BEWARE PENSION SHARING - A WARNING FOR ARMED FORCES PERSONNEL

Bryan Scant, a Pensions specialist and Solicitor in the Family Law Team at Coffin Mew Solicitors warns about the treatment of pensions following a divorce. “In any divorce involving services personnel, it is often the case that the most valuable asset in a marriage is the terminal grant and pension,” says Bryan. "However there are some real areas of concern that need to be carefully considered to avoid any pitfalls.”

In this article Bryan highlights some of these areas. With no intended presumptions the servicemen will be described as ‘the husband’ and his spouse as ‘the wife’.

Unlike many occupational schemes, the armed forces pension scheme is unfunded. Therefore, there is no actual pot of money available to pay the pension. The pension and lump sum are earned over a period of years by virtue of length of service - and for ranks of NCO and below are often taken at the end of 22 years service. Because there is no money tied-up in the scheme, the pension is valued on a notional actuarial formula. This is called a Cash Equivalent Transfer Value (CETV) and is the estimated pot of money which would be required to provide the benefits which have been earned. This CETV is the figure utilised in the divorce court to assess the value of the pension.

What are the options available on divorce in respect of the pension?

1. Pension Sharing

The first option is to have a pension-sharing order. Under this option, a percentage of the notional value of the pension is taken from the pension ‘pot’ and transferred to the wife. Often, when calculating how much should be transferred out of the husband’s pension pot into that of the wife, pre-marital service is disregarded. However, it is invariably the case that the proportion of the pot which has been earned during the marriage will be divided equally. For example, for someone with 20 years service who has been married for 10 years, one-half of the CETV might be subject to a claim by a wife, and that proportion be split equally, which would mean that the wife would be apportioned 25% of the CETV. The effect of a pension-sharing order of this nature would be that 25% would immediately be transferred to the wife and there will be a corresponding reduction in the husband’s benefit, when paid. A pension sharing order allows the parties to obtain a clean break of pensions, because neither party remains financially tied to the other i.e. the wife does not need to wait for the husband to draw his pension before she can draw hers.

2. Pension Attachment

This differs from pension-sharing. In essence, the benefits payable are charged with a percentage in favour of the wife. The benefits remain in the husband’s name but as and when they are paid, a corresponding percentage is diverted to the wife - be it terminal grant or pension or both. Attachment orders are rarely used now for the following reasons:

1. The member is liable to pay the tax on the whole pension, including the part that is ultimately paid to the ex-spouse.

2. Payments to the ex-spouse would cease on their re-marriage (a lump sum would still be paid if applicable).

3. The ex-spouse has to wait until the member receives payment before they can receive any money, hence there is no clean break between the parties.
4. Attachment orders can be varied, which leaves uncertainty.

5. Ongoing payments to the ex spouse would cease on the members death i.e. the order dies with them.

There are limited circumstances in which an attachment order might be suitable but generally speaking a pension sharing order provides greater flexibility and a clean break.

3. Off-setting

This is where a serviceman keeps his pension but in return, gives up a corresponding proportion of other existing matrimonial capital e.g. equity in the house. This can be difficult to calculate because £1 of pension is not necessarily equivalent to £1 of a capital asset, since a capital asset is money available imminently whereas pension is often not available until some point in the future.

Compensation benefits such as Early Departure Payments cannot be shared by way of a pension sharing or attachment order but can be considered as a matrimonial asset and offset against the pension fund value.

It will be evident from these points that the treatment of a services pension on divorce is complicated. It is now well documented that in some instances, by virtue of the methods by which the CETV is calculated, that it is sometimes under-valued (as in the case of NCO rank and below) or over-valued (more often in the calculation of officer’s pensions).

The reasons why are too complex to detail in this article, but it is increasingly the case that independent actuaries reports are commissioned to comment upon the accuracy or otherwise of the pension CETV valuation. An even bigger pitfall has become apparent with pension-sharing orders to which some people have already fallen foul, usually because they have not taken legal advice or have received inadequate legal advice.

Those affected are more likely to be those who have already received their lump sum benefits and are receiving their pensions, perhaps having left the service in their early 40s.

“There have been situations where servicemen have agreed to pension-sharing orders, and have given up to one-half of their pensions away on divorce, believing that their pension would not be affected until age 65,” says Bryan. “In fact, although the ex-wife does not receive the benefit of the pension-sharing order until she is 65 (may now draw as early as 55), an immediate debit is made to the serviceman’s pension”. If a husband is in, say, his forties at the time the pension sharing order is made he could potentially lose tens of thousands of pounds, with his wife gaining no immediate benefit whatsoever.

Bryan emphasises. “If you are getting divorced and unsure what to do with your pension, you need to obtain legal advice from a lawyer with experience in Services Pensions as soon as possible. They are more complex than other pensions and there is a real danger that if a wrong decision is made it could have an impact on the ex-serviceman for a lifetime.

“The situation is complicated further in view of the multiple pension schemes that have been introduced. AFPS 75 was introduced in 1975 and closed to new entrants or re-joiners after 5 April 2005. AFPS 05 was introduced 6 April 2005 to 31 March 2015 and serving members of the 75 scheme were given an opportunity to transfer to this scheme. Finally, AFPS 15 was introduced on 1 April 2015 and members of the 75 and 05 schemes without transitional protection were automatically transferred to this scheme. Therefore most servicemen are likely to be a combination of the 75 or 05 scheme and the 2015 scheme. It is important that a lawyer acting in divorce proceedings is well aware of the fundamental differences between the relevant schemes ”.

|Some examples of the differences for the schemes are as follows:|

1. Cash Equivalent Value – for AFPS 75 members’ the length of service and rank at the relevant date will be used by Veterans UK to value the scheme. For AFPS 05
members the best consecutive twelve months final pensionable pay in the three years preceding the relevant date will be used in the valuation. For AFPS 15 it will be the value of the scheme members’ pension pot at the relevant date.

2. A pension lump sum is not automatically payable in AFPS 15 – a member must take retirement commutation to create a lump sum.

3. The deferred pension age varies.

4. Early Departure Payments are paid under the AFPS 15 and AFPS 05 schemes although governed by different rules within the schemes, but are not paid under the AFPS 75 scheme.

5. What a former spouse receives into their estate on death will vary according to the different schemes.

PENSION SHARING ORDERS IN PRACTICE

An explanation of how the various orders can operate in practice is given below.

Follow this link to a table showing some of the potential advantages and disadvantages of the various options. MMP131 - AFPS Divorce-Dissolution Guide

50% PENSION SHARING

**Advantages – Husband**
Enables a clean break with no future uncertainty.
Husband accumulates post-divorce benefits from future service at full rate.

**Disadvantages – Husband**
The reduction in the husband’s benefits will be made immediately, even though the wife does not immediately receive any benefit.
Pension debit can have the effect of reducing the husband’s pre-divorce benefits by more than the percentage credited to the spouse.

**Advantages – Wife**
Can obtain a separate pension fund for retirement.
Death of husband does not mean loss of pension.
Wife’s remarriage does not affect right to the pension.
Can enable a clean break to be achieved.

**Disadvantages – Wife**
Cannot access benefits until aged 55 at earliest.

50% ATTACHMENT

**Advantages – Husband**
If wife remarries she loses right to share of pension income; lump sum element is also variable.

**Disadvantages – Husband**
The percentage applies to benefits on leaving the service, therefore wife can receive not only 50% of pre-divorce benefits but also post divorce benefits.

**Advantages – Wife**
Chance to acquire share of gratuity and pension when husband retires from service.
Not only does wife receive 50% of pre-divorce benefits but also can receive benefit accumulated after divorce but before retirement.

**Disadvantages – Wife**
Loses right to pension income if remarries.
Always open to variation (gratuity) before actual payment; thus no certainty.
Pension income attachment open to variation both prior to retirement and / or once in
Pension dies with husband so wife loses benefits if husband predeceases.

**PENSION OFFSET**

**Advantages – Husband**
Can potentially preserve pension benefits in full.
Can achieve a clean break.
Can work out a settlement to suit circumstances.

**Disadvantages – Husband**
Where value of pension exceeds other capital, his right to that capital can be wiped out, leaving him with no capital to start again

**Advantages – Wife**
Can enable wife to gain greater share of existing capital.
Can work out settlement to suit circumstances.

**Disadvantages – Wife**
Wife may accept settlement of capital which is lower than the true long term value of the pension. Wife may not have enough income on retirement pending her own pension provision.

**Both**
Although there can be advantages to both parties it is important that the offset is fair. Both parties should ensure that the CETV is an accurate valuation of the true underlying value of the benefits – an actuaries report may be necessary for this.

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Pension Sharing

Effect of 50% pension sharing order

Husband suffers 50% debit thus reduced gratuity/pension, but date on which benefits can be taken is unaffected.

Wife receives pension credit but not until age 65 (or potentially age 55 if requested but pension will be actuarially reduced).

Effect of 50% pension sharing order (Pension in payment)

Husbands gross pension payment debited immediately. 50% pension debit.

Wife receives pension credit but not until age 65 (or potentially age 55 if requested but pension will be actuarially reduced).

Effect of 50% gratuity/pension attachment order

Husbands retains benefits until they are claimed i.e. on leaving service then receives 50% of gratuity and pension.

Wife gets no separate pension credit until husband leaves service then receives 50% of gratuity and pension.