Ministry of Defence

Armed Forces Pension Scheme: Retrospective Remedy

Consultation Addendum

Enclosure 13: Divorce and Dissolution

3 APR 2023

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Introduction

1. This enclosure sets out how the retrospective remedy will apply to those in scope who divorce or dissolve a civil partnership in circumstances where their pension benefits are taken into account as part of the financial settlement.

2. There are three main ways in which pension benefits may be taken into account in the context of divorce or dissolution of a civil partnership:

   - **Offsetting** the value of the pension benefits against other assets.

   - An **Earmarking Order** (EO) or a **Pension Attachment Order** (PAO).

   - A **Pension Sharing Order** (PSO), or a legally binding agreement.

General

3. A divorcing couple may decide to offset the value of pension rights against the value of other financial assets, for example by one party keeping a greater share of their pension in return for ceding a larger share of the value of a house. Where the pension rights are fully offset against other assets, no order affecting the pension is made by the court. Where the value of the pension is only partially offset against the value of other assets, a PSO or EO/PAO may be put in place in relation to the affected pension rights.

4. In cases where pension rights are in play, the member will usually obtain a statement of their pension benefits from the pension scheme for these purposes. There are also circumstances in which the court may request such information. The statement shows the value of the member’s pension rights as a snapshot of the position on the valuation day, and it is not a guarantee of the member’s benefits in the future. Where the scheme has issued the relevant pension information before 1 October 2023, and it has not been updated, the financial settlement may not reflect any change in pension rights that occurs as a result of the implementation of the remedy.

5. This enclosure covers Earmarking and Pension Attachment Orders but focuses primarily on Pension Sharing Orders. This is because there is very little legislative change required in

relation to EO/PAOs as any consequences flow automatically from the member's choice. However, Pension Sharing Orders sit within a complex legislative framework and scheme rules require significant amendment in this regard.

Earmarking Orders /Pension Attachment Orders (EO/PAO)

6. An Earmarking or Pension Attachment Order is a court order under which a part or all of the member's pension benefits must be paid to their former spouse, at the point when those benefits become payable. In England, Wales and Northern Ireland the member's pension, pension commencement lump sum and any lump sum payable on death can be earmarked. In Scotland, PAOs are still known as Earmarking Orders, and can only apply to pension commencement lump sums.

7. The member retains ownership and control of the pension benefits and can decide when and how to take them – subject to the constraints of scheme rules and legislation. In the context of the pension remedy, it is the member who will make the remedy choice.

8. Where a pension is in payment on 1 October 2023, the member will be an immediate choice member and will be required to make an election in due course. In the meantime, until the expiry of the election period, the existing pension benefits will remain in payment. When the member makes their remedy choice, the value of the pension in payment may change as a result. Where the EO/PAO applies to a pension in payment, the value payable to the former spouse or civil partner may therefore change once the choice is made.

9. Any change in value of the pension in payment will be retrospective, to the point at which the pension became payable. In principle, there may have been overpayments (where the value of the pension has decreased) or underpayments (where the pension has increased). In all cases where there has been an underpayment, MOD will pay the relevant arrears, plus interest if applicable to the relevant party.

10. However, where the value of the pension is reduced as a result of the member's remedy choice, MOD will apply the principles set out at paragraphs 3.41 to 3.44 of the principal consultation document[1] when determining whether to recover overpayments.

[1] Armed Forces Pension Scheme: Retrospective Remedy - GOV.UK (www.gov.uk)

11. Although less common, it is possible for older (pre-2000) EO/PAOs to determine a specific amount to be paid to the former spouse/civil partner, rather than a proportion/percentage of the member's pension. In such cases, the amount payable to the former spouse/civil partner will not be affected by the member's choice and will remain the same.

Pension Sharing Orders (PSO)

12. Pension sharing is a formal agreement to divide a member's pension assets at the time of divorce or dissolution of a civil partnership. The Welfare Reform and Pensions Act 1999 (WRPA 1999) provides the framework for this complex regime. A PSO is always a court order in England, Wales and Northern Ireland, and in Scotland these can be made either by a qualifying agreement or court order. The purpose of the PSO regime is to provide a clean break between the parties: after implementation, the parties each have their own separate pension accounts which are not affected by subsequent changes to either party's circumstances. In short, once the PSO is implemented the pension credit no longer belongs to the pension debit member (PDM) and they have no further interest in what happens to it.

13. A PSO in England, Wales and Northern Ireland sets out what percentage of the member's rights in a pension scheme are to be shared with (transferred to) the former spouse/civil partner. In Scotland, the PSO may specify a percentage, but it can also specify an amount to be paid to the former spouse/civil partner. The share of the pension awarded to the former spouse/civil partner provides what is known as the pension credit, and the former spouse/civil partner is known as the pension credit member (PCM). The member's pension is subject to a pension debit of the specified percentage and the member is known as the pension debit member (PDM). Very briefly, the member's pension rights which are subject to the pension debit are established on the date the PSO becomes effective, and they are then subsequently valued to establish the amount which will be awarded to the PCM, in order to purchase pension credit benefits for them in the scheme. The pension credit is retained within the scheme and is subject to specific rules which may be different to those for other members. The PCM is then a member of the pension scheme in their own right, independently of the PDM.

14. Where the debit member has pension rights in more than one pension scheme, and the PSO is to apply to more than one scheme, the PSO will contain an Annex for each scheme to be shared, specifying the percentage to be shared from that particular scheme. It is possible to share benefits from only one scheme, and it is also possible to share different percentages in different schemes. It is therefore possible for a PCM to have pension credit accounts in more than one pension scheme.

Out-of-scope pension sharing orders

15. The pension remedy only applies where the PSO applies to shareable rights which were accrued as a result of the member's remediable service. Accordingly, it is not the date on which the PSO was made or becomes effective which is relevant, but rather whether it covers rights accrued through remediable service during the period 1 April 2015 to 31 March 2022.

How the remedy works

16. The remedy works differently, depending on whether the case falls into the following categories:

    - Was the Cash Equivalent Value (CEV) (pension information) on which the PSO is based provided by the scheme before 1 October 2023?
    - Was the CEV on which the PSO is based provided by the scheme after 1 October 2023?
    - Was the CEV on which the PSO is based provided by the scheme after the member had made their remedy choice?

17. The remedy will also work differently for Pension Credit members and Pension Debit members.

18. As mentioned above, it is standard practice in divorce proceedings where any kind of pension sharing is under consideration, for the scheme to issue pension information in the form (usually) of a Cash Equivalent Value (CEV). This provides the parties and the court with a snapshot of the member's pension rights at a particular point and any PSO (or EO/PAO) which is ultimately made usually relies to some extent on this information.

19. After 1 October 2023, where:

    - the scheme provides this information (CEV) for the purposes of any divorce proceedings where pension rights have been accrued through remediable service, and
    - the member has not yet made their remedy election,

    the scheme manager will carry out the following process:

    - calculate the CEV of the remediable service benefits as if they were paid on the legacy scheme basis and then again as if they were calculated on the reformed scheme basis;

- the CEV provided to the parties or the court, will include the higher of the two valuations.

20. After 1 October 2023, where this information is provided in cases where the member has made their remedy election (which is irrevocable[2]), then the information provided by the scheme manager must be based on the benefits actually payable to the member – in other words, on their remedy choice. In such cases, the pension credit and debit are calculated on the basis of the choice made by the remedy member and the remainder of this enclosure does not apply.

Pension Credit Members: information provided before 1 October 2023

21. Pension credit members do not have remediable service under the Public Services Pension and Judicial Offices Act 2022 (PSPJOA 22). They will not be rolled back on 1 October 2023 and will remain members of the scheme(s) named in their PSOs. Cases in this category will include those where the PSO has already been made and/or implemented before 1 October 2023, and it will include cases where the PSO was made and/or implemented after that date. The key point is that the CEV was issued before 1 October 2023.

22. In such cases, it may be that if the value of the remediable service benefits had been calculated based on the alternative scheme model, the amount available as a pension credit would have been higher.

23. The regulations will require the scheme manager to revalue the pension credit relating to remediable service benefits and, where the alternative value would have been higher, the scheme manager must pay the difference (a "top-up") into the PCM's pension credit account. to purchase additional pension benefits.

    - Where the PCM only has an account in one pension scheme, the top up will be applied to that account.
    - Where the PCM has pension credit accounts in relation to the relevant remediable service in more than one scheme, the PCM will be offered a choice as to the scheme in which they wish the top-up to purchase additional benefits.
    - Where a PCM fails to make such a choice within the required timescale, the top-up will be applied to purchase benefits in the legacy scheme.

[2] In this regard, it is worth noting that an irrevocable remedy choice may be made many years before the relevant pension is due to come into payment – for example where the member is in receipt of an EDP, is an RFPS 05 member who received a Tier 1 lumpsum under the EDP 15 regulations or a member who was made redundant after 1 January 2021.

24. For Scottish PSOs or qualifying agreements which specify an amount by which the member's pension is to be reduced, rather than a percentage, the scheme will calculate an implied percentage which will be used to determine the amount to be transferred on the basis of the alternative scheme model.

25. This process applies whether or not the PSO has been implemented before 1 October 2023 – as set out above the key point is whether the CEV, by reference to which the court based the order, was provided before that date. A PSO is a court order, and the pension remedy does not change the terms of the order: what it does is adjust the benefits payable to pension credit members to ensure that they do not suffer any adverse impact as a result of the pension remedy.

26. In a case where the PSO is implemented after 1 October 2023, the scheme manager will implement it in strict accordance with the terms of the order and will then carry out the valuation process as above, paying a top-up where this is required.

Pension Credit members: information provided on or after 1 October 2023

27. On 1 October 2023, members with remediable service will be rolled back into the relevant legacy schemes and the value of their pension rights will change accordingly. The position for full protection members does not change at this point, although they are able to make a remedy election for reformed scheme benefits in due course. However, until those members make a remedy choice, the value of their remediable benefits is not set in stone and can change. Accordingly, from 1 October 2023 schemes will provide information in accordance with the process outlined in paragraph 19.

28. When a PSO is made based on information provided after 1 October 2023, and the member has not yet made a remedy choice, the scheme manager will calculate the higher of the two alternative values for the remediable service benefits as at the valuation day, and the pension credit will be calculated on the basis of this CEV. No top-up is payable in these cases – these are not necessary as the pension credit is based on the highest valuation.

Pension Debit Members: PSO based on information provided before 1 October 2023

29. Where the PSO has been made on the basis of a CEV provided for the purposes of the divorce before 1 October 2023, it may apply to rights which either no longer exist (the member left

service before 31 March 2022) or are significantly reduced after roll back (the member has service since 1 April 2015, or some PTVR service during the remedy period). The PSO itself cannot be changed by scheme rules, but the PSPJOA 22 provides that schemes may adjust benefits payable to pension debit members. This section sets out how pension debit reductions will be calculated and applied where the PSO is based on information supplied before the remedy was implemented.

30. The basic principle underlying the calculation of the pension debit is that it should reflect the percentage awarded by the PSO in relation to benefits accrued during the remedy period, irrespective of the scheme named on the PSO Annex. It is easier to explain this by using examples, as follows:

Example 1: A is a Full Protection member of the AFPS 75, requests a CEV for divorce proceedings on 1 April 2023 and the PSO is made on 2 November 2023. The PSO awards 70% of the AFPS 75 pension to A's former spouse.

- At rollback, nothing changes because A was always in the AFPS 75 during the remedy period.
- When A makes their remedy choice, they elect for reformed scheme benefits for the remedy period.

The value of their pension account is re-calculated to reflect the mix of legacy and reformed scheme benefits. A pension reduction of 70% is still applied but the value will change to reflect that they have elected reformed scheme benefits for the remedy period.

Example 2: B is an unprotected member of the AFPS 05, requests a CEV for divorce proceedings on 5 March 2019 and the PSO is made on 1 April 2020. The PSO awards the former spouse a 50% share in the AFPS 05 pension and 10% share in the AFPS 15 pension and is implemented accordingly.

- At rollback, B returns to the AFPS 05 for the remedy period and their pension rights change: the value of their AFPS 05 pension increases and the value of their AFPS 15 pension decreases.

- The pension reduction is re-calculated to reflect that their AFPS 05 shareable rights <u>accrued during the remedy period</u> are subject to a 10% reduction and not 50% because this is the reduction set out in the PSO in relation to service in the remedy period.

- When B makes their remedy choice, the percentage reduction applied to their rights for the remedy period is still 10% but the value may change if they elect for reformed scheme benefits.

31. The pension debit reduction in these cases is completely de-linked from what is happening in relation to the pension credit account. The rules for pension debit members aim to adjust pension benefits to reflect the percentage reduction ordered by the court in relation to the benefits accrued through remediable service.

32. The member’s pension account will be reviewed and adjusted as soon as possible following rollback.

Pension Debit Members: PSO based on information provided on or after 1 October 2023

Members who have not made a remedy choice

33. As set out above, where a scheme is requested to provide information for the purposes of divorce proceedings on or after rollback, the scheme manager will calculate the value of the remediable service benefits under the legacy scheme model and the reformed scheme model. The higher of the two valuations will be included in the CEV provided to the parties and/or the court.

34. Where a PSO based on a CEV provided after rollback is received, and no election has been made by the member, the scheme must calculate the pension debit on the valuation day as though the rights relating to remediable service were in the legacy scheme, and then again as though they were in the reformed scheme. For the purposes of calculating the pension debit in respect of remediable service, the scheme must apply the percentage (or implied percentage in Scotland) set out in the PSO for the legacy scheme, as the member has been rolled back into that scheme. The pension debit reduction actually applied on implementation of the PSO will be based on legacy benefits for the remedy period.

35. However, at the point when the member makes their remedy choice, if they elect for reformed scheme benefits for the remedy period, the pension debit reduction amount will need to be revised in accordance with the alternative valuation mentioned above, because the value of

the benefits will change. The RSS will outline the calculations for both legacy and reformed scheme benefits.

36. In these cases, the percentage reduction specified for the legacy scheme will still apply to the remediable benefits.

Members who have made a remedy choice

37. Where a member has made a remedy choice before the scheme provides the CEV for the purposes of the divorce on which the PSO is based, there is no need to adjust either the pension credit or the pension debit amounts because they will be based on the final position.

Charges

38. Legislation provides that pension scheme administrators may levy charges associated with the administrative costs for work carried out in connection with divorce/dissolution proceedings[3]. In cases where any re-calculation of the debit or credit benefits is required because the PSO was based on a CEV issued before 1 October 2023 no further charges will be levied. Where the relevant CEV is issued on or after 1 October 2023, current charging protocols will apply in the normal way.

Tax

39. Where a pension earmarking or attachment order is in place, the member remains responsible for any tax charges that might arise. Where a pension sharing order is in place this will affect the pension debit member's position in relation to the annual allowance charges for tax. Likewise, the pension credit account will form part of the pension credit member's pension rights for the purposes of the annual allowance charges. Further information on the tax implications of the remedy in respect of divorce/dissolution, including the changes that were announced in the Spring budget in respect of the life-time allowance, will be issued in due course.

Q19: Do you have any comment on the MOD's approach to divorce policy and its application in respect of the retrospective remedy?

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[3] The Veterans UK 'Pensions of Divorce or the Dissolution of a Civil Partnership Charging Regime' booklet is available on the gov.uk website: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/820099/20160901-Pensions_on_divorce_or_dissolution_of_a_civil_partnership-Charging_Regime.pdf