

## **Divorce advice considerations**

Synopsis: The need for financial advice during the divorce process given the different outcomes achieved by offsetting earmarking and sharing.

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### **50:50 divorce split or split on basis of “fairness”**

In the UK, divorce settlements typically aim to achieve a 50/50 split for both parties. However, sometimes this is not the case and one party receives a larger proportion of the matrimonial assets than the other.

The relevant legislation remains the Matrimonial Causes Act 1973 and subsequently the Civil Partnership Act 2004 when dividing assets in a divorce in the UK. This means that a number of factors need to be taken into account when determining the split of assets on divorce, which includes...

- The income and financial needs of each party.
- The family's standard of living before the marriage began to collapse.
- Income of each party – in particular if either party has high earning potential in the foreseeable future.
- Financial responsibilities that each party has or will have in the future.
- The contributions that have already been made to the welfare of the marriage or contributions that will need to be continued.
- Severe issues of conduct of either party (for example domestic abuse).
- Health problems or disability which might impact on earnings capacity or care costs.

Note that the welfare of any children is always the first consideration.

More than twenty years on, the case of Mr and Mrs White (2000) - which was a farming divorce - remains one which changed the landscape in relation to the split of assets.

The division of assets decided by the Court of Appeal was upheld by the House of Lords – 43% to Mrs White and 57% to Mr White. This ruling made it clear that equality (i.e. a 50/50 split) should be departed from only if, and to the extent that, there is a good reason for doing so.

Mrs White did not receive half the assets because Mr White had, a year before the breakdown of the marriage, acquired a separate farm as an inheritance.

So, whilst the House of Lords urged fairness it recognised that an equal division of assets would not result in fairness in all cases.

### **Offsetting, earmarking or sharing?**

The courts, in theory, have three options to consider when dealing with pension rights on divorce/ dissolution of a civil partnership. Although each case needs to be considered on its own merits, the following may help to set out some of the advantages and disadvantages of each of the approaches...

#### **Offsetting**

Where offsetting is used, the value of the member's pension rights are taken into account in any divorce settlement although the actual rights are retained by the member. In effect, the value of the pension fund is set off against other assets of the member (e.g. the ex-spouse/former civil partner may receive other non-pension assets - e.g. matrimonial house) as part of the divorce settlement.

Offsetting may be attractive where...

- The divorcing couple are fairly young, both at work, there are no children involved and there are sufficient non-pension assets to allow 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/former civil partner already has a decent retirement income, which would normally make pension sharing less appropriate.

Offsetting may be less attractive where...

- The member's pension value is high compared to other assets which may make offsetting extremely difficult or impossible.
- A replacement pension will be needed for the ex-spouse/former civil partner, which may be difficult to provide if the time to the ex-spouse's/former civil partner's retirement date is limited, money is short, or if the ex-spouse/former civil partner is not working.
- Life assurance benefits under the member's pension scheme are lost by the ex-spouse/former civil partner.

#### **Earmarking**

Earmarking enables an English or Welsh court to direct the trustees of a pension scheme to make payments to an ex-spouse/former civil partner from the date the member draws benefits under deferred maintenance orders. In Scotland, an earmarking order can only be in respect of lump sum benefits.

Earmarking suffers from a number of problems including...

- The dependent ex-spouse/former civil partner can receive no benefit until the member decides, or is forced, to retire.
- The dependent ex-spouse/former civil partner will lose all benefits if they are predeceased by the member.
- The pension benefits will cease if the ex-spouse/former civil partner remarries/forms another civil partnership (unless the order is in respect of lump sum benefits).
- The member may effectively be able to reduce the benefits of the deferred maintenance payment. For example, the member could opt out of their employer's scheme and make alternative provision by means of a separate savings vehicle (e.g. an ISA), which would not benefit the ex-spouse/former civil partner.
- The basis of benefits under the member's scheme may change between the time that the court order is made and when the member retires.
- The ex-spouse/former civil partner will need to keep the scheme trustees advised of any changes in their circumstances (e.g. change of address, remarriage, etc.).

Earmarking can, however, be attractive in a number of areas including...

- Where the divorcing couple are in their 50s and other forms of maintenance provision are inappropriate. This will particularly apply where the ex-spouse/formal civil partner is unemployable (either because of their age or lack of experience).
- Where the pension scheme does not have any readily realisable assets (e.g. where a small self-administered scheme is almost wholly invested in the company's own property, this will make sharing very difficult).
- Where the lump sum death in service benefit is earmarked for the ex-spouse/former civil partner.
- Where the member is already in receipt of an annuity. Although it is possible to "share" an annuity, earmarking may be seen as more appropriate in many cases. For example, where an annuity is shared, it will be achieved by creating a new pension or deferred pension with the existing provider.

As any new annuity will need to take into account the state of health and relative ages of the annuitants at the time, it is quite possible that the pension available to an ex-spouse/former civil partner will be lower than

expected. For instance, a wife divorcing a husband of the same age could not expect to receive half of his pension because of her greater life expectancy.

- Where an annuity is earmarked, the need to set up a new annuity for the ex-spouse/former civil partner will be avoided as they 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/former civil partner which will result in the earmarked benefits ceasing. In such cases, some form of contingent life cover may be required.

### **Sharing**

Pension sharing provides an extension to the "clean break" principle. It seems most likely to be used in the following situations...

- Where the ex-spouse/former civil partner is relatively close to retirement. The ex-spouse/former civil partner may find it very difficult to build up a comparable pension fund in the short remaining period to retirement.
- Where the divorcing couple are older. Here the ex-spouse/former civil partner will be able to take benefits from age 55 (age 57 from 6 April 2028) in respect of the "pension credit" rather than have to wait until the member retires (as would apply in respect of earmarking).
- Where the ex-spouse/former civil partner may be thinking of remarrying. Unlike earmarking, any pension sharing arrangements would be unaffected by this.

Pension sharing may be less attractive where...

- The retention of the family home is a key priority for the ex-spouse/former civil partner. 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.

- The ex-spouse/former civil partner already has adequate pension provision.

### **Conclusion - a clear need for financial advice**

While pension sharing introduced much greater choice in the utilisation of pension benefits in divorce settlements, it also results in a much greater need for advice to the divorcing parties on the available options and to scheme trustees on how the new legislation affects their schemes.

A financial adviser is able to explain the complexities and may provide support for the legal team involved in determining the most appropriate course of action for

the divorcing parties and scheme trustees. The following is a list of some of the areas where expert advice may be required.

### **Which options?**

“Divorcing clients” need support on which of the options may be most appropriate to their circumstances.

### **Which sharing option?**

If sharing is determined as the most appropriate option, and the ex-spouse/former civil partner is offered the choice of retaining benefits under the member’s scheme, or transferring the “pension credit” to another scheme, they will need advice on the best option.

If a transfer is seen as the most appropriate, advice will be needed on the optimum receiving scheme: such as personal pension and an appropriate provider for such a scheme.

### **Earmarking or maintenance order?**

Advice on whether an earmarking order would be better or worse for a client than a maintenance order of the same value.

### **Valuation of pension rights**

Divorcing clients will wish to feel satisfied that a CETV provides a fair valuation. Problems may arise particularly where either discretionary benefits are ignored in the calculation of the CETV, or where the valuation is in respect of an active member of a final salary scheme.

### **Ex-spouse’s/former civil partner’s lump sum**

Where the ex-spouse/former civil partner is to receive a lump sum (whether in the form of tax-free cash from a “pension credit” or otherwise) as part of a divorce settlement, advice may be needed on how best to invest this.

### **Restoration of member’s pension rights**

The member may need advice on how best to restore any lost pension benefits as a result of a pension sharing order. Great care will need to be taken where a member has enhanced or primary protection as any attempt to provide further pension benefits is likely to result in the loss of such protection.

This will necessitate an analysis of all available investment options (and not simply pensions).

### **Business impact**

If a 50:50 split of assets in the divorce settlement is determined, this may result in significant changes to the shareholdings in many family businesses.

This will result in a need to review any business financial planning (e.g. key person, share purchase agreements, etc.)

### **Life assurance on the member's life**

Where part of the member's pension benefits is being earmarked for the ex-spouse/former civil partner, it may be appropriate for the ex-spouse/former civil partner to take out life assurance on the member's life to allow for the loss of income which would occur if the member were to predecease them.

### **Liaising with solicitors**

Most family solicitors will need financial and pensions assistance in ensuring the various options are explained and appropriate recommendations are made to their clients. A financial adviser who is conversant with pension schemes is an ideal person to provide such assistance.

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