time to share?

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With the Pensions Bill currently going through Parliament, Adrian Walker explains some key areas that may affect clients going through divorce proceedings.

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While focus has mostly been on the recent Budget and Finance Bill announcements affecting registered pension schemes, the Pensions Bill is likely to bring about more significant changes to the ongoing structure of UK pension provision in the short to medium term.

One change which will have a more immediate impact on advice is that regarding pension sharing as part of divorce proceedings. The differences are in two areas – safeguarded rights and the pension protection fund.

safeguarded rights

Safeguarded rights arising from pension credits involving contracted-out benefits that have been transferred into a money purchase registered pension scheme operate under a separate set of rules to those of other benefits held within a registered pension scheme.

There is currently no pension commencement lump sum available from such funds and benefits are only available from age 60.

Proposals

As part of a wide-ranging review of pension simplification, the Pension Bill proposes that these rights will no longer be treated differently to non-protected rights held within a registered scheme. As such, benefits from such rights will become available from age 50 (rising to 55 from the 2010/11 tax year) and a pension commencement lump sum will be provided from such funds. Retirement options such as income withdrawal will be available from an earlier age. Similarly, wider income options through annuities will become available, enabling a more flexible approach to meet the client's specific needs. Initial estimates from the Department for Work and Pensions (DWP) are that this will come into effect from October 2008, although the legislation may be enacted before the close of this parliamentary term.

Pension sharing

If implemented as proposed, these changes will have a significant impact for financial advisers and companies currently involved in this area of financial planning. The increased flexibility of these rights as far as future benefit provision is concerned may make pension sharing a more attractive solution, whether in part or in full, within the divorce process.

This may be of particular importance where the existing pension provision is held in a final salary scheme with either or both of a Guaranteed Minimum Pension and S(9)(2b) rights forming part of the entitlement under review. Many such schemes will not offer the ex-spouse the option of continued membership of the underlying scheme, and a cash equivalent to a separate registered pension scheme may be the only option available.

These changes will not impact members of statutory schemes, where continued scheme membership for the ex-spouse will still remain the only initial option available as a means of securing the relevant share of those rights.

pension protection fund (PPF)

The second change in this area of practice may be of more limited impact, but could provide a wider choice of options for those clients affected.

Pension assets are currently taken into account during financial divorce proceedings, and may be shared. The PPF is not a pension scheme and consequently the sharing regulations do not apply. However, the Bill provides for the sharing of PPF compensation payments.

These changes should allow financial advisers working in this area (or who have clients currently affected by divorce proceedings) to review the basis for potential settlements and establish whether better solutions involving pension sharing will shortly be available.

This article is based on Skandia's interpretation of the law and HM Revenue & Customs practice as at 31 March 2008. We believe this interpretation to be correct but cannot guarantee it.