

Pensions And Divorce

Between 2005 and 2006, the number of divorces granted in the UK fell by 4.5 per cent to 148,141, from 155,052. This is the second consecutive drop in the number of UK divorces and the lowest number since 1977. The figure is 18 per cent lower than the highest number of divorces, which peaked in 1993 (180,018).

The number of divorces in England and Wales fell by 6.5 per cent to 132,562 in 2006, accounting for the fall in the UK overall. Conversely, divorces in both Scotland (13,014) and Northern Ireland (2,565) increased in 2006 by 19 per cent and 9 per cent respectively. The rise in Scotland may be due in part to an amendment to the Family Law (Scotland) Act 2006 (*Source: National Office of Statistics 2007*). Like it or not, with pensions being most people's second biggest asset, a major consideration is always going to be pension benefits.

1. PREVIOUS LEGISLATION

Whilst the consideration of pension benefits within divorce settlements was an issue in 1969 (study by the Law Commission) the key legislation has been:

1.1 Matrimonial Clauses Act 1973

Ss 23-25 deal with the provision of a "clean break" wherever possible.

1.2 Pensions Act 1995 (PA)

The PA 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.

1.3 Pension Sharing On Divorce (including draft Harman Bill) June 1998

Came into effect in December 2000. The thrust of the legislation is to attempt a "clean break" settlement for pension funds on divorce. The legislation 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 (and probably much more appropriate) option was introduced which allows the pension benefits to be shared or split between the parties.

2. OFFSETTING

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 the ideal world this system would be by far the simplest and arguably the best solution. Unfortunately, however, many people do not have sufficient assets to enable offsetting to be applied.

3. EARMARKING

Came into effect in 1996. Earmarking applies to all private pensions (including those in payment), but not state benefits.

In brief, "earmarking" 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 in Japanese smaller companies, or take any other action prejudicial to the ex spouse there is nothing they can do about it.

- If the petitioner remarries, the earmarking lapses.
- Earmarked benefits are all taxed at the highest rate of the pensioner, irrespective of the tax rate for the ex spouse.

To be frank, if there is every likelihood 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.

4. PENSION SHARING

Introduced in December 2000. Pension sharing applies to all pensions excluding the state basic old age 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 granted by way of a transfer 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. Such changes will also leave the schemes open to further grievance procedures and will also entail complex redrafting of scheme rules. The rules allow schemes to insist on buying-out the spouse's benefits if the scheme considers this to be more appropriate, and our experience to date is that nearly all schemes are insisting on this route. The one exception is usually the government and Local Authority schemes which are "pay as you go" and hence are not keen on paying out large transfer values.

Pensions in payment can be "unbought", split and "rebought" using the annuity rates for the member and petitioner at date of divorce. Indeed, 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. After the pension transfers fiasco of the late 1980's, few financial advisers are either qualified or willing to undertake transfer work, and those that are, will charge substantial fees.

As many divorces are Legal Aid based, there will not be money available to pay for good advice which means that the recipient will either lose substantial sums via commission payments, or transfers will not proceed as they will be uneconomic.

At present, no consideration has been given to "co-habitant" relationships, although this is an area where much lobbying is going on.

5. CASH EQUIVALENT TRANSFER VALUE (CETV)

The CETV is the prescribed 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. For the purposes of this legislation the date of valuation will be 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. This sum 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. In the case of some investment funds (ie, with profits) the value will be after short term market value reductions which may not be there when the remaining member retires. Unfortunately, no one seems to have worked out a better system at this time.

6. SUMMARY

We expect pension sharing to be used in the vast majority of divorce cases where offsetting is not an option. Cost will, however, remain an issue and any transfers will have to be sufficient to warrant the large costs involved in calculating and organising the new arrangements.