

Pensions and divorce

A guide for information

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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 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

Historically, in Scotland, the value of pension benefits could be offset as part of the financial settlement, though the ex-spouse had no direct access to the pension. (There was no compulsion to allow for the pension value in sharing the assets for England, Wales or Northern Ireland.) The 1985 Act set out the principles to be applied, sharing the value of matrimonial property and factors to be taken into account.

Only assets accrued during the marriage (or civil partnership) are taken into account in Scotland (whereas all assets are taken into account elsewhere in the UK).

Pensions Act 1995

Prior to the Pensions Act 1995, the only way of taking account of the value of pension benefits was by 'offsetting'.

This Act gave the courts in England, Wales, Scotland and Northern Ireland the power to earmark pensions. For divorces petitioned (started) on or after:

- 1 July 1996 (England and Wales)
- 19 August 1996 (Scotland) or
- 10 August 1996 (Northern Ireland).

The Act made it compulsory for courts to take pension rights into account when determining the value of the matrimonial estate.

The Act also applies in cases of civil partnership dissolution and nullity proceedings.

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 who do not want to use Pension Sharing.

Divorce Dissolution & Separation Act 2020

This is an Act of Parliament of the United Kingdom which removes the requirement to establish the facts of divorce and permits a no-fault divorce.

This Act only applies in England & Wales.

To help simplify the explanations, assume that

- the 'ex-spouse' includes 'ex-civil partner', and
- the member is male and the ex-spouse is female.

There are differences between the law for Scotland and for the rest of the UK and these are pointed out where relevant.

In England and Wales in accordance with the Marriage (Same Sex Couples) Act 2013 and in Scotland in accordance with The Marriage and Civil Partnership (Scotland) Act 2014, same-sex marriages are treated as the same as opposite-sex marriages for the purposes of divorce and pensions. In Northern Ireland, same-sex marriages are treated as the same as civil partnerships.

The options for pensions

Offsetting

This involves 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 are unable to compel the pension holder to set aside any of his or her pension benefit for his or her ex-spouse, the courts take account of the value of the pension by offsetting this against other assets. Effectively, the ex-spouse gets another asset, or share of another asset (up to the appropriate value of the share of the pension) instead of the share of the pension. Normally, this involves the ex-spouse getting a larger share of the matrimonial home to compensate for the pension share.

Example:

Angus and Agnes are divorcing. Angus has a personal pension worth £150,000 and the family home is worth £200,000 (no mortgage). There are no other assets (or liabilities).

Therefore the total assets are worth £350,000.

If the courts awarded each of them a settlement of 50%, this would result in a value of £175,000 for each of them:

- Agnes would get £175,000 of the equity in the home and
- Angus would keep his pension (valued at £150,000) and get £25,000 of the equity in the home.

Attachment orders

An attachment order, or, in Scotland an earmarking order, is effectively deferred maintenance.

The sequence of events leading to an earmarking or 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, if earlier, when the divorcing couple separated. 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 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 setting out the terms of the attachment/earmarking. The provider/trustees can object to the terms of an order within 14 days of its receipt. They may want to object if the order states that the scheme/provider is to arrange for the split, rather than the member accessing the pension and passing on the attached/earmarked payments to the ex-spouse.
- **For divorces in England, 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 benefits. Prior to 1 December 2000, the Court could specify a monetary amount although this option is no longer available.

- 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 attachment/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 attachment/earmarking order by the transferring scheme. The ex-spouse should be informed of the transfer within 21 days.

Impact of pensions flexibility on attachment/earmarking orders

In divorce cases, or on dissolution of a civil partnership, the courts may order that an attachment order is placed on a person's pension. The attachment order requires the scheme administrator or pension provider to make certain payments from the amount due to the individual.

Since the individual as a scheme member retains control of the pension, under new flexibility to take pension savings under pension flexibility introduced on 6 April 2015, this might result in a former spouse or former civil partner receiving less than they expect. For this reason a pension providers, trustees and advisers need to notify a former spouse or former civil partner.

Considerations when opting for attachment/earmarking orders

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 bring various disadvantages:

- Attachment/earmarking orders automatically lapse on remarriage of the ex-spouse, in relation to any periodical pension payments due. Any tax free retirement lump sum earmarked when the member takes benefits would still be payable to the ex-spouse unless the Court Order specified otherwise. Similarly attachment/earmarking orders automatically lapse on the member's death, except where the Order covered any lump sum death benefit to be paid to the ex-spouse. In these cases the terms of the Order may still apply on the member's death, even if the pension is already in payment depending on the terms of the Order.
- Subject to normal HM Revenue & Customs rules, the member can opt to take benefits whenever he decides. This could result in delaying 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 attached/earmarked (but can be used in the value for offsetting purposes).
- The pension is taxed as the member's income and attached/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 options for pensions continued

- 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.
- Attachment/earmarking does not allow a clean break divorce.

Pension sharing

The aim of pension sharing is to separate the ex-spouse's pension entitlement from the member's pension so that there's a clean break.

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 agreement by a court order or by completing a registered Minutes of Agreement. However, in both England and Wales, this can be achieved only by a court order.

The pension sharing process

- The Court instructs the member to get a valuation of his pension benefits (a Cash Equivalent Transfer Value, or CETV) of the benefits as at the date of petition or, if earlier, when the divorcing couple officially separated along with certain other information about his benefits. If a CETV has been provided within the last 12 months, there's no need to get a more up-to-date figure.
- The provider or trustees of the pension scheme must supply 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 need to get an up-to-date CETV, the scheme must provide the requested information within a month.

- Contracted-out rights and former contracted-out rights may be shared.
- The 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 is particularly important given that the value of the pensions may have changed substantially between the point of separation and the date that the pension debit is actioned).
- 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 their own right OR to take the transfer value to another registered pension scheme. In practice, it's likely that most schemes will allow only a transfer out. There are two exception categories:
 - where the member's pension is being paid through a guaranteed pension annuity with a pension provider, the pension provider may insist on an annuity with that provider OR
 - where assets cannot be readily cashed in, the scheme may decide that the ex-spouse needs to become a member of the scheme, in their own name. This would apply in, for example, unfunded schemes, public sector schemes or, where the assets are in property such as in SIPP/SSASs.

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, if the scheme requires 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:

- they have 3 weeks 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 to implement the Pension Sharing Order. This implementation period involves discharging the Pension Debit/Credit by way of an internal or external transfer.

Tax aspects

The changes to pensions legislation from 6 April 2006 affected the treatment of pension entitlement on divorce. Before then, the old rules (such as the maximum benefit rules for occupational schemes) needed different considerations, but are historical now, so not covered here.

The impact of the tax rules depends on the option chosen, or agreed.

Offsetting

Where “Offsetting” applies the sharing arrangements are outside the pension scheme.

Attachment Orders/Earmarking

Any tax free cash made through the order to the ex-spouse, is assessable against the member’s Lump Sum Allowance (LSA) and Lump Sum and Death Benefit Allowance (LSDBA) and any pension income paid to the ex-spouse is assessed against the member’s income tax liability. This is despite the fact that a portion of the benefits will be paid to the ex-spouse.

Pension sharing effects on the member

- If the member is subject to a pension debit and has registered for Primary Protection, the Primary Protection factor will be reduced to take into account the reduced pension.
- If the member has Individual Protection 2014 (IP14) or Individual Protection 2016 (IP16) the appropriate amount used for the protected value is reduced by 5% for each complete tax year between 5 April 2014 (IP14) or 5 April 2016 (IP16) and the transfer day. This could result in IP14 or IP16 being lost in full.

Pension sharing effects on the ex-spouse

- A pension credit will not be treated as a contribution when checking against the Annual Allowance.
- If the ex-spouse has a pre-commencement credit factor awarded in respect of pension sharing order made before 6 April 2006, both their LSA and LSDBA will be increased by pre-commencement pension credit factor.
- If the ex-spouse has an enhancement factor in respect of a pension credit awarded after 5 April 2006 their LSDBA will be increased by the enhancement factor. If the ex-spouse has not yet applied for an enhancement factor in respect of previously crystallised pension rights they have until 5 April 2025 to apply for this.
- Once the ex-spouse has received the pension credit, they have control over the investment and timing of when benefits are taken (that is, subject to the normal rules).
- Pensions in payment which originated from a pension credit are taxed as the individual’s own income, (the ex-spouse pays the tax on the part they have been given)

The options for pensions continued

Protections and divorce

There are some Lifetime Allowance (LTA) protections that can impact on the decisions made during divorce.

Impact of April 2015 pensions legislation changes on divorce

Pension flexibility, introduced in April 2015, raises further issues around how pensions are considered on divorce. This affects all three options (offsetting, attaching/earmarking and pension splitting).

Although pensions legislation has changed, other relevant parts of legislation (and practice) in relation to divorce has not.

It's too soon for any case law covering interaction between the new pension flexibility and divorce, but legal challenge could come. In the meantime, there should be even more focus on ensuring that Court Orders reflect the intended result, in a way that cannot be frustrated through pensions flexibility. Additional issues include:

Offsetting

Currently pensions are not usually valued on a pound for pound basis with other assets, because of the uncertainty around the true eventual value of the pension. However, for those 'divorcees' who are over 55 (57 from 6 April 2028, unless they have a protected pension age), there is now total access to defined contribution pension funds. This may lead to value parity with other assets. If so, the tax and future contribution issues surrounding accessing flexibility need to be addressed in the settlement discussions.

Earmarking

Pension flexibility may have a significant impact on the application of earmarking orders – potentially leaving scope to circumvent the requirements set out in the order, unless the details in the order are very specific.

For example, the member (the pension-owning individual) may be able to avoid the payment of the income as set out in the earmarking order. This could be done by choosing to take some or all benefits as cash lump sums, also known as an uncrystallised funds pension lump sum (UFPLS). If the earmarking order doesn't specify exactly when and how benefits must be taken, and/or doesn't specify "tax-free lump" or 'pension commencement lump sum (PCLS)', the order can be circumvented by taking the UFPLS (which isn't a PCLS). Then, if there are no pension funds left to crystallise, there's no income left to be covered by an income earmarking order.

Also (although not strictly an issue created by pensions flexibility) historically, the assumption was probably that pension income covered in an attachment/earmarking order would be regular guaranteed income for life payments, also known as an annuity. The member could go into flexible income, also known as drawdown and take no income or a minimal amount. In addition, legislation, post 2015, allows annuity income to reduce.

All this means that the original intention behind an attachment/earmarking order could be frustrated.

Pension sharing – your questions answered

Post April 2015, the ex-spouse may prefer to have cash rather than a share of a pension fund. If the member is over 55 (57 from 6 April 2028, unless they have a protected pension age), this is possible, even if the ex-spouse is much younger, as the right to access the pension fund is linked to the member's age.

The courts may decide that a cash lump sum, or a series of cash lump sums, should be paid instead of pension sharing. However, that could result in serious tax implications for the member and restrict tax relief on future contributions (because of the Money Purchase Annual Allowance).

All of this requires detailed financial advice and could lead to legal challenges of existing Orders, further expense, delay and frustration for some.

What happens once a pension sharing order is finalised?

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

- For the ex-spouse, full name (and details of all previous names used by that person), date of birth and National Insurance Number.
- Copy of the final pension sharing order.
- Copy divorce papers including Decree Absolute / Final Order. In Scotland there is a one stage divorce decree, called a decree of divorce (or Decree Nisi / Conditional Order). 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.

The provider has 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 the provider has all the documentation and information required pension credit can be released. Following payment of the pension credit, the member 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 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 the pension credit to another plan:

- 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.

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

Pension sharing – your questions answered continued

Can the ex-spouse join the member's 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.

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 if an insured pension policy that is subject to a pension share is invested in a With-Profits fund?

If the policy (or any part of the policy) to be disinvested contains With-Profits funds, then money withdrawn from this fund may be subject to an adjustment. This will depend on the terms of the pension policy.

Can the pension provider make any separate charges for implementing pension sharing orders?

Details of any charges due to be paid must be provided before a pension sharing order is implemented.



Summary

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

Pension Offsetting

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 their 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, 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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