

# Pension options in a divorce

Outline	Under the Matrimonial Causes Act 1973, the pension assets of both spouses form part of the overall distribution of assets when two parties seek a divorce. A court will aim to achieve a 'fair' financial outcome in terms of splitting assets. If you're going through a divorce, a pension sharing	report from a financial adviser will allow you to understand and assess your options. This fact-sheet explores the three methods that can be used to divide assets, the potential pitfalls to watch out for, and the benefits that financial advice can provide after a pension transfer has taken place.
Pension sharing	One common method used when splitting private pension assets is pension sharing. Depending on the size of the respective pots, the parties split their pension assets with the aim of achieving an 'equal' outcome. Once a pension sharing court order is made, one party will receive a percentage of their former partner's pension assets. This share	is called a pension credit. The recipient's new assets either remain with their same pension provider and they become a member of the scheme (internal transfer), or an external transfer takes place into a new and separate pension scheme. Pension sharing is a popular option, as it leads to a clean break between the parties.
Offsetting	Another option that couples can use is offsetting. Offsetting sees the receiving 'in credit' party take a lower share of pension assets in favour of other non-pension assets, such as cash or property. Or in some cases, one party could retain the entire share of their pension. For example, Spouse A has a workplace pension pot worth £400,000. Spouse B has no private pension assets. The divorcing couple's home is valued at £900,000. In order to achieve an 'equal' outcome, the court could allow	Spouse A to keep their whole pension pot, but in turn decree that Spouse B is entitled to a £650,000 share of house sale proceeds, while spouse A is afforded a £250,000 share.  Like pension sharing, offsetting provides a clean break, but appropriate liquidity is required, and for many people their pension is one of their main assets. Allowances can be made to reflect different tax treatments of pension and non-pension assets.
Earmarking	Earmarking, also known as attachment, is a rarely used option that sees pension benefits paid to a former partner when the scheme member claims their benefits. Pension income, tax-free cash lump sums and death benefit lump sums can all be included in a court order. This is often not an appropriate option because there is no clean break	between the parties, and payments aren't made until the scheme member retires. Attachment orders may also automatically end upon the remarriage of the ex-spouse in receipt, or if the pension holder dies. Because of these factors earmarking/attachment is very rarely appropriate.
Cash equivalent transfer value	The cash equivalent transfer value (CETV) is the amount that a defined benefit pension plan member may receive if they decided to leave the pen-	sion scheme, foregoing lifelong guaranteed benefits for a lump sum transferred to a personal pension/defined contribution arrangement.

## How the CETV and fair value of defined benefit pensions can differ

Example of the quoted CETV of two defined benefit pensions and the estimated amount (fair value) that would be required to buy those benefits from an insurance company in the open market.

Illustrative figures	CETV value	Fair value	Difference
Pension plan X	£ 500,000	£ 900,000	+80%
Pension plan Y	£ 100,000	£ 198,000	+98%

## Fair value calculations

As the illustration on page 1 shows, the CETV of a defined benefit/final salary pension is often not a true reflection of the value of the pension benefits on the open market, and is therefore not a good basis for sharing pensions on divorce. A fair value can be estimated through the replacement cost, the amount that would be required now to match a pension in the event of an external trans-

fer, based on general assumptions about future investment growth, inflation (general increases in price levels), interest rates and mortality.

In some circumstances the fair value may be almost double that of the CETV. Uniformed service public sector pension schemes are particularly complicated in this regard.

## Potential pitfalls

There are a number of other complicating factors to watch out for where expert advice may be required to ensure a fair division of pension assets. Some of these are listed below:

- **Inflation** – Some pension plans may benefit from annual inflation-linked increases, whereas other pensions may not increase at all.
- **Guaranteed annuity rates** – Certain older-style personal pensions can include guaranteed annuity rates. This may mean the pension is more valuable than the cash equivalent transfer value quoted by the pension company.
- **Age** – Significant age gaps between the two parties can affect proceedings.
- **External/internal transfers** – Where there is a choice of an internal pension credit

transfer within the existing scheme, or an external transfer to a new scheme with a different provider.

- **Excluding pension assets** – Typically a court will take into account all private pension assets. In certain circumstances, however, it could be necessary to exclude pensions that have been accrued either before marriage, or before cohabitation.
- **Medical status** – Where one or both parties has a serious medical condition.
- **Tax-free cash** – 25% of a pension pot can usually be taken as a tax-free lump sum, but some older occupational pension schemes set up before April 2006 can have a significantly higher tax-free cash entitlement.

## Planning for the future

Once a decision has been reached on the sharing of assets and a divorce is finalised, a financial adviser can help to arrange a pension transfer, and provide ongoing advice about investment opportunities, particularly to the ‘in credit’ party.

A financial adviser can also assist with long-term cashflow forecasting, allowing you to effectively

plan and budget for your new way of life. Divorce can be a stressful and complicated time, but seeking financial advice can ensure fair pension outcomes, streamline the process, help you save money, and allow you to secure your financial future. Your pension is a vital part of retirement planning, so it’s important to make the most of this crucial asset.

## In expert hands with Lumin

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