Institute and Faculty of Actuaries

Compensation for Loss of Pension Rights in Employment Tribunals

IFoA response to the Courts and Tribunals Judiciary

20 May 2016

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Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Institute and Faculty of Actuaries

Dr Brian Doyle
President, Employment Tribunal (England and Wales)
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20 May 2016

Dear Dr Doyle

Compensation for Loss of Pension Rights in Employment Tribunals

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to this consultation paper on compensation for loss of pension rights in employment tribunals. Members of the IFoA's Pensions Board and General Insurance Board have contributed to the drafting of this response.

General comments

2. The IFoA is generally supportive of the intention of the default positions set out in the consultation paper. However, as the defaults will not apply in a majority of cases, there will only be a limited benefit from their application.

3. While there are many advantages derived from using a simple approach to calculating compensation, the IFoA has concerns that the approach presented over-simplifies many of the potential complexities that can arise in individual cases. We would have preferred the consultation paper to include a range of case studies that highlighted some of the more common complexities that can arise. The case studies could then have included an explanation for ignoring these complexities in individual cases. The alternative to not having case studies is that there would be legal argument, perhaps unnecessary, about the specifics of individual cases.

4. The consultation paper refers (paragraph 123) to an expert panel that will report to the Lord Chancellor. We understand that the panel has already reported to the Lord Chancellor (one of our Fellows was part of the Panel). As yet, there has been no decision from the Lord Chancellor on any change to the discount rate to be used in personal injury cases. Our response to this consultation reflects the current position. If the Lord Chancellor were to suggest an alternative discount rate, we would encourage a further review to the discount rate used for loss of pension rights.

5. The purpose of the employment tribunal is to offer compensation from the employer, and hence it would appear reasonable to set out an approach to compensation that is not subject to decisions by pension scheme Trustees. Judges should be aware there are a number of valuation bases that pension schemes use as part of their operation. Some of those bases are scheme specific. Eg Cash Equivalent Transfer Values (CETVs). It would be theoretically

possible to use the CETV basis for pension loss calculations (as is the case for pensions sharing on divorce); however, there would be the risk that individuals in identical circumstances would receive different amounts of compensation.

Q1 The working group proposes that the tribunal operates a default assumption that claimants will retire at state pension age, with the onus on the parties to persuade the tribunal to depart from it by terminating loss before or after that age. Please say whether you agree or disagree, explaining why.

6. We agree that the proposed default assumption (that the claimant will retire at State Pension Age (SPA)) is appropriate. It would be challenging to argue for any other default assumption.

7. For many schemes outside the public sector, scheme members will probably have a normal pension age that is lower than (SPA). Some public sector schemes have retirement ages lower than SPA, (eg Police, Fire Services and Armed Forces). Even in other public sector schemes, much past service will be payable from a normal pension age that is lower than SPA. Consequently, we believe that either party is likely to challenge this assumption in most cases, at least where there is a Defined Benefit (DB) pension scheme. In practice, the default assumption may prove to be ineffective for DB schemes.

Q2 The working group proposes that the tribunal operates a default assumption that claimants will suffer no loss to their state pension, with the onus on claimants to persuade the tribunal otherwise. Please say whether you agree or disagree, explaining why.

8. We believe that the default assumption (no loss in the (basic/single) state pension) is reasonable. We would highlight that the payment of voluntary Class 3 NI contributions is a relatively low cost way to mitigate any shortfall in qualifying years resulting from the loss of employment.

Q3 The working group proposes that the tribunal operates a default assumption that claimants will suffer no loss of additional state pension rights, with the onus on claimants to persuade the tribunal otherwise. Please say whether you agree or disagree, explaining why.

9. The IFoA is not clear about the need for such an assumption. Our assumption is that these proposals will take some time to implement. By then, most cases will be in respect of a loss of employment after 5 April 2016. As such, there could not be any loss of Additional State Pension accrual. Even for cases that include a short period of loss prior to 6 April 2016, the loss in respect of Additional State Pension will be negligible.

Q4 The working group proposes that the tribunal operates a default assumption that claimants will suffer no loss by reason of losing the facility to make employee contributions (including AVCs), with the onus on claimants to persuade the tribunal otherwise. Please say whether you agree or disagree, explaining why.

10. We believe that the default assumption (no loss in relation to the cessation of employee contributions) is reasonable. Indeed, even where there is an impact, in almost all cases this will arise from tax consequences rather than any direct loss. As such, we would question whether it is appropriate to provide any scope for the claimant to argue against the default.

Q5 Please say whether you agree or disagree with the default assumptions in simple DC cases where the contributions method is deployed, explaining why.

11. We agree that the default assumption (in the event of future employment the claimant will be eligible for auto-enrolment into a scheme providing the statutory minimum contributions) is appropriate. This assumption merely reflects the statutory position.

12. We are not convinced that there should always be an assumption that the claimant would not have opted out from the respondent's scheme (and to ensure consistency the scheme of any future employer). If the factual position at the date of loss of employment is that the claimant had been subject to auto-enrolment, but had opted out, we would suggest the factual position is more relevant than any assumed default.

13. The consultation paper (72.2 and 72.3) suggests that the claimant would bear the onus of persuading the tribunal that the respondent would have contributed more than the mandatory minimum level of contributions. This implies a default assumption that the respondent would only have paid the mandatory minimum level of contributions. However, we note that this is not included within the question. If this were to be part of the proposed default, we would suggest that this default should be stated explicitly. However, if the factual position at the date of loss of employment is that the respondent was already paying a higher level of contributions than this minimum level, we are not convinced that this default is appropriate.

14. An additional part of the proposal is that the claimant can claim additional loss, for example because the respondent would have paid more than the mandatory minimum level of contributions. It would be consistent to allow the respondent to argue for greater mitigation of loss from any future employer paying higher contributions than the mandatory minimum. This could arise if the claimant had already secured employment with such pension provision by the time of the hearing.

Q6 Please say whether you agree or disagree with the default assumptions in simple DB cases, explaining why.

15. We would highlight certain aspects of calculating the cost of accrual that the simplified default overlooks:
    - The contribution rate payable by an employer to a DB scheme in respect of the cost of accrual is generally the average across the active members of the scheme.
    - There can be a wide variation in cost between members, due to their different ages, which is masked by the single average contribution rate.
    - The employer also often pays an average contribution rate for members with different benefit scales, even though the underlying cost of benefits under the different scales can be very different.

16. The contribution method excludes any allowance for the potential difference between the rate of increase in past benefits in line with pensionable pay (before the loss of employment) and in line with the revaluation of deferred pensions (after the loss of employment). This difference (which is ignored) could in reality lead to a significant difference in the loss suffered. As many schemes have applied a cap to increases in pensionable pay the difference could be either positive or negative for the claimant and it is not limited by the commencement of replacement employment.

17. This approach also simplifies the complexity of revaluation rates for many public sector Career Average schemes. There is no "one size fits all" solution thus leading to the same consequences as set out in the previous paragraph.

18. The consultation paper appears to assume that any employee, who is a member of a DB scheme at the point of loss of employment, would have remained in that scheme. With the recent history of scheme terminations or amendments in recent years, particularly in the private sector, we would question the validity of this assumption. There should be consideration of the possibility of a reduction in the rate of benefit accrual or of termination and subsequent replacement by a Defined Contribution (DC) scheme.

Q7 Please say whether you agree or disagree with the proposed approach for complex cases, explaining why.

19. The IFoA has concerns that the approach set out for complex cases may be unworkable. The suggested default approach is to use the Ogden tables, using the discount rate currently prescribed for personal injury cases, or more rarely the actuarial expert approach. The consultation paper (para 121) sets out a view that the Ogden tables incorporate an out-of-date (too high) discount rate, thus understating the loss. Consequently, we would question whether any claimant would accept the Ogden table approach unless the Tables were used with a more market related discount rate. Indeed, a claimant could use the argument set out in this consultation paper as evidence to support their argument that the Ogden approach would understate their loss.

20. On the expert approach, there is no clarity whether (for example) the intention is for the loss to be calculated:
    - Using a risk free discount rate (as used in a personal injury context following their Lordships' decision in *Wells –v- Wells*); and
    - With, or without, allowance for the potential difference between the rate of increase in past benefits in line with pensionable pay (before the loss of employment) and in line with the revaluation of deferred pensions (after the loss of employment).

21. Without clarity on the intended principles for calculating loss (and legal certainty as to their standing), the main cost of the input from the actuarial expert(s) will be in relation to putting the relevant case.

22. The actuary instructed by the Court will be bound by the Civil Procedure Rules and will act in accordance with Actuarial Practice Standard X3: The Actuary as an Expert in Legal Proceedings..

23. Further, we note that the intention of the Ogden tables is to provide values for pensions payable over the life of the claimant, but with no allowance for the additional value of any survivor pensions following the death of the claimant. The explanatory note to the Ogden tables explains that the tables require adjustment where there is any survivor pension. The consultation paper ignores the need for this adjustment, both in the text and in the examples (including that for "Bob"), which would be misleading. We would recommend that any Presidential Guidance should address this issue.

24. As for Q6, the consultation paper appears to make an implicit assumption that any member in a DB scheme at the point of loss of employment would remain in an unchanged scheme indefinitely, or at least for the period up to the commencement of any assumed future employment. As in our response to Q6 (para 15), we would question the validity of this assumption.

Q8 **Do you have anything further to say about the working group's proposal for a distinction between "simple" and "complex" cases? What additional guidance do you believe should be given about when to choose one approach over the other?**

25. We would have welcomed reference to the impact of the statutory cap on compensation (paragraph 2 of the consultation paper) on the approach adopted. Our understanding is that in practice for many cases where the cap applies, it is clear to both sides that the compensation will be capped irrespective of the approach to calculating pension loss. Consequently, both sides are willing to adopt a simple approach, irrespective of whether it is appropriate in a particular case, as it would not affect the compensation in any case. The calculations merely serve to establish that the underlying loss exceeds the cap and there is no benefit to either party arguing about how much the loss exceeds the cap.

Q9 **What examples would you like to see in Presidential guidance to assist parties and unrepresented litigants in understanding the proposed revised approach to calculating loss of pension rights?**

26. We suggest that unless, and until, there is clarity on the intended principles and certainty about their legal standing), explaining the proposed approach and providing helpful examples may not be productive.

27. Should you wish to discuss any of the points raised in further detail please contact Philip Doggart, Technical Policy Manager (Philip.doggart@actuaries.org.uk / 0131 240 1319) in the first instance.

Yours sincerely,

Nick Salter
Immediate Past President, Institute and Faculty of Actuaries