accrues doubles after twenty years’ membership;

- parties are able to provide information to the Court on the value of pension rights additional to the CETV assessment (although the Court is not obliged to take such information into account);
- advisers should be alert to the possible manipulation of pension contributions: the owner of a business may claim, for example, that adverse trading conditions prevented him or her from making any contributions in the most recent year despite the fact that there is a history of regular contributions in previous years;
- the freedom from April 2015 to take defined contribution savings as a lump sum, or series of lump sums, from the age of 55 has increased the scope for a party to strip the pension ahead of any formal order by the Court; and
- it is important to take into account pension rights arising from past pension arrangements in estimating a couple's aggregate assets, as accrued benefits from any schemes of which they were members may have a substantial value, and, in this context, there may be rights arising from the Additional State Pension.

Despite pension sharing having been possible for over 15 years, it appears that pension sharing orders represent only a small proportion of "financial remedy orders". For instance, Family Court statistics for the quarter from April 2016 to June 2016 show that pension sharing orders represented only 13% of total "financial remedy disposals". It is possible that clients are reluctant to explore the possibilities of pension sharing because of perceived legal and financial complexities and because they take a short-term view driven by immediate needs such as housing or child support. However, the lack of popularity of pension sharing should not obscure the fact that it may often be worth exploring, particularly if one party has an occupational pension and the other has no pension provision, and the couple's only substantial assets are pension rights and the family home.

Even if pension sharing is not considered as part of a settlement, many couples' pension rights will be too large to be ignored when valuing the "family estate". It is therefore important to obtain a realistic assessment of the value of the pension rights to be brought into the settlement.

To obtain further details of our activities or to benefit from the firm's experience and expertise, please contact George Sim or Rakesh Kapila.

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