

# **COMPENSATION FOR LOSS OF PENSION RIGHTS IN EMPLOYMENT TRIBUNALS**

## **A CONSULTATION PAPER**

March 2016

### **Introduction**

1. Employment law practitioners, Employment Judges and non-legal members should all be familiar with the booklet entitled “Compensation for Loss of Pension Rights: Employment Tribunals” (henceforth the “Guidance”). Indeed, this paper assumes familiarity with it. It was originally published in 1991, written by a panel of chairmen (as they were then called) with actuarial tables supplied by the Government Actuary’s Department (GAD). The most recent edition, the third, appeared in 2003. The thirteen years since have seen very significant changes to the pensions landscape but the Guidance has not been updated to reflect those changes.
2. It has long been recognised that lost pension rights can comprise an important element of the compensation awarded to a successful claimant, particularly in cases where there is no statutory cap on the amount that a tribunal can award. It is also widely appreciated that lost pension rights can be difficult to calculate. The Guidance has sought to make this process easier.
3. In essence, where a claimant has been dismissed from employment carrying the benefit of membership of a defined contribution pension scheme, the most straightforward method for assessing compensation involves equating the value of lost pension rights with the contributions that the employer would have paid into the scheme during the period of loss – the so-called “contributions method”. The process of calculating compensation is, however, more complex where membership of a defined benefit pension scheme is concerned. The Guidance suggests that a “simplified” approach is appropriate for some cases, while a “substantial loss” approach is appropriate for other cases. Both the “simplified” and the “substantial loss” approaches use multipliers, developed by GAD from actuarial assumptions applicable in 2003. The tribunal’s decision of whether to adopt the “simplified” or “substantial loss” approach is an important one.
4. The Court of Appeal examined the Guidance in *Griffin v. Plymouth Hospital NHS Trust* [2014] IRLR 962. Underhill LJ said this:

**The Guidance [has been] rightly described ... as “extremely valuable”, and it and its predecessors have been used by industrial and employment tribunals on countless occasions and to good effect. In this appeal neither party has questioned its terms, and the issue has been presented purely on the basis**

of how they should be understood. But it should not be assumed that that will be the correct approach in every case. The Guidance has no statutory force and the recommendations in it are not gospel ... But there is a more particular reason for its application to be considered critically. There have been a number of important changes in pension law and practice since the current edition of the Guidance was published in 2003, and others are imminent: the extent to which its recommendations on particular points remain valid will increasingly need to be carefully considered. I would very much hope that HMCTS and/or the Judicial College may give priority to producing an updated version.

5. Following the Court of Appeal's decision in *Griffin*, the Presidents in England & Wales and Scotland jointly convened a working group of Regional Employment Judges and Employment Judges to consider what approach tribunals should adopt in future to calculating pension loss. This consultation paper is the result.
6. It is important to state at the outset that no funding has been made available to support the ongoing involvement of GAD. Without GAD, an approach based on new bespoke multipliers for Employment Tribunal proceedings is simply not feasible. The assumptions underlying the Guidance are no longer reliable – many such examples are given in this paper – and continued reliance on it will lead to over-compensation or under-compensation. A different approach is needed.

### **Executive summary**

7. The working group recommends formal abandonment of the Guidance. It has developed a proposal for the future, described in this document, and invites comments from the tribunal's users and stakeholders. The essential proposals are:
  - 7.1 The abandonment of lost additional state pension rights as a head of loss.
  - 7.2 A new category of "simple" cases, which will apply to both defined contribution and defined benefit schemes. In such cases the tribunal will exclusively use the "contributions method" to assess compensation. This means, in respect of defined benefit schemes, abandoning as a discrete head of loss the lost enhancement of pension rights that accrued before dismissal. This approach takes account of changes to the wider pensions landscape, such as the move away from final salary pension schemes and the regime for auto-enrolment. Based on their experience the members of the working group anticipate that the vast majority of cases where the tribunal awards pension loss will be "simple". The method for calculating loss will be transparent and straightforward.

- 7.3 A new category of “complex” cases, equivalent to the “substantial loss” cases. The members of the working group anticipate that such cases will be rare. Their rarity, coupled with their potential high value, will justify a different approach to case management. Cases involving a realistic prospect of a significant award for pension loss will be identified at an early stage of case management, so that liability and remedy are listed separately. The tribunal would discourage claimants from using the phrase “to be confirmed” (or similar) in schedules of loss in respect of their pension loss. If and when the claimant succeeds in the claim and a significant award for pension loss remains feasible, the tribunal will then allocate dates for a two-stage remedy hearing.

The first-stage remedy hearing will enable the tribunal to conclude straightforward matters of remedy. Some examples are the basic award for unfair dismissal, unpaid holiday pay or notice pay, an award for injury to feelings and perhaps even past or future pecuniary loss that is not pension-related. It will also enable the tribunal to make findings of fact on the areas that, in consultation with the parties, are considered relevant to the calculation of pension loss in the particular circumstances of the case. Some examples are the claimant’s date of retirement, the accrual rate for the defined benefit scheme and the prospects that the claimant would have been promoted to a better remunerated job if he or she had not been unlawfully dismissed. The parties would then be given a time-limited opportunity to agree quantum of pension loss.

If the parties cannot reach agree quantum of pension loss, the tribunal would take one of two approaches:

- (a) The first approach, which the members of the working group anticipate will apply in most “complex” cases, would involve the application of the Ogden tables (which are explained in further detail later in this paper). Again, this could be done by agreement or at a second-stage remedy hearing. The outcome would not be precise but it ought still to be both just and an improvement on use of the Guidance. It would involve less cost to the parties and be more straightforward than the alternative, which is set out at (b) below.
- (b) The second approach, which the members of the working group consider will apply even more rarely, involves use of expert actuarial evidence. The members of the working group recognise that such evidence is costly. The tribunal, in consultation with the parties, would make directions for such expert evidence, with the strongly preferred approach being a jointly instructed expert. The parties would be encouraged to agree the basis for funding such joint expert evidence but, in the absence of agreement, the tribunal would rule on the

point after hearing submissions. It is possible that the losing respondent would be ordered to pay the entire cost of the expert's report; but it is also possible that the tribunal would order the claimant to contribute to the cost using funds that the tribunal has already ordered the respondent to pay by way of compensation. It is also possible that there are cases where it would be appropriate for the parties to instruct an expert each. It will all depend on the circumstances of the particular case and the working group considers that a "one size fits all" approach could be problematic. The hope, however, is that the tribunal is able to adopt a joint expert's figures for the claimant's pension loss unless there was a very good reason to do otherwise. Again, this could be done by agreement or, where areas of dispute remained, at a second-stage remedy hearing.

The parties would be consulted throughout. The underlying idea is that they are given every encouragement to agree quantum of pension loss (with the benefit of the tribunal's findings of fact where appropriate) and that they bear the cost of expert actuarial evidence only where it is proportionate to do so in view of the potential amount of compensation in issue. It is hoped that the second-stage remedy hearings will rarely be needed but that, where they are, the tribunal will not be required to embark on the type of actuarial calculations that, without expert input, it is ill equipped to perform.

The members of the working group consider that this approach would be in accordance with the overriding objective. The parties would be free to propose an alternative approach if they wished to do so but, having been formally abandoned, the members of the working group recommend that the Guidance should not be an available approach.

- 7.4 If the circumstances justified it, the tribunal would offer judicial mediation, before a different judge, as an alternative mechanism for reaching agreement on the amount that the respondent should pay as compensation.
8. This new approach to calculating compensation for pension loss would be set out in Presidential guidance (whether integrated within current case management guidance or in a separate document). Current Presidential guidance can be downloaded from these locations:  
For England and Wales:  
<https://www.judiciary.gov.uk/wp-content/uploads/2014/08/presidential-guidance-general-case-management.pdf>  
For Scotland:  
<https://www.judiciary.gov.uk/publications/directions-for-employment-tribunals-scotland>

This approach has the advantage of flexibility. The working party would remain a standing body, adapting the approach in the light of appellate case law and changes to the Ogden tables (for example in respect of the discount rate).

9. This document and the proposed Presidential guidance would not have statutory force. They would simply set out the approach the tribunal would propose to adopt in both simple and complex pension loss cases, with a view to assisting the parties in presenting their respective cases (and, in particular, in evaluating the potential value of pension loss) and with a view to assisting Employment Judge and non-legal members in adjudicating on such cases. It is recognised by the working group that parties might prefer a convenient checklist, or new and bespoke actuarial tables, which tell them with precision how much pension loss is worth in any case that they might encounter. However, in the absence of GAD funding, the members of the working group do not consider that it can or should be their purpose to remove the “litigation risk” from these cases. They wish to emphasise that the parties would still be free to submit that other approaches should be adopted and that the tribunal would consider such submissions on their merits.
10. The working group recognises that many people have a “blind spot” where pensions are concerned. With this in mind, the group decided that it would be appropriate to set out in this consultation paper the rationale for the proposed changes to the manner in which pension loss is calculated. This will require a discussion of the pensions landscape: how it has developed in recent decades, how it has changed since the Guidance was published in 2003, and how it may continue to change.

### **The basics**

11. A pension is best understood as a regular income received by an individual in retirement. At its simplest there are three basic types of pension provision in the UK: (a) the state pension; (b) personal pensions; and (c) occupational pensions.
12. Each type of pension operates in parallel. Some individuals receive all three in retirement. In short:
  - 12.1 The state pension involves minimum income payments made by the state to an individual who receives those payments in his or her capacity as a citizen. At its simplest, individuals qualify for a state pension by virtue of reaching state retirement age and after having made sufficient National Insurance (“NI”) contributions during their working life. It is undergoing significant reform, which is explored below.
  - 12.2 A personal pension is more like a traditional savings vehicle. Individuals pay money into a pension scheme, usually described as a pension “pot” or “fund”. There will be a gap of many years,

often decades, between when the contributions are made and when the benefits are received. A private provider, chosen by the individual, invests the pot or fund with a view to increasing its value over time. Later in life those individuals can use the money thereby accumulated to purchase an annuity (a financial product giving a retirement income for the remainder of a person's life), which they receive in their capacity as a consumer; this is why this type of scheme has often been referred to as a "money purchase" scheme. Recent reforms provide more flexibility over the use that can be made of the fund.

12.3 An occupational pension, which is sometimes known as a workplace pension, is a benefit provided by an employer as part of an individual's overall remuneration package. Occupational pensions typically take contributions from the individual and the employer and, through tax relief, from the state (these contributions should not be confused with the NI contributions underlying the state pension). There are two types of occupational pension scheme to consider:

(a) Defined contribution (or "DC") schemes. In such a scheme, a private provider, perhaps chosen by the employer, invests the pot or fund with a view to increasing it. The amount of the resulting pension will depend on the performance of that pot or fund and the size of the annuity it can purchase. It operates very much like a personal pension and is "money-purchase" in nature.

(b) Defined benefit (or "DB") schemes. In such a scheme, the pension benefit is guaranteed regardless of the performance of the underlying fund. Until recently, the most common examples of defined benefit schemes were "final salary" schemes, but defined benefit schemes will increasingly be Career Average Revalued Earnings (or "CARE") schemes which are typically less generous (see below).

There will usually be an option upon retirement to "commute" part of the annuity (in a DC scheme) or the pension income (in a DB scheme). This means that some of the future income element is sacrificed in exchange for an immediate lump sum.

Some schemes are hybrid in nature. For example, an employer may have closed a DB scheme to new employees but created for them a DC section within the same scheme.

13. The pension schemes that tribunals will principally encounter when calculating a claimant's loss will be occupational in nature. These are the schemes that provide benefit to individuals in their capacity as employees; losing that employment, and losing that benefit, causes loss. That loss is very difficult to calculate because it is based on a number of

assumptions about the future. It is impossible to achieve precision. The tribunal's task is akin to hitting a moving target.

14. Although this paper will focus on occupational pensions, we must start by examining the state pension system. This is because it interacts with occupational pensions in a number of important ways. One cannot understand the way occupational pension schemes approach the concept of a retirement age without understanding, for example, the state approach to the concept of a retirement age.

## **The state pension system**

### ***A brief history***

15. Governments of all political persuasions have sought, through state pension policy, to address the problem of relative poverty in old age. The policy approach is influenced by the assumptions one might make about why people experience poverty in retirement. For example:
  - 15.1 If it is thought that people experience poverty in retirement because they have not saved enough during their working lives, in consequence of poor planning and a lack of self-control, there will be pressure on public policy to tend towards state intervention in the form of compulsory saving.
  - 15.2 If it is thought that people experience poverty in retirement because of lifelong low incomes or factors outside of their control, there will be pressure on public policy to tend instead towards state intervention in the form of income support for pensioners.
16. Over the years, public policy has experimented with carrots and sticks to varying degrees. All governments have faced the difficult task of reconciling the prohibitive cost of universal coverage with the perceived disincentives of means testing. Policy has also shifted as a result of improved health in old age, which has brought increased life expectancy. At various times policy has also reflected contemporary assumptions about gender and marriage. The affordability of the overall welfare bill is also relevant: the cost of the state pension rose from approximately 2% of national income during the 1960s to 4.5% in the 1980s. It is currently projected to reach about 6% by the 2040s.
17. The state pension in the UK has existed since the Old Age Pensions Act 1908; this provided for payment of a means-tested amount to women and men who had reached the age of 70. That age was seen, at the time, as advanced: few expected to reach it; fewer expected to go much beyond it.
18. A more recognisably modern system developed with the implementation of the 1942 Beveridge Report. It resulted in the system of social insurance embodied in the National Insurance Act 1946. This model was

known as the basic state pension. It brought forward the age of receipt to 65 for men and 60 for women. It embodied the notion of providing an income in retirement to those individuals who had paid sufficient NI contributions during their working lives.

19. Because of its roots in NI contributions, the state pension system has always had to address the challenge of those who experience long-term unemployment (for example through ill health) or who have taken time out of paid employment for other reasons (such as childcare). However, the contributory nature of the state pension can be misleading: over time, the link between the system of NI contributions and state benefits has weakened. Nowadays the government sets NI rates according to its overall budgetary needs. The overall benefits paid to pensioners depend less and less on the number of years that the individual made NI contributions and hardly at all on the precise amount of NI contributions paid by an individual: those of pension age can now take advantage of a mixture of pensioner benefits that are universal (e.g. the winter fuel payment) and means-tested. The most significant means-tested benefit in recent years has been the Pension Credit. It has provided a minimum income to pensioners since 2003 but is being reformed in 2016 with the advent of the single-tier state pension.

#### ***The basic state pension (1946-2016)***

20. As matters presently stand the basic state pension is payable on a weekly basis to an individual who has reached the state pension age and who has made a minimum number of NI contributions. The amount paid depends on the number of qualifying years during an individual's working life that he or she has been credited with accrual to the basic state pension:
  - 20.1 A qualifying year is a year in which the individual has earned more than a specified amount (£5,284 in the 2015-16 financial year).
  - 20.2 A full basic state pension is paid to those who have accrued a set number of qualifying years.
  - 20.3 The set number of qualifying years was originally 44 (for men born before 6 April 1945) and 39 (for women born before 6 April 1950). These figures were later reduced to 30. The Pensions Act 2014 increased the number of qualifying years: from 6 April 2016, the number of qualifying years required for a full state pension will increase to 35 (for women born on or after 6 April 1953 and men born on or after 6 April 1951). The paper returns to this point when examining the new single-tier state pension.
  - 20.4 Those who have accrued fewer years will receive a pension on a pro rata basis. It has been possible, in certain circumstances, to



fill in the gaps in a NI record by making voluntary (Class 3) NI contributions.

21. A basic state pension based on an individual's past contributions is known as a Category A pension. Any individual not entitled to a full basic state pension based on his or her own NI contributions record may be entitled to a supplementary pension based on the record of a partner, which is known as a Category B pension. Other categories of state pension are outside the scope of this paper.
22. For the financial year 2015-16, the full amount of the weekly basic state pension is £115.95. (It is possible to increase this sum further by delaying the point of receipt past state pension age, known as "extra state pension". A supplement is also payable upon reaching the age of 80.)
23. As noted above, from its inception the state pension age was 65 for men and 60 for women. It remained so until April 2010. Since then it has been modified to reflect two changes in the political consensus:
  - 23.1 The view that women and men should be treated equally; and
  - 23.2 The view that increases in life expectancy should be accompanied by an increase in the length of a working life.
24. The Pensions Act 1995 provided that, between April 2010 and March 2020, the state pension age for women would increase by one month every month (tapered by date of birth) until the state pension age for women reached 65, the same as for men. When published in 2003, the Guidance presupposed equalisation by 2020. However, the Pensions Act 2011 accelerated the process of equalisation so that it will now be achieved by November 2018 (that is, for women born no earlier than November 1953).
25. The changes do not stop there. Having not been updated since 2003, the Guidance also omits the fact that the state pension age for women will thereafter increase steadily, alongside (and at an equal pace with) men. The first attempt to do so came with the Pensions Act 2007, which aimed to increase state pension age for both women and men to 66 by 2024-26, to 67 by 2034-36 and to 68 by 2044-46, again tapered by reference to date of birth. A second attempt came with the Pensions Act 2014, which accelerated this change and brought forward the increase in state pension age to 67 by 2026-28.
26. This means that, as matters stand, any person born between 6 March 1961 and 5 April 1977 will have to wait until the age of 67 to receive the state pension. As for the increase to age 68, that is still slated for 2044-46 (i.e. for those born after 5 April 1977). The government intends to carry out a review in 2017, and every five years thereafter, to consider

whether that increase should also be brought forward. Further changes are likely.

27. A series of helpful tables placing different dates of birth alongside different state pension ages can be found here:  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/310231/spa-timetable.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/310231/spa-timetable.pdf)
28. These changes are important in the field of occupational pensions as well. Many schemes align the age from which a member can claim an unreduced occupational pension with his or her state pension age. In a career loss case, this may mean that the tribunal must now assess financial loss beyond the age of 65, the age on which the various tables in the Guidance are based, to a later age (up to 68).
29. It should be borne in mind that the default retirement age (or “DRA”) was abolished in October 2011. This had been a feature of the Employment Equality (Age) Regulations 2006 and it, too, was aligned with state pension age. The working group considers that, in the interests of simplicity, it should be assumed that a claimant would retire upon reaching state pension age. More technically, this default position will operate as an evidential presumption that can be displaced by either party. It will provide a clear terminal point that the parties will find easy to understand. It also means that the parties can adjust their approaches accordingly if the Government makes further changes to state pension age with its five-yearly reviews.
30. The working group recognises that evidence is mounting that a significant and increasing number of people are choosing to work beyond their state pension age. The working group does not wish to discourage tribunals from awarding financial loss beyond state pension age or terminating loss before state pension age. The point is that, if the parties wish the tribunal to conclude that a claimant would have retired later (or sooner) than state pension age, they will have to produce some evidence and make submissions to that effect. Of course, the tribunal should make no deduction for state pension benefits received after state pension age, since the claimant would have been entitled to a state pension regardless of the continuation or termination of employment.

**Question 1: 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.**

### ***The additional state pension (1961-2016)***

31. In the late 1950s the government faced increasing pressure to introduce a mechanism for supplementing the basic state pension through an earnings-related “top-up”. Such a top-up was felt to be necessary because, at this stage, occupational pensions schemes were rare.
32. This top-up system has varied in structure and has gone by different names over the years:
  - 32.1 The first top-up scheme, known as Graduated Retirement Benefit or GRB, operated between 1961 and 1975. It introduced the idea that further NI contributions could result in a “graduated” increase in the pension through the accumulation of GRB “units”. An individual could accumulate a maximum number of units during employment in this way (86 units for men and 72 units for women), with each unit translating as a weekly pension supplement. Individuals who accrued GRB between 1961 and 1975 still retain it; the value of each unit is set each financial year and, for the 2015-16 financial year, stands at a modest 13.30 pence. Thus, for 2015-16, the maximum income supplement available to a male pensioner in receipt of GRB is £11.44 (86 x 0.1330) and the maximum income supplement available to a female pensioner is £9.58 (72 x 0.1330).
  - 32.2 The second top-up scheme, known as the State Earnings-Related Pension Scheme or SERPS, operated between 1978 and 2002. It was a response to the growth in occupational pension schemes during the 1970s. In essence, employees would receive a SERPS pension representing 20-25% of their earnings above a “lower earnings limit” (about the same as the weekly basic state pension) and subject to a cap at the “upper earnings limit”. The resulting pension income is calculated at retirement according to complex formulae. Individuals who accrued a SERPS entitlement between 1978 and 2002 will retain it.
  - 32.3 The current iteration of the concept of an earnings-related top-up is the State Second Pension or S2P. It was introduced by the Child Support, Pensions and Social Security Act 2000 and came into force in April 2002. The 2003 edition of the Guidance described it as the “new” S2P (which it was at the time). It has been reformed since then. SERPS was of particular value to employees in middle-income brackets. In contrast, the policy rationale behind S2P was redistributive: to focus on those on low incomes or unable to work because of their caring responsibilities. By introducing three new bands between the lower earnings limit and the upper earnings limit, the effect was to skew the accrual of benefits to those on lower incomes: those in the lowest band, for example, accrued benefits at twice the rate they did under SERPS.

33. It is important to remember that many individuals will, depending on their date of retirement, receive additional state pension derived from a combination of GRB, SERPS and/or S2P. As time passes the recipients of GRB in retirement will be fewer, but a mixture of SERPS and S2P will remain common for a while yet. Even if the state pension system were never reformed again, the first individuals to receive an additional state pension derived exclusively from S2P benefits would be those who began their working lives after April 2002; if they started work at age 16, they would not reach state retirement age – for them, 68 – until 2054. And, as we shall see, S2P will be abolished in any case in April 2016.

### ***Contracting out of the additional state pension (1961-2016)***

34. Ever since the state pension has incorporated an earnings-related top-up element it has been open to individuals to “contract out” of it, subject to having access to a sufficiently generous occupational pension scheme. More particularly:

34.1 In relation to the GRB (1961-1975), the employer made the decision about contracting out. An employer could contract its employee out of part of the benefit if it operated an occupational pension scheme that paid out sums at least as good as those payable under the GRB. A decision to contract out did not entirely remove the employee’s entitlement to an additional state pension; it simply reduced the maximum number of GRB units that could be accrued (to 48 for men and 40 for women).

34.2 In relation to SERPS, the choice to contract out was one for the individual employee. Initially (1978-1988), individuals were only permitted to contract out of SERPS if the employer operated a DB pension scheme. In return for contracting out, the individual employees and their employer paid NI contributions at a reduced rate. Latterly (1988-2002), individuals could also contract out of SERPS if the employer operated a DC pension scheme. The mechanism was straightforward: some of the NI contributions paid by the employer and the employee would be diverted, in the form of age-related rebates, into a money-purchase scheme operated by a private provider. Reflecting the consensus and economic outlook of the time, it was believed that the amounts thereby invested would ultimately yield a better return – and purchase a better annuity – than could be provided by remaining “contracted in” to the additional state pension. For a long time there were separate rules about the investment of the so-called “protected rights” deriving from NI rebates. These rules have now been abolished. Such sums are now an ordinary part of the investments made in individual or group personal pensions.

34.3 In relation to S2P (2002-2016), the method for contracting out was essentially the same as the method for contracting out of

SERPS: a system of age-related rebates of NI contributions. However, the ability to contract out of S2P through an employer's DC pension scheme came to an end in April 2012; the process had become increasingly complex and the rebate levels were seen as less and less attractive. After April 2012, it was only possible to contract out of S2P through an employer's DB pension scheme (again, in the form of reduced NI contributions).

35. All contracting out options cease in April 2016 with the abolition of S2P.

***The future of the state pension (2016 onwards)***

36. Recognising that the method of providing for an additional state pension had become ever more complex, plans were set out in the Pensions Act 2007 to make S2P a simple flat-rate pension by some point in the 2030s. This would be achieved through annual earnings growth while keeping the various thresholds unchanged. The idea was that the ever-loosening link to an earnings-related element would at the same time make contracting out less and less attractive, and it would wither on the vine. In an important development, however, the Pensions Act 2014 accelerated that process. The decision was taken to abolish the basic state pension and S2P and to replace them, with effect from April 2016, with a single-tier state pension.
37. The single-tier state pension is a universal benefit. It pays a flat-rate amount set above the current minimum guarantee embodied in the Pension Credit (this was mentioned above as a means-tested benefit for pensioners but it is to be reformed and partly abolished). The White Paper that preceded the 2014 Act assumed a starting level of £144 per week for the single-tier state pension. The government of the day will set out the uprating policy that will apply. Eligibility for the full amount will, as before, depend on 35 qualifying years. Individuals will retain the ability to increase the sum by delaying the point of receipt past state pension age.
38. By returning to a flat-rate system with no earnings-related element, the state pension will have come full circle.

***Loss of state pension: issues for the employment tribunal***

39. Having not been updated since 2003, the Guidance is far behind the times. It does not deal with changes to the state pension age, the abolition of the earnings-related top-up element or the introduction of a new single-tier state pension. What does this mean for how employment tribunals should now calculate pension loss derived from state pension entitlements?
40. In 2003 the Guidance recognised that a person who was dismissed might suffer financial loss if, as a result, their accrual of basic state pension was interrupted. But it also recognised that such loss would be negligible or non-existent so long as the individual concerned achieved

new employment relatively quickly. It suggested, at paragraph 2.13, that the tribunal should assume no loss of basic state pension and that the onus would be on the claimant to show otherwise.

41. The working group shares the view that the chances of a claimant incurring a measurable loss to his or her basic state pension (or the single-tier state pension from April 2016) will remain nil or relatively small. It is easy to see why. A school leaver may have a working life of about 50 years, and even graduates would have plenty of time to reach the number of qualifying years required for a full state pension (although admittedly it will be slightly harder to reach 35 years than 30 years). That is not to say that there would never be a case where a claimant could demonstrate that, but for his or her dismissal, he or she would have reached 35 qualifying years and must now take a reduced state pension. But, in the working group's view, the onus should remain on the claimant to persuade the tribunal to award loss in this regard.
42. The principles involved in this calculation would require an assessment of the difference between (a) the value of the claimant's state pension after failing to reach 35 qualifying years as a result of the dismissal and (b) the value of the claimant's state pension if he or she had not been dismissed, and then building in a sum that represents the loss of that amount in each year of retirement after state pension age. In the working group's view, such a scenario is likely to be very rare indeed.

**Question 2: 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.**

### ***Loss of additional state pension: issues for the employment tribunal***

43. Similarly, an employee who loses his or her job also loses the opportunity to have the earnings-related top-up to the basic state pension. The Guidance recognised that a loss of S2P would arise if the employee were in a job with no occupational pension scheme or in a job where there was an occupational pension scheme but he or she was not contracted out of S2P; and this led to the tables set out in Appendix 3 to the Guidance. However, in the face of auto-enrolment (see below), no qualifying employees should in future be in a job without a minimum level of occupational pension; and the diminished opportunities for contracting out in recent years (and the reduced value in doing so) has greatly reduced the differential impact on those who contract out and those who do not. Finally, as noted above, April 2016 sees the abolition of S2P and the dismantling of the concept of an earnings-related top-up.

44. Taking account of these factors, and with a view to maintaining as much simplicity as possible, the working group considers that it is time to abandon the notion of compensating claimants for the loss of additional state pension rights. Once the single-tier state pension is in place, determined principally by how many qualifying years (up to 35) a recipient has accrued, the loss of a job will in most cases lead to nil loss, or a relatively small loss and, as a default position, the tribunal can ignore it. Once again, the view of the working group is that the claimant has the onus of showing otherwise.

**Question 3: 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.**

### **Occupational pensions: introduction**

45. We now move from state pension benefits to occupational pension benefits. Plainly, when calculating pension loss, the tribunal's attention will principally be on occupational schemes. This paper examines, in turn, the two main types of occupation scheme: defined contribution (DC) and defined benefit (DB).
46. The loss of occupational pension benefits under a DB scheme or a DC scheme may call for compensation in a particular case, but the necessary calculation will only be complex where the successful claimant faces a substantial period of future loss or a substantial quantifiable loss and, in his or her previous employment, had been a member of a DB scheme.
47. The working group endorses what the authors of the Guidance had to say about the rarity of substantial loss cases at paragraph 4.13:

**Experience suggests that the simplified approach will be appropriate in most cases. Tribunals have been reluctant to embark on assessment of whole career loss because of the uncertainties of employment in modern economic conditions.**

48. Paragraph 4.13 of the Guidance continued:

**In general terms the substantial loss approach may be chosen in cases where the person dismissed has been in the respondent's employment for a considerable time, where the employment was of a stable nature and unlikely to be affected by the economic cycle and where the person dismissed had reached an age where he is less likely to be looking for new pastures. The decision will, however, always depend on the particular facts of the case.**

This analysis has changed in some ways. Nowadays, fewer jobs can be described accurately as insulated from the economic cycle and job instability is no longer limited to cyclical industries. A lengthy or stable period of prior employment, then, may be a weaker indicator of job security than once it was. It might also be said that the reluctance of older workers to move to “new pastures” has less to do with satisfaction in their present role than the disadvantages faced by older people in the job market. The crucial issue is likely to be whether, but for dismissal, the worker’s pension benefits would have lasted until retirement age. This may be the case even where the worker succeeds in getting a new job fairly quickly, since new jobs today are less likely to replicate generous DB benefits.

### **Occupational pensions: defined contribution schemes**

49. We shall deal with DC schemes first, as they are the simplest. They are self-evidently cheaper for an employer to operate because an employer is only promising to pay a defined amount into the scheme now (the present cost of which can easily be ascertained) as opposed to promising to pay a retired employee a defined amount in the future (the present cost of which cannot easily be ascertained, based as it must be upon a series of imponderables relating to life expectancy, investment returns, length of service and future rates of pay).
50. In a DC scheme the cost to the employer is mainly limited to the total cost of contributions it makes into a pension pot for each employee. The tax and administrative consequences, such as management charges, need not concern us. We call these “employer contributions”. If the employee makes his or her own contributions into the scheme, these are “employee contributions” or sometimes “member contributions” (where the word “member” relates to the employee’s status as a “member” of the occupational pension scheme).
51. DC schemes are typically of two types:
  - 51.1 In a trust-based scheme, the employer establishes a board of trustees to administer the scheme. They will be responsible for monitoring the performance of the underlying fund and ensuring that it complies with legislative requirements. Such a scheme might be “branded” with the employer’s name. There will be ongoing legal and accounting costs involved with keeping records up to date and reporting to members.
  - 51.2 In a contract-based scheme, the employer appoints an independent provider (such as an insurance company or building society) to run the scheme. The employer is responsible for ensuring that the appropriate contributions are made, including in respect of employee contributions deducted from payroll, but the provider handles most of the administration. They are sometimes



seen as cheaper alternatives because they can be bought “off the shelf”.

52. There are certain tax advantages in registering a DC scheme for tax (and most schemes are registered):

52.1 Contributions paid to the scheme attract tax relief;

52.2 Investment returns during the life of the fund are largely free from income and capital gains tax; and

52.3 On retirement, part of the employee’s benefits can be taken as a tax-free lump sum (traditionally up to 25% of the value of the fund).

53. However, as a result of being tax-registered, there are certain HMRC limits that operate:

53.1 There is a personal “lifetime allowance” for all pension savings that a person makes in a registered scheme, which was introduced in April 2006. The allowance applies to all of an individual’s tax-registered pension arrangements and not to each arrangement separately. Although individuals can save more than the lifetime allowance (set at £1m from April 2016), the excess will be subject to a tax charge imposed at the time of retirement and on the subsequent pension income. The authors of the Guidance could not have foreseen this in 2003.

53.2 There is an annual limit on the amount of pension contributions that can be made on which tax relief is available. In the past individuals were able to claim tax relief on pension contributions, available at the highest applicable tax rate. What did this mean when the Guidance was published in 2003? A person paying basic rate income tax at the (then applicable) rate of 22% would gain tax relief. The effect of this was that for every 78 pence saved to a pension scheme, the state would contribute 22 pence. For a person paying higher rate income tax at 40%, the effect was more generous: for every 60 pence saved to a pension scheme, the state would contribute 40 pence. It was a system that operated to the benefit of all who made contributions but to the particular benefit of higher earners. However, since April 2006, an individual has only been able to claim tax relief on contributions within an “annual allowance” (currently £40,000, but which from April 2016 is tapered for those with an adjusted income of over £150,000). Its application requires care in respect of defined benefit schemes. Once again the allowance applies to all of an individual’s tax-registered pension arrangements and not to each arrangement separately. There is no limit on the maximum amount of combined employer and employee contributions that can be made to a registered pension scheme but, if they exceed

the annual allowance, tax will be levied on the excess in order to recoup the relief.

54. It should be noted that, for those who do not pay income tax due to low income, tax relief is still available at the present basic rate level of 20% on the first £2,880 paid into the pension (which has the effect of topping it up to £3,600).
55. We will look at the lifetime allowance and the annual allowance in more detail in the context of DB schemes, where they are more likely to be relevant when assessing substantial pension loss for high earners in tribunal proceedings.
56. Tax aside, the aim of the trustees or the independent provider will be to invest the pot or fund of contributions with a view to increasing it. The amount of the resulting pension will self-evidently depend on the performance of that pot or fund. Like personal pensions, a bigger fund will support the purchase of a bigger annuity and a bigger tax-free lump sum. Indeed, one of the few differences between an orthodox DC scheme organised by an employer and a purely personal pension scheme is that the individual, who benefits from being a member of a larger group, can expect to pay a lower administration charge.
57. So, where a successful claimant in tribunal proceedings has, through his or her dismissal, lost the benefit of membership of a DC scheme, it is usually straightforward to calculate the resulting pension loss that is attributable to the employer and which flows from its unlawful conduct. The basis for calculation will be the “employer contributions” for whatever period of loss the tribunal has identified. As we noted in the introduction, this has been called the “contributions method”.
58. This approach does not of course extend to the loss of the employee’s own contributions: those contributions are deducted from the employee’s own salary and he or she is still free to make contributions of the same amount to a personal pension from whatever sum the tribunal awards in respect of salary loss. It is true that the successful claimant may face higher administration charges when no longer a member of a DC scheme, but these charges would be difficult to identify and calculate and likely be relatively small. For this reason the working group considers that the loss of the facility to make employee contributions can be ignored.
59. There is one exception to this: in some occupational pension schemes employees may make additional voluntary contributions (or “AVCs”). Where AVCs to a DC scheme are entirely employee-funded, they can be ignored for the same reason as normal employee contributions. It is feasible, however, that the employer might have provided some form of contribution towards the employee’s AVCs; in that case, the loss of that employer contribution should be brought into account when assessing the claimant’s pension loss. In broad terms, however, the tribunal’s

default position will be to ignore the loss of all employee contributions and the onus will be on a claimant to show why a different approach should be taken.

**Question 4: 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.**

***Detour: the new “pension freedoms”***

60. How do annuities work? As a rough idea, take an individual retiring at age 65 with a personal pension pot valued at £133,333. Suppose the individual takes a cash-free lump sum of £33,333 (25% of the overall value) and the remaining £100,000 is available to purchase an annuity. At current rates a sum of £100,000 would buy an annuity – i.e. an annual pension income – of about £5,800 (annuity rates have fallen: in 2008 it would have been closer to £7,500). The annuity would reduce further if an individual wanted to retire earlier and/or build in guaranteed future increases and/or make a portion of the annuity available to his or her spouse upon death. So, for example, if an individual wanted to retire at age 60 with an income that increased by 3% a year, at current rates £100,000 would buy an annuity of about £3,500.
61. Given the low level of annuity rates, the legal compulsion to purchase an annuity has been criticised. Others have viewed that compulsion as a necessary mechanism for protecting people from themselves (in colloquial terms, to reduce the risk that they will “blow” the pension pot too quickly). Ultimately this debate was a political one about how much people could or should be trusted to spend their savings.
62. An attempt to resolve that debate came with the Pension Schemes Act 2015. With broadly cross-party support, it introduced in stages between 2015 and 2016 one of the more important reforms of recent years: the so-called “pension freedoms”. In essence, these freedoms allow individuals to access their full pension pots from age 55 (although the age will rise for those born later). Crucially, individuals will no longer be compelled to purchase an annuity, although there are tax consequences of exercising the freedoms.
63. Those freedoms will have no impact upon the calculation of pension loss in tribunal cases. We are not concerned with how people spend their pension savings, but how the employer contributes to the cost of accruing them. In a DC scheme, it is the disappearance of that employer contribution, following an unfair or discriminatory dismissal, which leads to compensable loss.

## ***Auto-enrolment***

64. Some successful claimants forget to claim pension loss entirely and focus instead on their salary loss. Perhaps this reflects the fact that, for many years, it was not compulsory for an employer to set up a pension scheme. This landscape has changed in recent years, and continues to change, as the UK moves towards a system in which the law encourages private pension provision through employment even if it does not (yet) go quite so far as to compel it.
65. One attempt to encourage private pension provision through employment, especially for those on lower earnings, came with the Welfare Reform and Pensions Act 1999. This Act introduced so-called “stakeholder” pension schemes in the UK in April 2001; indeed, they arrived in time to merit a short mention in the Guidance. Employers with five or more employees would have to provide their employees with access to a designated stakeholder pension scheme (unless those employers provided a suitable alternative pension scheme). A designated stakeholder scheme, which would be a DC scheme, would have to meet certain conditions (such as a cap on administration charges, flexibility for stopping and starting contributions and flexibility for moving between different employers). However, there was no compulsion on employees to join such schemes and no compulsion on employers to make contributions to them. Stakeholder schemes had little impact on the work of the tribunals in calculating pension loss and they had a limited effect on encouraging lower earners to improve their private pension provision. The legal requirement on an employer to designate a stakeholder pension was repealed in October 2012.
66. The Pensions Act 2008 introduced a new approach: the requirement for the vast majority of workers to be enrolled automatically into a qualifying pension scheme. The Government has set up a vehicle for that purpose, the National Employment Savings Trust (or “NEST”), but other pension vehicles operated by private providers are available and employers are also free to set up their own schemes (or use existing ones) provided that they satisfy certain minimum requirements. The idea is for individual employees to have portable “personal accounts” and that they would be enrolled automatically in such a scheme. NEST is free for employers to use although they are not compelled to use it. It is a trust-based not-for-profit DC scheme with low administration charges. The so-called “auto-enrolment” scheme for employees formally commenced in October 2012 and it is intended that it will be implemented fully by February 2018. This new regime has had a long gestation and the hope is that it will provide the architecture for occupational pension provision for many years to come.
67. The auto-enrolment scheme can be summarised as follows:
  - 67.1 Commencing in October 2012, employers have been required to assess their workforces and enrol eligible workers automatically

into an occupational pension. Under the new regime, crucially, workers must no longer make a conscious decision to join such a scheme but instead must make a conscious decision to leave it. The underlying policy is that the tendency of some individuals towards inertia on financial matters will encourage them to make pension savings.

67.2 The extended implementation process has started with the largest employers and it will end with the smallest. The implementation period was originally intended to be three years, but it has been increased twice. As matters stand the implementation period will last 5½ years with the last employers finally joining in February 2018. The Pensions Regulator writes to employers to give them 18 months' notice of their staging date for compliance with the regime. By way of overview:

- (a) Employers with more than 250 workers were assigned their staging dates first, falling between October 2012 and February 2014.
- (b) Employers with between 50 and 249 workers were assigned staging dates between April 2014 and April 2015.
- (c) Employers with fewer than 50 workers have been assigned staging dates between June 2015 and April 2017.
- (d) New employers set up between April 2012 and September 2017 have been (or will be) assigned staging dates between May 2017 and February 2018.

67.3 Given that the legal requirement on employers with five or more employees to designate a stakeholder pension was repealed in October 2012, it follows that – as at the date of this paper – employers are under no legal obligation to offer their employees any sort of access to occupational pension provision until they have passed their auto-enrolment staging date. However, for those employees who were already members of their employer's designated stakeholder scheme, transitional arrangements will apply.

67.4 For those employers already operating occupational pension schemes (whether of a DB or DC nature), these changes will make little difference. This is because, subject to making proper checks, their existing arrangements are very likely to satisfy the basic requirements for minimum contributions (see below). The real targets of the changes are those employers who have no such schemes and for whom it is not viable to set one up through a large commercial provider. Such employers can use NEST or a similarly structured scheme set up by a private sector provider.

- 67.5 Not all workers must be auto-enrolled. There are detailed rules about the circumstances in which an individual worker qualifies as an eligible “jobholder” (the term used by the new regime). Given that workers today may have atypical working arrangements, it is expected that employers must make continuous assessments of the auto-enrolment eligibility status of their individual workers, such as those on “zero-hours” contracts. For example (and in very general terms), the conditions for auto-enrolment are that a worker ordinarily works in Great Britain under a contract, is aged between 22 and state pension age and is paid “qualifying earnings” by an employer (taking account of bonuses, overtime, statutory maternity pay etc). The gross annual “earnings trigger” for auto-enrolment is £10,000. Once triggered, contributions are paid upon earnings in a qualifying earnings band; this is reviewed annually and, for the 2015-16 tax year, runs from £5,824 to £42,385.
- 67.6 The basic requirements for such a scheme include mandatory minimum pension contributions by both employer and jobholder. In other words, the element of compulsion is not in respect of jobholder membership of such schemes but in respect of employer and jobholder contribution to such schemes. By way of overview:
- (a) Until April 2018, the jobholder must make a mandatory minimum contribution of 1% of pensionable pay, while the employer must make a matching contribution of 1% (i.e. a total of 2%).
  - (b) Between April 2018 and April 2019, the jobholder must make a mandatory minimum contribution of 3% of pensionable pay, while the employer must make a contribution of 2% (i.e. a total of 5%).
  - (c) After April 2019, the jobholder must make a mandatory minimum contribution of 5% of pensionable pay, while the employer must make a contribution of 3% (i.e. a total of 8%).
  - (d) These contributions must continue until the worker opts out, leaves employment or reaches the age of 75.
- 67.7 Because of tax relief, the employee’s actual contributions will be slightly lower: if tax relief is given at the present basic rate of 20% on an employee contribution of 1%, the effective rate is actually 0.8%. Similarly, for 3% the effective contribution rate will be 2.4% and for 5% the effective contribution rate will be 4%.
68. The working group recognises that, at this early stage of the auto-enrolment regime, it is difficult to predict accurately how successful it will be. An unknown issue is whether opt-out rates will increase as the

employee contribution rate increases. Certainly the eligibility criteria for jobholders are drafted broadly enough to increase the chances of the regime achieving wide coverage. Each month the Pensions Regulator publishes a report detailing how many employers have submitted a declaration of compliance and summarising how many workers are involved. For example, by the end of February 2016, 100,668 employers had confirmed compliance. This covers some 21,673,000 workers. Of these, 6,091,000 workers counted as eligible jobholders who were auto-enrolled, while 9,557,000 were already active members of their employer's scheme on the relevant staging date.

### ***Simple DC cases: issues for the employment tribunal***

69. The spread of auto-enrolment has a number of consequences for the calculation of pension loss in tribunal proceedings. For example, the working group considers that, when assessing pension loss, a tribunal should be alert to the much greater likelihood that (unless he or she has opted out) the successful claimant will require compensation for losing mandatory minimum employer contributions to the DC scheme into which he or she has been auto-enrolled. This is especially true for those working in jobs that have hitherto been less likely to carry pension benefits. For the moment, it will require the tribunal to ascertain whether the losing respondent has passed its staging date, whether its DC scheme goes beyond the minimum contribution levels required by the new regime, whether the claimant has opted out and what "qualifying earnings" the claimant received by reference to which contributions must be paid.
70. If only minimum employer contributions on earnings in the qualifying earnings band are paid, the tribunal should be mindful that these are increasing from the present level of 1% to 2% in April 2018 and then 3% in April 2019. Moreover, given that such contributions could in principle continue until the age of 75, they may constitute an element of loss that continues beyond state pension age (for those claimants who persuade the tribunal that they would continue working beyond state pension age).
71. The spread of auto-enrolment also makes it increasingly likely that, when giving credit for earnings received through likely mitigation of future loss, the tribunal will have to assume that the hypothetical future employer will likewise pay mandatory minimum pension contributions, at the applicable rate on earnings in the qualifying earnings band, to a DC scheme into which the claimant has been auto-enrolled. This assumption will be even sounder after all employers have passed their staging dates.
72. The working group considers that a number of default assumptions can validly be made when applying the contributions method following dismissal from employment with a DC scheme:

- 72.1 The tribunal can assume that all employers have passed their staging dates (that will be a sound assumption from February 2018 and, until then, easily rebuttable by evidence from the respondent).
- 72.2 The tribunal will likewise assume that, once an employer has passed its staging date, the claimant was an eligible jobholder in the old employment. It will be for the losing respondent to adduce evidence showing why not (if, for example, the claimant had not yet passed the earnings trigger). Consequently, subject to having passed its staging date, the tribunal will assume that the losing respondent was required to make minimum mandatory contributions on the claimant's earnings within the qualifying band. The level of contributions should be readily ascertainable, for example from the claimant's payslips and the respondent's records.
- 72.3 On the assumption that the losing respondent was required to make minimum mandatory contributions on earnings within the qualifying band, the tribunal will order it to pay to the claimant the employer contributions that, but for the dismissal, it would have made during that part of the assessed period of loss when the claimant was out of work. (This "but for" wording is not meant to alter the approach set out in the statutory tests. So, for example, in an unfair dismissal case, the tribunal must still award the sum that is just and equitable in all the circumstances having regard to the loss the claimant has sustained in consequence of the dismissal insofar as that loss is attributable to action taken by the respondent.)
- 72.4 There may also be additional loss after the claimant has found new employment. From February 2018, the tribunal will be entitled to assume that the new employer has passed its staging dates. Until February 2018, it will be a matter for evidence. As above, the tribunal will likewise assume that, once an employer has passed its staging date, the claimant was an eligible jobholder in the new employment. Where there is an ongoing loss of employer contributions, relative to financial loss overall, the tribunal may consider it appropriate to order the losing respondent to pay the claimant any ongoing shortfall in employer contribution levels.
- 72.5 There will, of course, be variables. As noted above, some newer or smaller employers might not yet have reached their staging dates. If the respondent paid more than the minimum mandatory contributions required by the auto-enrolment regime and the new employer pays the minimum level, the pension loss will be greater. If the new employer pays more than the minimum mandatory contributions and the respondent only paid the minimum level, the pension loss will be less. The new employer



might even offer a DB scheme, in which the standard or notional level of contributions can readily be ascertained and could lead to nil pension loss and even reduced overall loss.

- 72.6 It will be a matter for evidence whether the period of future loss might encompass possible pay rises, with a consequent increase in the amount (although not the percentage) of lost employer contributions. That will be for the claimant to show.

**Question 5: The working group proposes that the tribunal operates the following default assumptions in a simple DC case where the contributions method is deployed:**

- The claimant was an eligible jobholder in the job from which he or she was dismissed and was therefore entitled to be auto-enrolled.
- The claimant did not opt out of the scheme into which he or she had been auto-enrolled.
- In the context of any successful mitigation of loss through finding future employment, the claimant would remain an eligible jobholder entitled to be auto-enrolled.
- The claimant would not opt out of that scheme either.
- In the context of assessing future pension loss, the claimant would need to give credit for employer contributions from the hypothetical future employer at the mandatory minimum level.
- If the claimant wishes to claim additional pension loss, for example by contending that the respondent would have paid more than the mandatory minimum level of contributions, as a result of membership of a more generous DC scheme, he or she bears the onus of persuading the tribunal.

**Please say whether you agree or disagree, explaining why.**

### **Occupational pensions: defined benefit schemes**

73. In a DB scheme, the pension benefit is guaranteed regardless of the performance of the underlying pot or fund. DB schemes and final salary schemes have often been thought to be synonymous. That is understandable since, for many years, DB schemes were usually structured around delivering retirement benefits based on final salary. More recently, however, other types of DB scheme have started to

emerge, such as CARE schemes. These will become increasingly important in future.

74. A profound change in the occupational pensions landscape of the last decade or so has been the widespread closure of DB schemes in the private sector, initially to new entrants and then to existing members, accompanied by a shift in the public sector from final salary designs to CARE designs. Corroboration of this can be found in the Pensions Trends series that was produced by the Office for National Statistics until 2013 (and which now takes the form of a periodically updated “pensions compendium”). Corroboration can also be found in the “Purple Book” issued annually by the Pensions Regulator and the Pension Protection Fund. The Purple Book sets out data on the decreasing number of open schemes (where members join the DB section and accrue benefits), the increasing number of those schemes that are closed to new members (in which existing members continue to accrue benefits) or closed to future accruals (where existing members can no longer accrue new years of service) and those schemes that are being wound up. The Guidance could not have foreseen this change. It cannot be ignored.
75. It may be helpful to explain some of the terms used in respect of DB schemes.

#### ***Funded and unfunded schemes***

76. DB schemes are sometimes described as being funded or unfunded (or non-funded). What is the difference?
77. In a funded scheme, the employer sets aside money to meet the predicted cost of the benefits when they fall for payment. This money is paid by way of what is called, like in a DC scheme, an “employer contribution”. The value of the money the employer sets aside is, in turn, based on actuarial advice about the minimum level of ongoing funding that is needed to pay the future benefits. For many years this was known as the “minimum funding requirement” (or “MFR”) but, following the Pensions Act 2004, it has been replaced by a “statutory funding objective”.
78. Of the few remaining DB schemes in the private sector based around final salary benefits, most are funded. The associated pension funds are sometimes huge; it has been wryly observed in this context that British Airways is a pension business with a sideline in flying planes.
79. The funding for such schemes does not come solely from the employer’s contributions. Most schemes levy a charge on employee members who pay their own contributions; so-called “non-contributory final salary pension schemes” are rare indeed today. As with DC schemes, these can be called “employee contributions” or “member contributions”. As more and more schemes struggle to produce a surplus, attempts are made frequently to increase employee contributions.

80. The Guidance estimated (at paragraph 6.7) that the cost to an employer of operating a final salary scheme was typically 15% of pensionable pay, or 20% of pensionable pay for a non-contributory scheme. This estimate will have been based on assumptions about investment returns at the time. Nowadays those percentage figures would be significantly higher.
81. In a further sign of the times in which it was written, the Guidance discussed (at paragraph 3.3) the “holidays” that an employer might take from making its own contributions. Nowadays it is not pension scheme surpluses that are in the news, but pension scheme deficits. Indeed, there have been examples of employers becoming insolvent while the scheme is in deficit, resulting in unexpected hardship and a failure to meet the “pension promise”. In a response to this, the Pensions Act 2005 set up the Pension Protection Fund (referred to above in the context of producing the Purple Book) with effect from April 2006. This can provide some compensation to affected individuals. It is funded by a levy on those employers operating similar schemes.
82. In an unfunded scheme, the employer does not set aside any assets but instead simply pays the benefits as and when they fall due. Indeed, by that definition, the UK state pension system can be seen as an unfunded scheme: benefits are paid out as and when due, and are funded from the public purse. It is very rare nowadays to find an unfunded DB pension scheme outside of the public sector. The pension schemes for the NHS, teachers, armed forces, civil servants and the judiciary are all unfunded and operated centrally (the pension schemes for police officers and firefighters are also unfunded but are operated locally). By contrast, the Local Government Pension Scheme is a funded scheme.
83. Even unfunded schemes, however, incorporate a notional level of employer contributions (to accompany the employee’s contributions) so that the promised pension benefits can be met. The working group’s expectation is that this figure can be obtained readily upon inquiries being made of either the employer or the trustees of the pension scheme.

#### ***Other benefits of DB schemes***

84. Defined benefit pension schemes are subject to complex rules and there may be important differences between them: one size does not fit all. Some are more generous than others.
85. Some schemes allow certain members to take an unreduced (or “unabated”) pension at a much younger age than the age at which they would receive a state pension; examples are police officers (who currently become entitled to an unreduced pension after 30 years’ service) and certain categories of mental health workers (who can retire from the NHS at the age of 55). Those individuals would still have to wait until state pension age, of course, to receive a state pension.

86. Other schemes align their retirement ages with the state pension system, such as the new scheme for judges. Members can still elect to leave earlier with a pension, subject to the scheme rules, but the amount of their pension is then actuarially reduced to reflect the longer period of receipt. The amount of actuarial reduction will vary from scheme to scheme but, by way of illustration, a person typically faces a reduction of around 5% in pension income for each year of early receipt.
87. Some schemes include a range of other benefits pertaining to matters such as pensions for survivors (widows, widowers and dependants), ill health or redundancy (including early retirement with unreduced pensions or “added years” of service), death in service, and pension enhancements for those injured in the performance of their duties. Such factors can all play a part in the assessment of overall loss but are not the focus of this paper.
88. If scheme members fall outside of those rules and leave employment other than for retirement (e.g. they have been dismissed and do not qualify for early retirement), their pension will be deferred in the usual way until they reach the age at which it comes into payment.

### ***Final salary schemes***

89. The Guidance proceeds on the assumption that the DB scheme the tribunal will typically examine when assessing pension loss is a final salary scheme. That is now an unsafe assumption. There has been a widespread move in the public sector to CARE schemes, which impact on the future service of most employees (apart from those who benefit from transitional provisions designed to protect those closest to retirement, the rules for which will vary from scheme to scheme). Indeed, it is possible that some claimants will, in the past, have been over-compensated in public sector career loss cases: the tribunal will have assumed, quite reasonably, that they would have remained in a final salary scheme until retiring, such that the entirety of their pension would then benefit from career promotions and pay rises at later stages; however, unless they qualified for some form of transitional protection relating to their age which delayed their exit from a final salary scheme, such people will already have moved into less generous CARE schemes.
90. Does the steady decline of final salary schemes across the board mean that they can be ignored entirely when assessing pension loss? It does not. A claimant in a public sector career loss case may still have accrued a substantial period of membership in a final salary scheme before being moved into a CARE scheme. Those accrued rights in final salary schemes remain valuable. They will still lead to a final salary pension for the period of membership of the final salary scheme. They will still benefit from future pay enhancements. Recent public sector pay restraint may mean however that, in the absence of promotion, pay enhancements are minimal.

91. So it remains necessary for tribunals and parties to understand how final salary pension schemes operate. At their simplest, they provide both for an income in retirement and for a lump sum:
- 91.1 The income element will be calculated on the basis of the accrual of fractions of pensionable pay, such as sixtieths or eightieths. In a sixtieths scheme, for example, one-sixtieth of the full-time equivalent gross annual salary paid to the employee at retirement (or perhaps the average of the last three years of employment) will be multiplied by the total number of years in employment. This will then provide a pension income up to a typical maximum of two-thirds of final salary after 40 years' service. In eightieths schemes the typical maximum is one-half of final salary after 40 years' service. Part-time employees usually accrue service on a slower, pro rata, basis. (Some final salary schemes have also permitted employees to pay AVCs, with the effect of purchasing "added years" of scheme membership.)
- 91.2 The lump sum benefit will accrue, usually based on a certain multiple (e.g. two or three) of the pension income. For final salary schemes with an eightieths accrual rate the lump sum is generally provided in addition to the annual pension, whereas in schemes with a sixtieths accrual rate the lump sum is generally provided in return for a reduction in the amount of the annual pension. (This can mean that the overall value of the pension benefits is broadly the same for both accrual rates.)

***Simple DB cases: issues for the employment tribunal***

92. In most cases, where the period of loss to be compensated is relatively short, it will be possible to make a tolerably accurate assessment of a claimant's loss of DB pension rights simply by taking the standard level of contributions made by the employer (in a funded scheme) or the notional level of contributions (in an unfunded scheme) and then applying those figures, as percentages of the gross annual salary previously enjoyed by the claimant, to the relevant period of loss that resulted from his or her unfair or discriminatory dismissal. In this context the "standard" level of employer contributions refers to the usual percentage contributions as opposed to any periodic increase (to cover a deficit) or decrease (to benefit from a surplus). Where the claimant has found other paid employment, it would be appropriate for the tribunal – as part of the process of examining mitigation of loss – to take account of any pension contributions made by his or her new employer. This will become more common with the spread of auto-enrolment.
93. In the Guidance, however, the so-called "simplified approach" looks at more than just the employer's actual or notional contributions during the period of loss. It includes, at chapter 5, a section on calculating the loss of enhancement of those final salary pension rights that accrued before

dismissal. In broad terms this is designed to compensate a claimant in respect of the pension rights he or she accrued in the past and which, because of the unfair or discriminatory dismissal, may no longer be subject to an increase in future. This is because the accrued pension would no longer benefit from the increases in pay, which, but for the unlawful dismissal, the claimant would have received. This head of loss partly reflected an assumption, before the days of pay restraint, that earnings growth would outstrip pension growth. It also reflected an assumption that the losing employer would continue to operate a final salary scheme in future. Neither assumption is safe anymore.

94. In the view of the working group, it is no longer appropriate, in simple cases, to make a default assumption that the claimant's accrued rights in a final salary pension scheme would lose out on enhancement – at least not in a manner that calls for compensation as a default position. The working group considers that a better default approach would be to focus purely on the employer's standard or notional contributions, in the manner already set out at Chapters 6 and 7 of the Guidance, and to discard the enhancement element. As with the loss elements associated with the state pension, the onus would be on the claimant to show otherwise.
95. The 2003 Guidance made clear that the choice between the "simplified" and "substantial loss" was an important one. The same can be said for the choice that the working group is proposing between a "simple" and "complex" approach. Many of the same factors will be relevant, such as the stability of employment and its insulation from the economic cycle. Also, it cannot be overlooked that many individuals who have been unlawfully dismissed from employment that carried the benefit of membership of a DB scheme will find it harder to replicate those benefits today than would have been the case in 2003. The decision will, however, always depend on the particular facts of the case.
96. If the tribunal is persuaded that such an individual will not be able to replicate those benefits, because the new pension arrangements will be substantially inferior, it may be appropriate to adopt the "complex" approach discussed later. Where the period of loss is longer, a "complex" approach may also be merited. However, the working group is certainly not proposing that every case involving dismissal from employment with DB benefits should be considered complex. For example, the tribunal may conclude that a teacher who has been unfairly dismissed by reason of redundancy will find work again as a teacher within a reasonable period. The tribunal may also conclude that the employment would likely have ended soon anyway and identify a "cut-off" period on that basis. There might be a sizeable percentage reduction on *Polkey* grounds or for contributory fault. These factors are all capable of making a case a "simple" one, where the contributions method should adequately compensate the claimant for his or her loss of pension rights in a manner that meets the overriding objective. The parties should easily be able to identify the actual or notional level of employer contributions for this

purpose, with case management interventions from the tribunal where appropriate.

**Question 6: The working group proposes that the tribunal operates the following default assumptions in a simple DB case:**

- **Reliance only on the contributions method, meaning no award for loss of enhancement of accrued pension rights.**
- **If the claimant successfully mitigates loss through finding future employment with comparable DB benefits, or the tribunal expects the claimant to do so, there will be no loss of pension rights beyond the start date of the new employment.**
- **If the claimant successfully mitigates loss through finding future employment with inferior DC benefits, or the tribunal expects the claimant to do so, then (unless a complex approach is merited) the tribunal will adopt the same assumptions about auto-enrolment as set out in relation to DC schemes.**

**Please say whether you agree or disagree, explaining why.**

97. Of course, the longer the period of loss, the less accurate this method becomes. This was in part the conceptual justification for the Guidance's original distinction between the simplified and substantial loss approaches. But, as this paper will now explain, the approach of the Guidance to substantial loss cases is no longer safe, mainly because of the widespread move to CARE schemes.

### ***The move to CARE schemes***

98. A small number of final salary pension schemes remain in operation in the private sector but, apart from in respect of accrued rights or those benefitting from transitional protection who maintain future accrual rights, they are effectively extinct in the public sector. In their place are CARE schemes.

99. When it took office in 2010, the Coalition Government's desire to achieve savings across the public sector was well known. It was widely known that the cost of funding the provision of pensions to public sector workers had risen steadily in recent years, principally because of increased life expectancy. It was thought that, unless public sector pension schemes were reformed, they would become increasingly unaffordable. In June 2010, within about a month of taking office, the Coalition Government commissioned a report on the subject from Lord Hutton, the former Labour cabinet minister.

100. The Hutton Commission published its final report in March 2011. Its key recommendations were as follows:

100.1 Final salary pension schemes would be replaced by CARE schemes. Specifically, pension benefits would no longer be linked to final pensionable pay but to the pensionable pay averaged over the time a person spent as a scheme member. (To calculate the “career average” for this purpose, each year’s pay would be uprated for inflation, then all such “slices” would be aggregated and the overall total then divided by the number of years of scheme membership.)

100.2 Existing members would move to new schemes for future accruals, while maintaining the link to final salary for calculating the value of the pension rights they had accrued up to that point.

100.3 Normal pension age would be aligned with the state pension age and, accordingly, increase over time with it (with the exception of the police, firefighters and armed services where the age of entitlement to an unreduced pension would only rise as far as 60).

100.4 Ministers would set a cost ceiling for the new schemes so as to limit employer contributions to a percentage of pensionable pay. Automatic stabilisers, such as further increases to employee contributions or reductions in benefits would be built into the scheme designs in order to keep future costs under control (and would be imposed if agreement could not be reached).

101. The Coalition Government accepted all of the Hutton Commission’s recommendations. In subsequently implementing them, it identified a “preferred scheme design” (PSD) for reform. The design was set out in the Treasury paper published in November 2011 bearing the title “Public Service Pensions: good pensions that last” (Cm 8214) and it formed the basis for negotiations with trade unions about individual schemes across the public sector. Its main features included the following:

101.1 Public sector schemes would remain DB schemes, but based on a CARE rather than final salary design.

101.2 Retirement benefits accrued prior to the implementation of the reforms would, as Hutton recommended, remain linked to the final salary at the date when retirement benefits were taken;

101.3 There would be a new accrual rate (this was initially set at sixtieths, but some unions have negotiated better accrual rates);

101.4 Accrued benefits would be revalued in line with earnings increases and benefits would increase in line with the CPI; and



- 101.5 Lump sums would be available through commutation only, whereby £1 of annual pension income could be converted to a £12 one-off lump sum payment (subject to HMRC rules and limits).
102. The principal civil service pension scheme offers a useful illustration. It has adopted an accrual rate of 1:43.1, which is obviously superior to the accrual rate of sixtieths embodied in the PSD. In broad terms, and prior to the recent pension reforms, the pension schemes for civil servants were as follows:
- 102.1 About 60% were in the “classic” PCSPS: final salary scheme, member contributions of 1.5%, accrual rate of 1/80, maximum pension of 45/80<sup>ths</sup>, lump sum of 3 times the pension income, and entitlement to an unabated pension at age 60. It closed to new members in 2002.
- 102.2 About 25% were in the “premium” PCSPS: final salary scheme, member contributions of 3.5%, accrual rate of 1/60, maximum pension of 45/60<sup>ths</sup>, no lump sum (but 1:12 commutation), and entitlement to an unabated pension at age 60. It closed to new members in 2007.
- 102.3 About 15% were in the “nuvos” PCSPS: CARE, member contributions of 3.5%, accrual rate of 1/43.5, maximum pension of 75% of final pensionable pay, no lump sum (but 1:12 commutation), and entitlement to an unabated pension at age 65. It closed in April 2015.
103. The new civil service scheme opened in April 2015. It incorporates CARE, higher member contributions, an accrual rate of 1/43.1, no lump sum (but 1:12 commutation) and entitlement to an unabated pension at state pension age. On a gross annual salary of £30,000, 1/43.1 represents a “slice” of about £696 in pension income, which is set aside and “banked” each year and then revalued at the point of retirement. Those civil servants who remain on more or less the same income throughout their career do better under a CARE scheme than a final salary scheme, because of the better accrual rate. Those civil servants benefitting from promotions and pay rises in the later parts of their career do less well.
104. It is still possible to pay AVCs in a CARE scheme, and (subject to the annual allowance) they will attract tax relief. In CARE schemes the AVC element will usually operate as a money-purchase supplement, i.e. it will be a DC “add on” to a predominantly DB scheme. Under the current “pension freedoms” a member would be entitled to draw down from an AVC “pot” from the age of 55.
105. As the above summary demonstrates, the proper assessment of substantial future pension loss under a CARE scheme would now have

to consider the lost “slices” of pensionable pay that, but for the unfair or discriminatory dismissal, the claimant would continue to have “banked”. For strict accuracy, that assessment would need to take into account the likely degree of CPI uprating, the extent of flexible commutation and the withdrawal factor (bearing in mind that this produces the number of years of scheme membership, which acts as the denominator). The prospect of future promotion remains important, although less financially valuable as future pension rights will not be pegged to a final salary.

106. So these cases are clearly “complex”. A further difficulty comes with the changing tax regime, to which we turn next. If the award for loss of pension rights is made net, the tribunal may have to gross it up. The complicating issue is the extent to which, in a significant case, grossing up may require the tribunal to pay attention to the impact of the lifetime allowance and the annual allowance.

***Tax: the lifetime allowance and the annual allowance***

107. In the context of tax-registered DC schemes we have already discussed the lifetime allowance (henceforth “LTA”) and the annual allowance (henceforth “AA”). They have greater relevance to DB schemes, most of which are also tax-registered. They have a material impact on a person’s overall pension benefits and, by extension, their net pension loss. Pension loss is assessed net and then grossed up, and grossing up can bring additional complexity.

108. The tribunal is unlikely to examine cases of significant pension loss from a DC scheme. It is an issue that is only likely to arise with respect to the higher benefits associated with DB schemes. In a tax-registered DB scheme, pension contributions are paid from gross rather than net salary and lump sum benefits are tax-free (subject to HMRC limits). As we have seen, the LTA represents the limit on the value of retirement benefits that can be drawn from registered pension schemes before tax penalties are imposed. When the Government of the day introduced the LTA in April 2006, it set it at £1.5m – a figure representing the overall value, actual or notional, of an individual’s pension pot. The LTA increased steadily to £1.8m. However, it has since been reduced: to £1.5m in April 2012, to £1.25m in April 2014 and to £1m in April 2016.

109. Its application in individual cases is complex. The following represents a broad-brush description. There is a scheme for assessing whether high value public sector pensions exceed the LTA: the annual pension figure at the date of retirement is multiplied by a factor of 20 and added to the lump sum.

110. Take the following example, derived from a final salary scheme:

110.1 Jane, a highly paid civil servant, retired in May 2016 on a final salary of £130,000 after 45 years service.

- 110.2 Her pension was  $45/80^{\text{ths}}$  of £130,000, i.e. £67,500. Multiplied by 20, the deemed value would be £1,350,000. (This would need to be added to the value of any private pension pot that Jane had accumulated; for the sake of simplicity, I shall assume there is none.)
- 110.3 Her tax-free lump sum would be  $3 \times £67,500$ , i.e. £202,500.
- 110.4 For LTA purposes, her pension pot would be valued at £1,350,000 + £202,500, i.e. £1,552,000.
- 110.5 In May 2016, the LTA is £1m, so the deemed value of Jane's retirement would exceed the allowance by £552,000.
- 110.6 Tax would be charged as follows: a one-off charge of 55% of the amount of the excess that is taken as lump sum and an annual charge based on 25% of the amount of the excess that is taken as pension income (in a defined benefit scheme, the 25% figure is divided by 20 and the annual pension income reduced by that twentieth). Subject to scheme rules, it might be possible to choose whether and in what proportion the tax penalty is borne by the lump sum and/or the pension income.
- 110.7 In Jane's case, for example, and assuming scheme rules permitted this, she could choose to pay 55% of her lump sum in tax (being £111,375), dealing with £202,500 of the £552,000 excess. The remaining £349,500 would then be taxed at 25% (i.e. £87,375), such that  $1/20^{\text{th}}$  of that amount (i.e. £4,368.75) would be taken from her annual pension each year in addition to ordinary income tax.
- 110.8 Alternatively, Jane could choose to take her entire lump sum tax-free and pay all the excess as tax on her pension income. In that case, all the £552,000 would be taxed at 25% (i.e. £138,000) and  $1/20^{\text{th}}$  of that amount (i.e. £6,900) would be taken from her annual pension income in addition to ordinary income tax.
- 110.9 Depending on individual circumstances, a combination of income tax and the 25% charge may actually mean that a 55% charge in the lump sum results in a lower overall tax charge. An individual would need to take financial advice as to how best to meet the charge.
111. A future government wishing to increase revenue could continue to reduce the LTA, increase the factor of 20 for the purposes of calculating whether the LTA has been exceeded and increase the LTA charging regime above 55%/25%. It has been proposed, however, that the LTA will be indexed annually in line with CPI from April 2018.
112. Tax-registered pension schemes are also subject to the AA, which

represents the ceiling up to which – but not beyond – the state will grant tax relief on pension savings (e.g. by allowing savings of £1 for every 60p contributed by a 40% taxpayer). The AA was set at £215,000 in April 2006 and increased steadily to £255,000 in April 2010 but, from April 2011, it fell sharply to £50,000. It reduced to £40,000 in April 2014. It is tapered further from April 2016, for those employees whose income (once adjusted by taking account of their pension contributions and the deemed increase in the value of their pension) exceeds £150,000. The extent to which the deemed pension savings exceed the AA (tapered if applicable) is generally declared on a self-assessment tax return and then taxed at the higher rate, presently 40%. Alternatively, it may be possible that the scheme will pay the AA tax through a reduction in scheme benefits.

113. In a tax-registered final salary pension scheme, a deemed value is given to the increase in value of that pension over the course of a tax year. In broad terms, this figure results from the application of a factor of 16 (which was increased in April 2011 from a factor of 10) to the increase in value to the pension and the lump sum between two input dates. Those who exceed the AA will receive reduced net pay, because they will not get tax relief on all deemed pension contributions that exceed the AA. Again, if a future government wished to increase revenue, it could reduce the AA further or increase the factor of 16 for the purposes of calculating whether the AA has been exceeded. It is notable that some public sector employers, such as the NHS, are suggesting to employees that they may wish to reduce their hours or defer promotion so as to avoid exceeding the AA. There is scope for rolling over unused AA from three previous tax years.
114. The point the working group wishes to make is that the impact of a changing tax regime makes it even harder to produce guidance that can accurately assist tribunals in the task of calculating net pension loss, and then “grossing it up” by an appropriate amount, in substantial loss cases: it is a further example of trying to hit a moving target. Certainly any attempt to hit that moving target based upon an approach developed in 2003 is bound to miss.
115. An accurate assessment of complex pension loss requires expert actuarial evidence. The working group’s view is that it is not the function of the employment tribunal to conduct actuarial calculations. Tribunals do not have the expertise to construct their own multipliers to replicate the task performed, now with high levels of inaccuracy, by the Guidance published in 2003.
116. The working group acknowledges that in some cases the parties may struggle even to produce the basic figures, comparing what the claimant’s pension would have been if he or she had worked to state pension age with what the pension will now be following dismissal. The impact of CARE revaluation based on projected CPI movement and the extent of flexible commutation means that this process might itself

require actuarial input. There are other “withdrawal” factors that might also require actuarial input: life expectancy, chances of employer insolvency or pension fund insolvency, chances of ill health or redundancy. The tribunal might be able to assess some of these factors for itself (the assessment of future promotion chances is an example of something tribunals are used to doing and which could be performed at the first-stage remedy hearing). Without expert input the tribunal is left making general reductions for “vicissitudes of life”, which can give the impression of arbitrariness. Actuarial multipliers avoid the need to conduct many of these exercises.

### ***The Ogden tables***

117. If the tables set out in the Guidance are unusable, can the Ogden tables be adopted as an alternative method? The formal title of the tables is “Actuarial Tables with Explanatory Notes for Use in Personal Injury and Fatal Accident Cases”. They are informally named after Sir Michael Ogden QC, who chaired the working party that originally produced them in the early 1980s. In 2011 a working group under the current chair, Robin de Wilde QC, produced the most recent (seventh) edition. The Ogden tables are admissible in evidence in civil proceedings by virtue of Section 10 of the Civil Evidence Act 1995.
118. The explanatory notes to the tables are produced by a working group, while GAD is responsible for the tables themselves – a similar process to the method by which the Guidance was produced. They act as an aid to assessing the lump sum appropriate as compensation for a continuing pecuniary loss in cases of personal injury or fatal accidents. Put simply, they help courts produce a single figure that, while not capable of perfect accuracy, properly represents the present capital value of future loss.
119. The explanatory notes make clear that if, for some reason, the facts of a particular case do not correspond with the assumptions on which one of the tables is based (for example, if it is known that the claimant will have a different retirement age from that assumed in the tables), then the tables can only be used if an appropriate allowance is made for this difference. The explanatory notes also acknowledge that, in some situations, the assistance of an actuary should be sought.
120. In trying to capture a single figure that represents the present capital value of future loss, the tables use a multiplicand and a multiplier. In very broad terms:
- 120.1 The multiplicand is the present day value of the future loss. Where the loss is an ongoing recurrent loss, it is the present day value of the annual loss. The loss is assessed net of tax in the case of earnings and pension (there is also provision for the costs and expenses associated with future care, which generally will not apply in employment tribunals). By way of example, if a claimant’s career-long loss is thought to comprise a net loss of £30,000 for

each of the next ten years (at today's value) and a net loss of £40,000 for each of the ten subsequent years (at today's value), the multiplicand will be (10 x £30,000) plus (10 x £40,000), i.e. £700,000.

- 120.2 The complex part is the relevant multiplier – this is a figure derived from the relevant Ogden table. Different multipliers take into account mortality (which, using mortality data from 2008, assesses the prospect of the claimant dying before the end of the period of loss or, where the loss is lifelong, dying before or after the “average” age of death), early receipt (which takes account of the fact that the damages are received as one lump sum rather than periodically and assumes that the lump sum will be invested and yield income) and other contingencies (ill health, redundancy, accidents or injury, career breaks for childcare and the like). This would produce a figure, such as 0.75, by which the multiplicand is multiplied. That, more or less, gives us the compensatory sum.
121. The House of Lords endorsed this method in *Wells v. Wells* [1999] 1 AC 345, with their Lordships determining that the discount rate should be based on the yields on index-linked government stock (sometimes referred to as “ILGS”). The discount rate is now fixed by the Lord Chancellor, pursuant to Section 1 of the Damages Act 1996; and, since the Damages (Personal Injury) Order 2001 came into force, it has been set at 2.5%. To be clear, that means it would be expected that lump sum damages, once invested, would yield annual growth of 2.5%, with the effect that such a figure should be subtracted each year from the lump sum to ensure that a claimant was not over-compensated. The assumption is that over the period in question the claimant will gradually reduce the lump sum so that, at the end of the period, it will have been exhausted. Historically it was assumed that the rate of return available to the claimant would more than offset the effects of wage inflation and so the choice of interest rate to apply to the multiplier would take the form of a discount. Given the financial turmoil of recent years, the current specified rate of return of 2.5% is not realistic – and its continuing application leads to under-compensation.
122. The courts have been reluctant to depart from the discount rate (see the early example of *Warriner v. Warriner* [2002] 1 WLR 1703 CA). In September 2010, however, a judgment of the Court of Appeal in the Island of Guernsey (*Helmot v. Simon* [2009-10] GLR 465), presided over by Sumption J A (as he then was), exposed the inadequacies of the discount rate. Although not technically bound by the Damages Act 1996, the Court of Appeal in Guernsey applied a lower discount rate of 0.5% for non-earnings-related losses and, strikingly, a negative discount rate of -1.5% for earnings-related losses. No order for periodical payments could be made because the Guernsey jurisdiction did not allow for them. Put simply, the expectation was that lump sum damages, once invested, would yield much more modest growth relative to wage inflation and that this should be reflected by an increase in the damages awarded. In

*Simon v. Helmot* [2012] UKPC 5, the judicial committee of the Privy Council upheld those figures.

123. In his introduction to the seventh edition in 2011, Robin de Wilde QC stated that the discount rate of 2.5% was already “long out of date” and did “not reflect the substantial reduction in yields” on government stock since 2001. The Lord Chancellor indicated in 2012 that the discount rate would be reconsidered. Following a consultation period, it was proposed that a panel of experts would be convened to advise the Lord Chancellor on any change to the rate. As yet there is no news of such a panel being appointed. The discount rate of 2.5% therefore remains in place. While there is a general reluctance in the civil courts to depart from it (see, in this connection, the High Court’s judgment in *LHS v. First-tier Tribunal (CIC) and CICA* [2015] EWHC 1077 (Admin), which upheld the use of a discount rate of 2.5% by the Criminal Injuries Compensation Authority), there seems to be a growing preference for periodical payments over lump sum awards as a means of ensuring full compensation.
124. The disparity between lump sum awards and periodical payments has a particular impact upon claimants in the employment tribunal, because the employment tribunal has no power to make a periodical payments order. However, like the Court of Appeal in Guernsey, the employment tribunal is not technically bound by the Damages Act 1996. There is EAT authority from 2004 that it is “good practice” to apply the 2.5% rate (see *Benchmark Dental Laboratories Group Ltd v. Perfitt* EAT/0304/04), but the tribunal can depart from it. An example of such departure is the first-instance employment tribunal judgment in *Michelak v. Mid-Yorkshire Hospitals NHS Trust* (ET/1810815/08), promulgated in December 2011, which yielded an award of about £2.4m (including pension loss of about £666,000), which the tribunal grossed up to about £4.5m. The tribunal heard submissions on the *Benchmark* case but nevertheless decided to apply a discount rate of 1% and its judgment was not appealed.
125. When it comes to loss of pension rights, the Ogden tables adopt a fairly simple approach. Take the case of Bob, a 40-year old civil servant on a gross annual salary of £40,000. He joined the principal civil service pension scheme (PCSPS) at the age of 25. He has suffered a serious and life-changing injury that means he will never again be in employment. But for that injury, he would have remained in civil service employment (and the PCSPS) until the age of 65. At that point he would have accrued an annual pension income valued at  $40/80^{\text{ths}}$  of his final salary (i.e. £20,000) and a lump sum of three times pension income (i.e. £60,000). As a result of the injury, he will instead receive an annual pension income of  $15/80^{\text{ths}}$  of his final salary (i.e. £7,500) and a lump sum that is three times that lower income figure (i.e. £22,500). For the purposes of this illustration we will assume that Bob was not in a CARE scheme and that he was not entitled to an ill-health pension.
126. So, applying the Ogden tables to Bob’s pension loss:

126.1 His loss of lump sum, at today's value, would be £60,000 - £22,500, i.e. £37,500. Based on the 2.5% column in Ogden table 27 ("discounting factors for term certain"), this would be reduced to £20,227.50 (i.e.  $0.5394 \times £37,500 = £20,227.50$ , where the factor of 0.5394 reflects 25 years of accelerated receipt at a discount rate of 2.5%).

126.2 His loss of annual pension income, at today's value, would be £20,000 - £7,500, i.e. £12,500. Based on the 2.5% column in Ogden table 21 (the table applicable to men in respect of loss of pension commencing at age 65), the appropriate multiplier is 8.43 years. This takes account of mortality and other factors. It would produce a loss figure of  $8.43 \times £12,500$ , i.e. £105,375.

126.3 So, under the Ogden tables and with a discount rate of 2.5%, Bob's total pension loss would be assessed as the sum of ( $0.5394 \times £37,500$ ) and ( $8.43 \times £12,500$ ). That would be an overall figure of £125,602.50.

It is worth observing that, with a zero discount rate, Bob's total pension loss would increase to the sum of ( $1 \times £37,000$ ) and ( $21.63 \times £12,500$ ), which is £307,375. With a negative discount rate of -1%, the loss would increase to the sum of ( $1.2856 \times £37,000$ ) and ( $32.25 \times £12,500$ ), which is £450,692.20. As can be seen, most of the difference concerns the impact of the discount rate on the multiplier applied to pension income.

127. Now, imagine that Bob had not lost his job through serious injury, but as a result of an unfair or discriminatory dismissal. Let us also imagine that the tribunal accepts that Bob's psychiatric response to that dismissal was such that, as in the case of a serious injury, he would never again find paid work. That would self-evidently call for a complex approach. What would the Guidance's "substantial loss" approach produce? As per paragraph 8.3 of the Guidance, and assuming no withdrawal factors, the calculation required for Bob would be "A" minus "B" minus "C", where:

127.1 "A" would be the value of prospective final salary pension rights up to normal retirement age in former employment, if he had not been dismissed. This would involve multiplying the annual pension income figure of £20,000 by 13.95, being the multiplier derived from Guidance table 5.2 ("men in public sector schemes", assuming a retirement age of 65). That would produce a figure of £279,000.

127.2 "B" would be the value of accrued final salary pension rights to date of Bob's unfair or discriminatory dismissal. This would involve multiplying the annual pension income figure of £7,500 by 9.84, being the multiplier derived from Guidance table 6.2 ("men in public sector schemes", assumed retirement age of 65). That would produce a figure of £73,800.



- 127.3 “C” would be the value of Bob’s prospective final salary pension rights to normal retirement age in his new employment (which we will assume to be nil, on the basis of his long-term inability to work).
- 127.4 There is no need to consider the diminution in Bob’s lump sum; the multipliers used in the Guidance are set so as to capture that loss. The overall figure for Bob’s pension loss under the Guidance would therefore be £279,000 less £73,800, i.e. £205,200.
128. In analogous situations, then, the Ogden tables (using a discount rate of 2.5%) would produce a figure for Bob’s pension loss of £125,602.50 while the Guidance would produce a figure for his pension loss of £205,200. The Guidance would be more generous by about £80,000. However, the Guidance would be less generous than the Ogden tables if a lower discount rate were applied. What explains these differences?
129. In the case of *Chief Constable of West Midlands Police v. Gardner* (EAT/0174/11) the EAT suggested that the main difference seems to be that, when assessing pension loss in a substantial loss case, the Guidance allows for continuing enhancement of earnings whereas the Ogden tables do not. The prospect of enhancement of earnings in a final salary scheme is likely to make a significant difference to the overall level of pension loss. Furthermore, it should be noted, the Guidance assumes annual salary increases of 5%. The multipliers in the Guidance also do not provide for withdrawal factors. These are dealt with separately by, for example, the application of percentage reductions to each of values “A”, “B” and “C” (see paragraph 8.9 of the Guidance for a helpful illustration).
130. The approach of the Guidance is problematic for other reasons. By 2015, Bob would have exited his final salary scheme and he would have joined a CARE scheme. While his future pension loss might have needed to include enhancements from the service he accrued in a final salary scheme prior to joining a CARE scheme, it would not involve any such enhancements in respect of his future CARE service. His wages might also be assumed to remain more static in future; given the recent climate of public sector pay freezes, he could not expect year-on-year pay rises of 5%. Moreover, if he did choose to retire at 65, he would only have been entitled to an unreduced pension insofar as his accrued final salary pension rights were concerned; the element of his pension derived from his CARE accrual would now be subject to an actuarial reduction by virtue of its early receipt – or else he would have to work to 68 (and which might result in three more years of salary loss). One happy observation: he would not be over the LTA as, following receipt of compensation, his lifetime pension pot would be valued at £460,000.
131. Some (but only some) of these concerns might be addressed through prudent use of the Ogden tables. It would not be a perfect solution, as those tables still pre-date the widespread move to CARE schemes. On

the other hand, the seventh edition does at least propose other multipliers based on alternative discount rates (moving in 0.5% increments between -2% and +3%).

132. If, in a career-long loss case, the tribunal could determine the claimant's retirement age and the shortfall in the pension lump sum, table 27 could produce a suitable figure for loss. Similarly, if the tribunal could determine the shortfall in the annual pension income from the date of retirement, it would be possible to use Ogden tables 15 to 26 to produce a suitable capital figure for loss of future pension income. A state pension age of between 65 and 68 would involve some tweaking of tables 21 to 24, but the figure could be an appropriate measure of loss because it would take account of mortality, albeit based on 2008 data.
133. As Bob's example shows, however, when using the Ogden tables the single most valuable question will likely be: what discount rate should the tribunal apply? The first option is that the tribunal applies the discount rate of 2.5%. This would be consistent with the Damages Act 1996, the Damages (Personal Injury) Order 2001, the "good practice" endorsed by the EAT in *Benchmark* and the High Court's judgment in *LHS*. The second option is that the tribunal is persuaded by either party to apply an alternative discount rate, although the tribunal might feel unable to reach a reliable figure of its own without expert evidence. Without funding from GAD, a third option (which is that the respective Presidents for England & Wales and Scotland set a bespoke discount rate for employment tribunals) is not feasible.
134. In the interests of both simplicity and consistency with the civil courts, while recognising its disadvantages, the working group considers that employment tribunals should, as a default position, apply a discount rate of 2.5% when using the Ogden tables. It will be open to the parties to argue for a different discount rate based on the alternative multipliers provided by the tables. But any submission that the tribunal should depart from a 2.5% discount rate is likely to be strengthened if supported by expert evidence; and even then it would be open to the tribunal to stick to 2.5%.

### ***A new approach to complex cases***

135. The working group proposes a new category of "complex" cases, equivalent to the "substantial loss" cases. It is anticipated that such cases would be rare. Their rarity, coupled with their potential high value, would justify a different approach to case management. Cases involving a realistic prospect of a significant award for pension loss would be identified at an early stage of case management, so that liability and remedy were listed separately. The tribunal would discourage claimants from inserting the phrase "to be confirmed" (or similar) in their schedules of loss in respect of pension loss. The liability stage ought still to include findings about some relevant withdrawal factors (such as *Polkey*) and/or

contributory fault, as they would have a bearing on whether it was appropriate to categorise the case as simple or complex.

136. If and when the claimant succeeded at the liability stage, and if there remained a realistic prospect of a significant award for pension loss, the tribunal would allocate dates for a two-stage remedy hearing. Ideally this would be done at the end of a case management discussion following the liability hearing, so that the parties understood what was required of them; failing that there should be a preliminary hearing, ideally by telephone but in person if appropriate. The tribunal would make orders for an updated schedule (and counter-schedule) of loss, disclosure of further documentary evidence if required, preparation and exchange of witness evidence and so on. Documentary evidence would likely include the pension scheme rules (for the old employment and, where relevant, the new employment), recent pension benefit statements, payslips that may detail pension contribution rates, reports and accounts of the pension scheme (to ascertain the standard or notional employer contribution rate), and so on. Indeed, there should already have been disclosure on such documents notwithstanding that liability and remedy hearings were listed separately.
137. The purpose of the first-stage remedy hearing would be to enable the tribunal to make findings on non-pension compensation (the basic award for unfair dismissal, awards for injury to feelings, wages, holiday pay and the like) and on as many areas as possible that are relevant to the calculation of pension loss (without descending into precise figures), which might include the nature of the successful claimant's pension benefits, the planned retirement age and prospects for future promotion. The parties would then be given a time-limited opportunity to agree the quantum of pension loss. If they did agree, there would be no need for a further remedy hearing and the tribunal could promulgate a remedy judgment (or supplemental remedy judgment, dealing with pension loss) by consent under Rule 64.
138. In the absence of such an agreement, the tribunal would list a second-stage remedy hearing to finalise the pension loss element. There would be two approaches:
  - 138.1 The first approach, which would apply in most of the very small number of "complex" cases, would involve the application of the Ogden tables and a discount rate of 2.5%. If the parties wished to adduce expert evidence in relation to a different discount rate, then frankly they might as well use the second preferred approach and the case would be managed accordingly. If and when the Lord Chancellor fixes a discount rate below 2.5%, the employment tribunals would follow suit and accompanying Presidential guidance would be amended.
  - 138.2 The second approach, which would apply even more rarely, would involve use of expert actuarial evidence. The tribunal, in

consultation with the parties, would make directions for such expert evidence, with the strongly preferred approach being a jointly instructed expert. The parties would be encouraged to agree the basis for funding such joint expert evidence but, in the absence of agreement, the tribunal would rule on the point after hearing submissions. It is possible that the losing respondent would be ordered to pay the entire cost of the expert's report; but it is also possible that the tribunal would order the claimant to contribute to the cost using funds that the tribunal has already ordered the respondent to pay by way of compensation. It is also possible that there are cases where it would be appropriate for the parties to instruct an expert each. It will all depend on the circumstances of the particular case and the working group considers that a "one size fits all" approach could be problematic. The key is flexibility. The hope, however, is that the tribunal would be able to adopt a joint expert's figures for the claimant's pension loss unless there was a very good reason to do otherwise. Again, this could be done by agreement or, where areas of dispute remained, at a second-stage remedy hearing.

139. The parties would be consulted throughout. The underlying idea is that they are given every encouragement to agree quantum of pension loss (with the benefit of the tribunal's findings of fact where appropriate) and that they bear the cost of expert actuarial evidence only where it is proportionate to do so in view of the potential amount of compensation in issue. It is hoped that the second-stage remedy hearings will rarely be needed but that, where they are, the tribunal will not be required to embark on the type of actuarial calculations that, without expert input, it is ill equipped to perform.
140. The members of the working group consider that this approach would be in accordance with the overriding objective. The parties would be free to propose an alternative approach if they wished to do so but, having been formally abandoned, the members of the working group recommend that the Guidance should not be an available approach.
141. If the circumstances justified it, it might also be possible for the tribunal to offer judicial mediation, before a different judge, as an alternative mechanism for reaching agreement on the amount that the respondent should pay as compensation. A fee of £600 would be payable by the respondent.

**Question 7: The working group proposes that the tribunal adopts the following approach in complex cases:**

- **Cases with a realistic prospect of the tribunal making a significant award for loss of pension rights would be identified at an early stage, through a telephone preliminary hearing, and have a split liability/remedy hearing.**
- **If the claimant succeeded at the liability stage and there remained a realistic prospect of a significant award for loss of pension rights, there would be a two-stage remedy hearing:**
  - **The purpose of the first remedy hearing would be to enable the tribunal to set the figures for non-pension loss and to make findings on areas relevant to the calculation of pension loss (following which the parties would be given a time-limited opportunity to agree the quantum of pension loss).**
  - **In the absence of agreement, the tribunal would proceed to a second remedy hearing to finalise the figures for pension loss. There would be two preferred approaches: (a) the Ogden tables approach using a discount rate of 2.5%; or (b) more rarely, the actuarial expert approach.**
- **There would be active consideration of judicial mediation.**

**Please say whether you agree or disagree, explaining why.**

## **COMPENSATION FOR LOSS OF PENSION RIGHTS IN EMPLOYMENT TRIBUNALS**

### **SUMMARY OF QUESTIONS**

We repeat below the seven questions we have asked during the paper, with two additional questions of relevance.

#### **Question 1**

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.

#### **Question 2**

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.

#### **Question 3**

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.

#### **Question 4**

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.

#### **Question 5**

The working group proposes that the tribunal operates the following default assumptions in a simple DC case where the contributions method is deployed:

- The claimant was an eligible jobholder in the job from which he or she was dismissed and was therefore entitled to be auto-enrolled.
- The claimant did not opt out of the scheme into which he or she had been auto-enrolled.

- In the context of any successful mitigation of loss through finding future employment, the claimant would remain an eligible jobholder entitled to be auto-enrolled.
- The claimant would not opt out of that scheme either.
- In the context of assessing future pension loss, the claimant would need to give credit for employer contributions from the hypothetical future employer at the mandatory minimum level.
- If the claimant wishes to claim additional pension loss, for example by contending that the respondent would have paid more than the mandatory minimum level of contributions, as a result of membership of a more generous DC scheme, he or she bears the onus of persuading the tribunal.

Please say whether you agree or disagree, explaining why.

### **Question 6**

The working group proposes that the tribunal operates the following default assumptions in a simple DB case:

- Reliance only on the contributions method, meaning no award for loss of enhancement of accrued pension rights.
- If the claimant successfully mitigates loss through finding future employment with comparable DB benefits, or the tribunal expects the claimant to do so, there will be no loss of pension rights beyond the start date of the new employment.
- If the claimant successfully mitigates loss through finding future employment with inferior DC benefits, or the tribunal expects the claimant to do so, then (unless a complex approach is merited) the tribunal will adopt the same assumptions about auto-enrolment as set out in relation to DC schemes.

Please say whether you agree or disagree, explaining why.

### **Question 7**

The working group proposes that the tribunal adopts the following approach in complex cases:

- Cases with a realistic prospect of the tribunal making a significant award for loss of pension rights would be identified at an early stage, through a telephone preliminary hearing, and have a split liability/remedy hearing.
- If the claimant succeeded at the liability stage and there remained a realistic prospect of a significant award for loss of pension rights, there would be a two-stage remedy hearing:

- The purpose of the first remedy hearing would be to enable the tribunal to set the figures for non-pension loss and to make findings on areas relevant to the calculation of pension loss (following which the parties would be given a time-limited opportunity to agree the quantum of pension loss).
  - In the absence of agreement, the tribunal would proceed to a second remedy hearing to finalise the figures for pension loss. There would be two preferred approaches: (a) the Ogden tables approach using a discount rate of 2.5%; or (b) more rarely, the actuarial expert approach.
- There would be active consideration of judicial mediation.

Please say whether you agree or disagree, explaining why.

### **Question 8**

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?

### **Question 9**

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?