

Pension Sharing

What is it and how does it work?

Pension sharing is a method of dividing pensions as part of a financial settlement in divorce proceedings. It is a way of redistributing a pension so that each spouse will have independent pension benefits at retirement.

When a pension sharing order is made by the court, pension benefits are transferred from one pension scheme to another. The spouse who receives the pension benefits then has his or her own freestanding pension scheme. The great advantage of pension sharing is that the pension will be payable to each spouse even if the other spouse dies. Dividing a pension scheme into two parts in this way can also lead to a significant income tax saving.

How it works

The way in which a pension sharing order works depends upon the type of scheme which is being shared. There are, very broadly, two different types of scheme which operate in different ways:

- (a) Employee "defined benefit" schemes: these are schemes where the pension benefits are worked out by reference to the service record of the employee. They may be Government schemes (like the Armed Forces, NHS and Teachers' Pension Schemes) or company pension schemes. The usual outcome for these schemes is that pension benefits are transferred within the pension scheme so that the receiving spouse becomes a member of that same pension scheme in his/her own right (this is called an internal transfer);
- (b) Defined Contribution/Money Purchase Schemes: in these pension schemes there is a pot of money/investments held within the pension scheme for the benefit of the scheme member. This applies to some company pension schemes and to all personal pension plans. When pension sharing takes effect, a sum of cash is lifted out of the scheme into a new personal pension plan for the benefit of the other spouse (and this is called an external transfer).

Working out a percentage

Pension sharing orders state that a percentage of the benefits should be transferred to the other spouse, and the amount of the percentage is a matter for negotiation.

In many divorce settlements it is agreed that a pension scheme or schemes should be divided equally between husband and wife. However, a 50% pension sharing order will not always achieve an equal division of the actual benefits at retirement, so

frequently a more sophisticated calculation is required. That may be because of age differences, or because women statistically live longer than men and so need a larger fund to achieve the same pension.

Where it is agreed that there should be equalisation of pension benefits, an independent pensions adviser will be instructed to work out what percentage of the scheme should be shared to achieve that equalisation. The pensions adviser will do a calculation and advise about the percentage required to achieve equalisation of:

- (a) the cash lump sums payable on retirement; and
- (b) income in retirement.

Equalisation of pension benefits is not always the outcome. In some cases pensions will be retained in their entirety by the person who owns them. In others, they will be shared in unequal proportions. Pensions are just one part of the wider financial settlement.

Because pension sharing orders have to be expressed as a percentage, the predictions about what the effect of the pension sharing order cannot be absolutely fixed and certain, for any type of pension scheme. If the pension is based on underlying investments in the scheme, the pension will depend on the value of those investments, and they may change between the date of obtaining forecasts and the date when the order comes into effect. Advice from a pensions expert will therefore make predictions about the broad effect of the pension sharing order rather than an absolutely accurate forecast.

"Quick Fix" Pension Sharing

There may be some circumstances where the husband and wife agree that they do not want to spend time or money getting a full pensions report, and that they simply want to divide the pension plans in an agreed percentage.

This would be highly inadvisable in a Defined Contribution/Final Salary Scheme where there is no underlying pot of cash/investments. It may however be a simple solution where there is an easily recognisable fund of cash and investments in a personal pension plan and the husband and wife agree that they will each take a percentage of that fund as their own personal pensions.

Even in these circumstances though, it is still preferable to take pensions advice. There might for example be a valuable guaranteed income from the pension scheme which would be lost if part of the fund was taken out through pension sharing.

continued

State Pension

Spouses often have quite different State Pension entitlement and it may be necessary to make adjustments for that in the overall financial settlement.

State Pension provision falls into two broad categories:

- (a) Basic State Pension; and
- (b) State Second Pension.

The State Second Pension is the enhanced earnings-related pension, and it can in theory be the subject of a pension sharing order. Alternatively, the value of the State Second Pension and Basic State Pension may be taken into account in working out what would be a fair percentage division of a larger private pension arrangement.

Valuing Pension Schemes

There is a standard measure for valuing pension schemes in divorce proceedings, the Cash Equivalent Transfer Value ("CETV"). This attributes a cash value to the overall benefits in the scheme.

The CETV is quite easy to obtain for private pensions, but it can take many months to get this information from larger occupational pension schemes and so time has to be allowed to apply for these valuations and forecasts.

Implementation of a Pension Sharing Order

Once a percentage has been agreed, a standard form called a Pension Sharing Annex is drawn up and served on the pension scheme. The pension scheme administrators then indicate whether they have any objection to the order; generally they cannot object other than in very limited circumstances.

Some pension schemes make charges for implementing pension sharing orders.

The pension sharing order is then approved by the court and served on the pension scheme.

Pension schemes can take many months to put the pension sharing order into effect and special care is needed to deal with the transitional period, particularly where the pension is already being paid out as income to the scheme member.

Alternatives to Pension Sharing

There may be reasons why pension sharing is impossible or impractical. These orders cannot be made where the divorce proceedings started before December 2000, or where parties separate permanently without divorce proceedings.

One alternative is an "earmarking" or attachment order, in which the actual pension income paid in retirement, or the cash sum paid on retirement, is divided up between the husband and wife without a wholesale restructuring of the scheme. These orders have many complications and so they are relatively unusual. They can however be useful as a way of securing ongoing maintenance payments without going as far as pension sharing.

Attachment orders can also be used to secure the payment of death in service benefits to an ex-spouse. It is a way of providing life insurance in the event of the death of a spouse who is paying maintenance for an ex-wife or children.

This is a very general explanation of the basic principles of pension sharing; it is a complex area and specific advice about how pension sharing works in individual cases will always be required.

For further information please contact:

Catherine Hallam



Partner

Tel: 0117 939 2000
Email: catherine.hallam@burges-salmon.com

Ashley Palminteri



Senior Associate

Tel: 0117 902 7761
Email: ashley.palminteri@burges-salmon.com

Sarah Woodsford



Senior Associate

Tel: 0117 902 7743
Email: sarah.woodsford@burges-salmon.com

Thomas Boyce



Associate

Tel: 0117 902 7710
Email: thomas.boyce@burges-salmon.com

Sharon Mahmood



Solicitor

Tel: 0117 307 6905
Email: sharon.mahmood@burges-salmon.com

Mary Gaskins



Solicitor

Tel: 0117 307 6870
Email: mary.gaskins@burges-salmon.com