Pensions in Divorce

A Guide for Clients

bradshaw dixon moore

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Warnings

All the information is provided in good faith by Bradshaw Dixon Moore Limited as an indication of its understanding. It does not warrant the contents as being true, accurate or reflecting current law or practice.

The guide not attempt to provide factual information on all the different types of pensions an how they work. A number of websites that provide such information are listed within the guide.

This guide does not specifically cover the mediation or similar processes, though the basic steps and comments remain the same.

Nothing in this guide is intended to constitute advice and it should not be taken as such.
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1 Starting your divorce

Pensions are unlikely to be either important or urgent when starting your divorce. However pensions are likely to form your largest or second largest financial asset. It is rarely wise to leave them to the end of the process.

If you or your spouse is in poorer health you may need to plan a different approach for them (see the separate note on Options when one or both party is in poorer health available from www.BradshawDixonMoore.com.)

Understand the potential size of your pension assets

If you are unaware of the potential value of your pensions then BDM offer a free Career Guide Calculator that needs just 3 items of data.

Example A

Information provided		Typical values of pension assets	
Age:	40	Between £	55,000
Current earnings: £	24,000	and £	153,000
Years in pensionable employment:	18		

The free Career Guide Calculator is at www.bradshawdixonmoore.com/calculator.html.

You may consider using a Financial Advisor to help you think about your aspirations for the final settlement.

Information on pensions

Apart from this guide websites can be good sources of information, including:

www.wikivorce.com/divorce/Divorce-Forum/Pensions/ - one forum in a community orientated site covering all aspects of divorce.

http://www.pensionsadvisoryservice.org.uk/ - an independent non-profit organisation that provides free information, advice and guidance on the whole spectrum of pensions covering State, company, personal and stakeholder schemes.

www.sharingpensions.co.uk - a lot of information on different pensions types and options, including pensions on divorce.

www.AncillaryActuary.co.uk – a blog predominantly for professionals, though may appeal to the more technically minded.

www.BradshawDixonMoore.com – our own website.

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2 Information gathering

Except for the Basic State Pension it is necessary to allow for past pensions as well as current ones. In Scotland and for shorter marriages this covers all pensions accrued during the marriage, otherwise it includes all pensions whenever accrued.

Identify pensions

You will need to be able to identify your client's pensions to be able to disclose them, and your spouse's pensions to be able to validate what they disclosures.

A convenient approach is to start with employment history and then determine what pensions, if any, were associated with each employment. Some points to note with this method:

- always include the Additional State Pension
- look at any employment gaps to see if you have missed something
- think whether any financial windfalls such as inheritances or redundancy payments put into single premium pension arrangements
- identify if older pensions were transferred into newer or alternative arrangements
- try to remember if additional voluntary contributions were ever made, as they often go into separate arrangements
- note if any pensions are already in payment

BDM produce a form suitable to complete as part of the data gathering process that can be downloaded free from www.BradshawDixonMoore.com/downloads.html.

You can trace if an employer had a pension scheme using the free Pension Tracing Service from The Pension Service (part of the Department of Work and Pensions), at http://www.thepensionservice.gov.uk/atoz/atozdetailed/pensiontracing.asp, or you can request forms to be sent to you by calling 0845 6002 537.

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Obtaining disclosure information on pensions

Additional State pensions

Valuation requests are made using form BR20 obtainable by request from The Pensions Service, though the quoted service delivery is an average of forty days. BR20 is available are available on their web site at www.thepensionservice.gov.uk, or we have put it on-line at www.bradshawdixonmoore.com/downloads.html.

Defined Benefit pensions (not in payment)

You must disclose in Form E the Cash Equivalent Transfer Value (CETV) valuation. This is obtained from pension schemes, who are must normally provide one free each year. Turnaround times vary up to 3 months. We also recommend asking for Form P and a scheme booklet at the same time to speed up proceedings later.

There are issues with the appropriateness of the CETV for use in the divorce process. However the CETV inevitably provides a lower value than that which an appropriate valuation would. Therefore these issues are addressed are best when considering the receipt of spouse's pension values during the Form E exchange.

2.1.1 Defined Contribution pensions (not in payment)

A transfer value should be both quick and easy to obtain and is the same as a CETV.

Pensions in Payment

As you cannot take a transfer from a pension in payment then CETVs do not exist. Therefore the choices are:

Valuation	From	Cost	Time
Cash Equivalent Benefit (CEB)	Pension scheme	An average of £500	Up to 3 months
BDM	Bradshaw Dixon & Moore	£100+VAT	5 working days
Full actuarial valuation	BDM or other providers	£475+VAT from BDM	Up to 3 months
Straight replacement value	Cost of annuity in the open market	Not appropriate - likely to over-value the pension	

The EPV is therefore the quickest and cheapest option. Its downside is that can be challenged if you cannot support with evidence the data you need to provide on pension payment amounts and terms of the payment.

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3 Exchange of information (Form E's)

Following the exchange of information, typically on Form E's, you need to ensure that the information provided by the spouse is both complete and correct.

There are systemic issues with using transfer values (CETVs) as specified by legislation for disclosure. Transfer values are the pension equivalent of an immediate, "fire-sale" valuation of a house, as opposed to an orderly-sale estimate. Frequently therefore the valuations provided by a spouse are too small.

Checking information received is complete

You should have from the fact-finding process a list of expected pension schemes, against which you can validate pensions disclosed. Do not forget to include that the Additional State Pension should be disclosed.

Checking information received is correct

The following types of benefit are likely to be incorrect.

- Defined benefit (final salary) pensions
- Defined contribution (money purchase) with
  - transfer value penalties or market value adjusters on with-profits; or
  - guaranteed annuity or other valuable options attaching
- Pensions in payment

Defined Benefit pensions (not in payment)

There are six reason why CETVs underestimate the true value of defined benefit pensions for a divorce.

1. CETVs can ignore discretionary benefits
2. Schemes can offer different benefits for active members and leavers
3. Active members lose the loyalty benefit of future salary increases
4. CETVs can be reduced in Under-funded schemes
5. CETV assumptions need only be reasonable, not best-estimate.
6. CETVs normally ignore the health of the individuals

If it is certain that pensions will be dealt with by offsetting, and you and your spouse agree on the use of actuarial values, then it is possible to move directly to getting either Express Pension Valuations or a full actuarial valuation report, with costs shared between the two parties.

Alternatively if it has already been determined that pensions will be shared then there is no need to determine an accurate valuation and it is possible to move directly to getting a full actuarial pension reallocation report, preferably with costs shared between the two parties.

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In other cases where offsetting is a possible solution then it will be necessary to argue for the use of a full actuarial valuation. This will mean convincing your spouse or a judge that the cost of the report is proportionate to its benefit.

We believe that the cost of a report will normally be proportionate where either the CETV is worth £30,000 or more or the pension relates to current employment in one of the uniformed services.

Example B – CETVs versus Actuarial Valuations

Scheme	CETV	Actuarial Valuation	Difference
Local Government	£ 84,000	£138,000	+ 64%
Private Company	£225,000	£324,000	+ 44%
NHS	£120,000	£244,000	+103%

Source: BDM reports

We have developed the Express Pension Valuation (EPV) to establish whether the cost of a full actuarial report is proportionate. It relies on information you provide, with some benefit simplifications, to produce a quick and affordable valuation based on sound actuarial principles. Due to the reliances and simplifications it is unlikely that EPVs will be accepted by a court if challenged by your spouse. You do not have to approach your spouse or their scheme to use it.

EPV payment is by credit card, or your solicitor may have an account with us.

On-line EPV - For most private sector pensions and non-uniformed services public sector pensions. Turnaround time typically less than 20 minutes.

Uniformed Services EPV - For valuing pension in

- Armed Forces Pension Scheme
- Police Pension Scheme
- Fire-fighter's Pension Scheme
- Prison Officers' Pension Scheme

Example C – Uniformed Services' CETVs versus Actuarial Valuations

Scheme	CETV	Actuarial Valuation	Difference
Police	£283,000	£520,000	+ 84%
Army	£105,000	£394,000	+275%
Firefighter	£101,000	£334,000	+231%

Source: BDM reports

Turnaround time is five working days from receipt of all necessary data.

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Defined Contribution pensions (not in payment)

Check whether the value provided for a defined contribution is a transfer value or a fund value. If a transfer value then for insurance-based pensions within 5 years of commencement or invested in with-profits ask for the fund value as well as this might be higher. Normally the fund value is the appropriate value to be used in a divorce settlement.

If the pension is insurance-based and started before 2000check if the policy has a guaranteed annuity or similar options attached. These may not be declared in pension benefit statements and original policy documentation should be checked. Guaranteed annuity options enable the fund at retirement to be converted into an annuity at a minimum rate that often compares very favourably with current annuities and means that the policy is more valuable than indicated just by the fund value.

A Financial Advisor could assist in identifying and resolving these issues.

Pensions in Payment

Pensions in payment have similar features to defined benefit pensions and the use of a full actuarial valuation, with prior justification by using BDM's Express Pension Valuation, is recommended.

Income drawdown or unsecured pensions as they are also called, are closer to defined contribution pensions and similar guidelines apply.

Pension in Payment EPV - For valuing pensions in payment. Turnaround time is five working days from receipt of all necessary data.

Example D – CEBs for pensions in payment versus Actuarial Valuations

Scheme	CEB	Actuarial Valuation	Difference
Army	£119,000	£140,000	+ 18%
Private Company	£380,000	£608,000	+ 60%
State 2nd Pension	£111,000	£114,000	+ 3%

Source: BDM reports

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4 Structuring the financial settlement

There are two basic ways to handle a pension: offsetting or splitting.

Offsetting

Offsetting simply involves allowing for the value of the pension asset in the settlement “in the pot” with all other assets. However as the pension is undisturbed it must belong to the pension holder in the final settlement.

Splitting

Splitting can aim to split the value of the pension in some proportion, or to achieve an equal pension income for both parties at some point in retirement.

Splitting can be achieved through the different legal mechanisms of pension sharing or attachment. Sharing produces a clean break and is generally considered the best solution, though it has a number of issues and attachment might be more appropriate in certain circumstances

Combination

When splitting pensions it is common to ring fence the pensions and split equally after the division of the non-pension assets. However it is possible to use uneven splits or a combination of offsetting and sharing in a combined solution.

Use in practice

Examples E show how the different approaches can be used in a simplified case. Note:

- Offsetting only can be restricting as large assets have to be kept with the pension holders
- Ring-fencing pensions is also restricting as it gives less scope for dividing the remaining assets
- Ring-fencing and sharing pensions by equalising income always produces a difference in value in the assets
- It might be judged that the best overall approach is the combination solution, involving unequal splitting of pension assets between the two parties.

In general BDM recommend that pensions be considered as part of a holistic settlement. You may find a Financial Advisor’s input beneficial as they can advise on how to reshape any settlement to better meet the your needs and aspirations, for example by the investment of a lump sum to generate future income.

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Example E : Dividing Assets Equally

Assumes for simplicity that exact equality of assets required with no other constraints.

Combined assets

Family Home	£300,000	less mortgage	£150,000
“His car”	£50,000		
His pension	£250,000	projected pension	£20,000pa
Other assets	£75,000	less other loans	£25,000
Total asset value net of mortgage and loans	£500,000		

Option 1 Offsetting – two possibilities

Possibility 1

	Him	Her
Family home		£300,000
Mortgage		-£150,000
“His car”		£50,000
Pension	£250,000	
Other assets		£75,000
Other debts		-£25,000
Total	£250,000	£250,000
Projected pension	£20,000pa	Nil

Possibility 2

	Him	Her
Family home		£300,000
Mortgage	-£75,000	-£75,000
“His car”	£50,000	
Pension	£250,000	
Other assets	£25,000	£50,000
Other debts		-£25,000
Total	£250,000	£250,000
Projected pension	£20,000pa	Nil

Option 2 Splitting – ring fence pensions

Equalising pension values

	Him	Her
Family home		£300,000
Mortgage		-£150,000
“His car”	£50,000	
Other assets	£75,000	
Other debts		-£25,000
Total excl. pensions	£125,000	£125,000
Pension	£125,000	£125,000
Total incl. pensions	£250,000	£250,000
Projected pension	£10,000pa	£8,000pa

Equalising pension incomes

	Him	Her
Family home		£300,000
Mortgage		-£150,000
“His car”	£50,000	
Other assets	£75,000	
Other debts		-£25,000
Total excl. pensions	£125,000	£125,000
Pension	£112,500	£137,500
Total incl. pensions	£237,500	£272,500
Projected pension	£9,000pa	£9,000pa

When equalising pension incomes there is an uneven split of total assets.

Option 3 Combination solution

	Him	Her
Family home		£300,000
Mortgage		-£150,000
“His car”	£50,000	
Pension	£175,000	£75,000
Other assets	£50,000	£25,000
Other debts	-£25,000	
Total	£250,000	£250,000
Projected pension	£14,000pa	£5,000pa

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Issues with offsetting

The major issues with offsetting are ensuring that asset values are correct and working around the pension holder having to retain their own pensions.

A secondary issue is that a high-earner might find it tax efficient to share their pension to their spouse and rebuild it fully tax-deductible from their future income. Such planning exercises would normally involve the use of a Financial Advisor.

Otherwise offsetting is a straight-forward and inexpensive approach.

Issues with pension sharing

A minor issue with sharing is the cost. Legal, scheme and actuarial fees should be expected to total about £2,500 plus VAT. The major issue is the different ways schemes implement pension sharing legislation. This could mean that by sharing you could between you lose a lot of the pension value and you might not end up with the share of the pension you thought you were getting.

Example F : Different outcomes of a 50% of CETV share

For a couple both aged 45 sharing his current defined benefit pension

His pre-share pension is projected to pay £25,000pa from age 60, to be worth £250,000 and with a CETV of £200,000.

Scheme type 1

Internal credit to her. His debit calculated and deducted at retirement

His pension	£16,500pa	Her pension	£7,900pa
Value	£164,700	Value	£ 82,300
	Total value	£247,000	
	Loss due to sharing	£ 3,000	(costs)

Scheme type 2

Internal credit to her. His debit calculated at date of share

His pension	£12,350pa	Her pension	£7,900pa
Value	£123,500	Value	£ 82,300
	Total value	£205,800	
	Loss due to sharing	£ 44,200	

Scheme type 3

External credit to a personal pension. His debit calculated at date of share

His pension	£12,350pa	Her pension	£7,500pa
Value	£123,500	Value	£ 78,100
	Total value	£201,600	
	Loss due to sharing	£ 48,400	

As shown in Example G there are three common approaches.

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Scheme type 1 could be considered the fairest approach, and is used by most state schemes. It sets up the receiving person as a deferred pensioner, based on their share of the CETV. Their pension is then independent of what happens to the donating party. The deduction from the donating party is only calculated at their retirement date as what they would have received without the sharing less the current value of the pension shared.

It can be seen that the intention is to try and provide the same total value of pensions as if there had been no sharing. Our valuations tend to show that they are a little under-value or a little over-value, but on average they are getting it right.

Scheme type 2 also sets up the receiving person as a deferred pensioner, based on their share of the CETV. However they calculate the deduction from the donor immediately, normally by reducing their accrued service pro-rata. The donor therefore loses any advantage of future salary increases on that service. In essence the scheme benefits by paying (lower) statutory increases, rather than (higher) salary increases on the shared pension.

Scheme type 3 is the common case, especially where the scheme administration is outsourced, where the receiver's share of the CETV is paid out as an external credit to a private pension. This is a double whammy as it capitalises the lower value of the CETV versus the pension's true value, and then it has to go through the initial and annual expenses of running a private pension. Further a personal pension subject to investment and other unknowns might be considered riskier than the company scheme that the donor remains in.

Whenever we at BDM produce a report on a pension share then we always report on the difference in overall value post-sharing compared to pre-sharing and on the risk factors. We do not provide individual advice on personal pension and recommend the use of a Financial Adviser.

In all cases the value of the receiver's pension is significantly less than that of the donor, even though the receiver got 50% of the CETV.

Example G reruns the case in Example F, but looking to equalise income at age 60. In each case significantly more than 50% of the CETV has to be shared to the receiver to generate equality of income.

The result is that when equalising income there can be major differences in the value of the post-shared pension to each member, and that there can be significant loss of overall value.

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Example G : Different values when equalising income
As in example F a couple both aged 45 sharing his current defined benefit pension

His pre-share pension is projected to pay £25,000pa from age 60, to be worth £250,000 and with a CETV of £200,000.

Scheme type 1
Internal credit to her. His debit calculated and deducted at retirement

Share	24%		76%
His pension	£12,100pa	Her pension	£12,100pa
Value	£121,000	Value	£125,900
	Total value	£247,000	
	Loss due to sharing	£ 3,000	(costs)

Scheme type 2
Internal credit to her. His debit calculated at date of share

Share	39%		61%
His pension	£9,600pa	Her pension	£9,600pa
Value	£ 96,500	Value	£100,300
	Total value	£196,800	
	Loss due to sharing	£ 53,200	

Scheme type 3
External credit to a personal pension. His debit calculated at date of share

Share	38%		62%
His pension	£9,300pa	Her pension	£9,300pa
Value	£ 93,100	Value	£ 97,000
	Total value	£190,100	
	Loss due to sharing	£ 59,900	

More over the share and value to each party will vary depending on their ages and potentially by the date at which the income is equalised.

The date at which the pension is equalised is only significant when pensions in payment escalate at different rates. This may be the case where more than one pension is being considered, or a pension includes a GMP element. Alternatively one pension may have a step change at some point in time. The main example of this is the early pension payable to members of the uniformed services. For a policeman that retires at age 50 their pension does not increase for 5 years and then has a large increase to catch-up on inflation since retirement.

Issues with attachment

Attachment does not create a clean break, although the spouse need only deal with the pension scheme not their ex-partner. However as the attachment is for a share of the partner's benefits then the spouse only gets those benefits when the partner does.

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Specifically for the receiving spouse the issues include:

- If the partner dies then any pension benefits stop
- if the spouse remarries then the attachment ceases
- The partner is taxed on the full pension
- The attachment is specified in terms of final benefits, even if these are unknown at divorce

The issue of the partner dying can be covered by insurance, and there are some advantages in terms of flexibility to specify attachment for pension, lump sum and death benefits separately, and to vary the order in future.

There are some situations where an attachment order might be considered in preference to a pension sharing order.

- When the spouse will not want to remarry
- When the pension holder is near to taking their pension
- When the spouse is in ill-health

Attachments can be particularly useful for dealing with uniformed services pensions where the pension holder might be taking an immediate pension at an early age. If the spouse took a pension share then they could not take their income until 60 or 65 depending on the scheme. However if an attachment is used both parties could take income as soon as it becomes available.

Actuarial Reports

Actuaries are professionals who value pensions and who can do the necessary splitting and sharing calculations.

BDM provide full actuarial reports that meet the requirements of an independent expert witness. Turnaround time is five working days from receipt of all necessary data. Depending on the pension scheme, we may need to obtain generic and client specific data from the scheme administrators which can add considerably to turnaround times.

We have robust data collection and follow-up processes that are effective both in achieving timely results and keeping your solicitor informed at all key stages.

At time of writing (June 2008) full actuarial reports to value pensions for offsetting purposes cost from £475 + VAT, and pension reallocation reports for sharing or attachment cost from £600 + VAT.

Our reallocation reports can report on sharing based on the capital sum, income equalisation or a combination. BDM test for any potential financial harm that might result from the proposed sharing order and report on the risks to the receiving party.

BDM's standard client instruction forms include an optional longevity assessment questionnaire. We have the capability to make medical longevity assessments in-house, which our actuaries can use in their calculations as appropriate. Not all actuarial firms have the ability to make individual medically based longevity assessments.

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Reports from BDM

During Information gathering

- **Pension in Payment EPV** on own client's pensions

Alternative to CEB from scheme for disclosing in Form E	Complete and return BDM instruction form	£100+VAT

- **Longevity report** on client or spouse

Quantifies effect of poor health on mortality and hence possible shape of financial settlement	Complete and return BDM instruction form	£100+VAT

On exchange of information (Form E's)

- **Uniformed Services EPV** on spouse's defined benefit pensions

Correct CETV from scheme which is likely to underestimate true value by between 50% and 300%	Complete and return BDM instruction form	£50+VAT with reconciliation

- **EPV** on spouse's other defined benefit pensions

Correct CETV from scheme which is likely to underestimate true value by 30% or more	Produce on-line	£25+VAT

- **Pension in Payment EPV** on spouse's pensions in payment

Alternative to CEB from scheme which may underestimate true value by 30% or more	Complete and return BDM instruction form	£100+VAT

Structuring the financial settlement

- **Full Actuarial Valuation**

Correct pension values for use in offsetting. Suitable for single or joint instructions.	Complete BDM application form for a quotation.	From £475+VAT

- **Full Pension Reconciliation Report**

Correct pension sharing or attachment percentages to meet income- or value-based objectives. Suitable for single or joint instructions.	Complete BDM application form for a quotation.	From £600+VAT

All forms can be downloaded from www.bradshawdixonmoore.com/downloads.html or phone 0845 838 2551.

All costs correct at time of writing (June 2008)

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