Offsetting, attachment or sharing? An explanation of pension options on divorce.

The following notes may help to understand the advantages and disadvantages of each of the three options. These notes do not take account of 'Mesher Orders', which allow for the sharing of different matrimonial assets now but with the actual division to take place at a later date for example when the youngest child reaches age 18.

The notes also do not consider 'Martin Orders' where any sharing is given effect to on the death of the ex spouse.

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Offsetting.

When offsetting is used the value of the member's pension rights are taken into account in any financial settlement although the member retains the pension rights. Offsetting can assist in achieving a clean break. In effect the value of the pension rights is set off against other assets of the member such as the matrimonial home as part of the ancillary relief process.

The party with the pension assets can continue their pension funds in the future. The ex spouse will receive other assets which can perhaps be invested in suitable arrangements to achieve income or capital growth.

Offsetting may be attractive where: -

The divorcing couple are relatively young, both of them are at work, there are no children involved and there are sufficient non-pension assets to allow the offset.

The couple's assets are such that even after the split they are still large enough to provide each party with sufficient resources to carry on with their lives.

The ex spouse has sufficient retirement income which would normally make pension sharing less appropriate.

Offsetting may be less attractive where: -

The member's pension rights are of high value compared to the other assets, which may make offsetting extremely difficult.

A replacement pension will be needed for the ex spouse which may be difficult to provide if the time to the ex spouse's retirement date and funds are short, or if the ex spouse is not working.

Life assurance benefits under the member's pension scheme are lost by the ex spouse.

If the ex spouse receives non-pension assets the tax position of these may not be as favourable as assets held within a pension fund.

The ex spouse receiving non pension assets may have a very low tolerance to investment risk, if the other party was a member of a defined benefit occupational pension scheme (such as any one of the public sector schemes). This would imply a much lower degree of investment risk, which could be suitable to the ex spouse, but which cannot be achieved with other assets.
Attachment Order.

This enables the court to direct pension scheme trustees to make payments to an ex spouse from the date the member draws on the pension benefits.

Attachment orders suffer from a number of problems including: -

The ex spouse can receive no benefit until the member decides to, or is forced to retire. Effectively the ex spouse has no control over the benefits unless the wording of the attachment order is correct. Without a correctly worded attachment order the member can control when the benefits come into payment, the investment options for the fund prior to retirement, and the structure of benefits at retirement.

The member may therefore be able to deliberately reduce the benefits subject to the attachment order. For example the member could, subsequent to the implementation of the attachment order, opt out of an employer’s pension scheme and make alternative provision by means of an ISA or personal pension scheme. In doing so this would not be subject to the attachment order and so would not benefit the ex spouse.

The ex spouse will lose all benefits if he or she pre-deceases the member.

The pension benefits will cease if the ex spouse remarries.

The basis of the benefits under the scheme may change between the time that the attachment order is made and when the member retires. For example a defined benefit occupational pension scheme may be wound up and future provision may be made through a money purchase or personal pension scheme. If the final salary scheme was in deficit at the time of the winding up taking place this could result in reduced benefits compared to those previously envisaged.

The ex spouse will need to keep the pension scheme trustees and administrators (or product provider in the case of an insured arrangement) informed of any changes in his / her circumstances e.g. change of address, remarriage etc. Failure to do so could jeopardise payment of benefits in the future and entail the ex spouse seeking payment of the benefits from the member.

Both parties have the ability to seek a variation in the order in the future.

The attachment order can be ignored by a Trustee in Bankruptcy and this could jeopardise the ex spouse’s benefits.

As the pension benefits legally still remain with the member the pension income is taxed at his or her marginal rate.

Attachment orders may be attractive: -

Where the divorcing couple are in their 50’s (or later) and other forms of maintenance provision are inappropriate. This will particularly apply where the ex spouse is unemployable (either because of age or qualifications / experience).

Where the pension scheme does not have any readily realisable assets for example in a small self-administered scheme (SSAS) or self invested personal pension (SIPP), which is almost wholly invested in property. This would make sharing extremely difficult.

Where the lump sum death in service benefit is to be provided to the ex spouse.
Where the member is already in receipt of an annuity or pension income from the scheme. Although it is possible to effect a pension sharing order on an annuity, an attachment order may be more appropriate in some circumstances.

For example if an annuity is shared it will be achieved by creating a new pension or deferred pension with the existing provider. Any new annuity will need to take into account the state of health and relative ages of the annuitants at that time. This would often mean that the pension available to the ex spouse would be lower than expected as a wife divorcing a husband of the same age could not expect to receive half of his pension income due to her longer life expectancy.

Where an annuity is subject to an attachment order the need to set up a new annuity for the ex spouse will be avoided as he / she will be receiving a maintenance payment of part of the member's annuity. However there remains the risk that the member will pre-decease the ex spouse which would result in the benefits ceasing or reducing depending on the annuity structure selected at outset.

The ability to vary the order in the future may be attractive to both parties.

Where the member's pension arrangement is a defined benefit scheme, the retention of this may be attractive to the ex spouse if he / she has a low tolerance to investment risk. This needs to be discussed and considered in the context of the employer and the funding position of the scheme.

If the pension is a defined benefits occupational scheme, tax-free cash may be available by commutation and this may be more suitable than where it is expressed as a percentage of a fund.

Death in service benefits may remain subject to a nomination in favour of the ex spouse. Of course this may cause problems in so far as if the member remarries and the new spouse argues over the use of the Trustees discretionary powers.

Pension Sharing Orders.

Pension sharing provides an extension to the clean break principle, and it may be attractive when: -

One party has high value pension assets relative to any other assets.

The ex spouse is relatively close to retirement. The ex spouse may find it difficult to build up comparable pension benefits over a relatively short period.

The divorcing couple is older. Here the ex spouse will be able to take benefits from age 50 (under current legislation) in respect of the pension credit rather than have to wait until the member retires (as would apply with an attachment order).

Where the ex spouse may be thinking of remarrying. The ex spouse obtains indefeasible rights and it is not possible to vary the order at a later date.

The ex spouse receiving the sharing order will be able to nominate potential beneficiaries of any death benefits in the event of his / her subsequent death prior to retirement benefits being taken.

A pension sharing order provides greater flexibility and choice to the divorcing couple and the courts and allows pension rights to assist in providing a fairer overall settlement of marital assets.

It is possible to apply for a sharing order subsequent to an attachment order having been made.

It is also possible to have ongoing maintenance as well as a pension sharing order.
Pension sharing may be less attractive when:

The retention of the family home is a key priority for the ex spouse. The sharing of the member’s pension rights may necessitate other assets to be shared (e.g. the family home). This could result in the sale of the matrimonial home and the need to trade down to a smaller property.

Where the ex spouse already has adequate pension provision.

Note that survivor's benefits (i.e. pension benefits paid following the death of a former spouse) are not shareable.

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