Pensions, Ill-health and Divorce

This paper considers the impact of ill health on the valuation and allocation of pensions in the event of divorce or dissolution.

- Extreme ill-health can trigger an immediate early-retirement pension on enhanced terms that requires individual valuation
- Less extreme ill-health reduces the value of pension assets
- Pension schemes do not normally allow for the actual state of health. Therefore CETVs can artificially over-value pensions, to the detriment of the person in ill-health
- It is possible to capitalise pensions valued by pension schemes at an artificially high level though transferring to spouse in better health through pension sharing

The impact of ill-health on pensions

Ill-health impacts pensions in two real ways:

- In extreme ill-health, where the person cannot carry on working, an ill-health, early-retirement pension may be paid which commences immediately and may be enhanced over the accrued pension to date.
- Less extreme ill-health lowers life expectancy and hence the time over which a pension will be paid. Therefore, the value of a pension of someone in ill-health is less then an equivalent pension for someone in average or better health.

The value of an ill-health early-retirement pension is a complex interaction between the health of the retiree and the early-retirement terms and requires individual consideration. This is available through the BDM Bespoke Pension Report service and is not considered further here.

The rest of this paper concentrates on people in ill-health, but not too ill to be eligible for an ill-health, early-retirement pension.

Overlaying the real impact of ill-health is an artificial one due to simplifying assumptions used in some pension valuations. A pension scheme often ignores the actual health of a member or their spouse in calculating CETVs and in pension sharing calculations. This will over-value the pension asset if either is in ill-health. The effect will be greater if it is the member in ill-health rather than the spouse or partner.

If to calculate a CETV the pension scheme does not ask for information on the health of the member or their spouse, then it is making simplifying assumptions and ignoring their actual health.

More appropriate valuations of pensions for use in divorces and dissolutions, such as the BDM Bureau and Bespoke[1] Pension Report services[2], have the option to allow for the health of an individual in calculating the value of the pension asset.

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[1] The Bespoke Report Service is used for very large pensions and those calculated using multiple benefit definitions.
[2] The BDM Express Valuation service also assumes the pension owner is in average health as part of streamlining the valuation process.

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Ill-health pension values

If a client is in ill-health the value of their assets will be lowered by allowing for their state of health. Usually a CETV will not be making this allowance. If allowing for the state of health of the client is carried through to the value of the spouse's pensions then these will also be reduced in value, though usually by a lesser amount.

If the spouse is in ill-health then the value of their assets will be lowered by allowing for their state of health. A CETV not making this allowance will produce a higher value for the spouse's pension assets. An appropriate valuation that does not take the option to allow for the spouse's state of health will normally produce an even higher value.

Pension sharing

If all pensions have been valued allowing for the state of health of the individuals then this has a neutral impact on the decision of whether and how to share pensions.

However if a pension scheme is valuing pensions ignoring ill-health, then it will have an artificially high value that can be captured by transferring the pension to the partner in better health through pension sharing.

The value of any benefit would be reduced by the costs of sharing and possible adverse terms offered to shared pensions. Sharing should not be undertaken without due consideration. The BDM Reallocation Report service can provide a professional report on any pension sharing solutions.

For example if Mr. and Mrs. A have total assets quoted in Form E's of £1,200,000, including a pension for Mr. A valued by his scheme for £480,000. However because he is overweight and smokes then his life expectancy is 7 years shorter than the average assumed and allowing for this his pension is only worth £380,000. So the real value of their assets is only £1,100,000 in total.

However if Mr. A shares his pension with Mrs. A so she gets all of it then the pension scheme will set up for Mrs. A a pension worth £480,000, an increase of £100,000. The total real value of the couple's assets to be divided therefore increases from £1,100,000 to £1,200,000[3].

The converse is also true and sharing the pension of someone in good or average health, with someone in ill-health, will normally reduce the actual joint assets.

Other opportunities

For members approaching retirement there may be other ways to capitalise artificially high pension valuations, for example through requesting a transfer to a private scheme and then buying an enhanced annuity from an insurer.

Consideration of such options requires financial planning advice. BDM introduces to the IFA Risk and Reward Consulting Limited who are authorised to provide this service.

[3] Less the expenses of pension sharing

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