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# Employees bank on pension compensation

**Ash Sanger examines the increasingly important role pensions are taking in employment tribunal awards**



**Retirement: higher compensation puts focus on pensions**

A large number of employers already provide pension schemes for their employees and a substantial proportion of them has provided these benefits for many years. For those not in such schemes, many now have personal pensions, and it has become more important than ever for people to save for their retirement in an era of reducing state benefits. In addition, although the role of the state in the provision of pensions is diminishing, significant benefits are still being provided in the state earnings related pension scheme.

Therefore, a person's individual pension rights are increasingly important and should be protected when loss of employment occurs. It is precisely because the pension rights and expectations are so important that there are now more disputes about them. Employment statements must specifically confirm if there is no pension scheme available. Where an employment contract does provide a pension benefit it becomes a contractual right. Even if there is no written contract but an employee is a member of an occupational pension scheme, he will have statutory rights to the protection of such benefits provided by that scheme.

Where termination of employment gives rise to an employment tribunal claim – mostly for unfair dismissal claims – a successful application will usually result in an order for compensation.

There are two elements of an award of compensation:

- The basic award. This is calculated by a fixed formula, and is dependent on weekly wages, number of years of service and the age at termination. The first two elements of the formula are subject to maxima.
- The compensatory award. The maximum amount that can be awarded under this head is determined by the Department of Trade and Industry. The tribunal must break down the award under this head into specific categories

which include loss of net earnings and future loss, loss of benefits such as health insurance and cars, loss of statutory protection, expenses incurred in seeking new employment and loss of pension rights. The award should be 'fair and reasonable'. However, the employee is under a duty to mitigate. If he fails to cut his losses the tribunal will penalise him.

The remedy available is clear. However, until recently the majority of cases did not consider the value of the loss of pension rights because the total of the other losses under the compensatory award would often achieve the maximum amount of the award.

The purpose of pension schemes is to provide financial security through a reasonable level of income on retirement. This is achieved by deferring some of the employee's income received during his working life. So, essentially the employee's pension rights are his deferred pay.

To consider the pension loss the adviser should find out what type of pension the employee has. There are three types of arrangements: the state pensions (based on national insurance contributions); personal pensions (which are taken out by individuals); occupational schemes (which are provided by employers). Occupational schemes are generally final salary or money purchase schemes.

An employee lucky enough to be in a final salary scheme will be protected from the vagaries of the stock market. Payouts are linked to salary and years of service, so regardless of stock market conditions the employee will receive the full pension entitlement. As a result this is a secure and often one of the most

valuable types of pension scheme available. The risk of low investment returns is with the employer.

With these schemes, there are two ways in which loss occurs. Firstly, the pension rights accrued to the loss of employment will now be crystallised in terms of the salary as at the date of leaving. While a degree of inflation proofing is mandatory this is unlikely to be as great as would have happened if the loss of employment had not occurred. This loss cannot be mitigated. Secondly, there will be no future accrual within the scheme. If future employment can be obtained, this loss will be reduced by the amount of future pension provision.

For money purchase schemes, there will be loss resulting from the future absence of the employer's contributions. In addition, loss occurs by the employee no longer being able to fund for retirement through his own contributions and obtain the generous taxation treatment available. This aspect has been somewhat reduced since the introduction of stakeholder pensions earlier this year, but will still apply where the salary would have been in excess of about £20,000.

For some time one of the heads of claim in employment tribunal cases – often unfair or wrongful dismissal claims – has been loss of pension rights. However, this claim has remained uncharted territory because the maximum claim for the compensatory award was low (£12,500). This limit was often reached even before a detailed assessment under the 'pensions' heading was considered.

The maximum compensatory award was increased with effect

from 1 February 2001 to £51,700. An important consequence of the increased cap is that an accurate calculation reflecting the extent of an employee's pension loss will be relevant in far more cases.

One of the first cases deciding on pension losses since the increase is *Clancy v Cannock Chase Technical College & anor* EAT, [2001] IRLR 331. The Employment Appeal Tribunal (EAT) noted the previous guidelines (published by Harvey) were drawn up when the maximum award was £10,000. This had the effect that the importance of calculating the pension sum was diminished. The EAT found the guidelines were now inappropriate and that in some pension schemes the loss of pension rights should refer not to the lost future contributions but to the actual benefits which they would have provided. Allowance should also be made in mitigation for benefits which will be provided by a scheme the employee might subsequently join. These will depend on the level of contributions and investment returns.

The new statutory cap for compensatory award in employment claims means that legal practitioners ought to obtain expert actuarial evidence to ensure loss of pension rights is accurately considered in all cases. This is particularly important, as there are a great number of different schemes and complicated rules, which are not easily understood by non-pensions experts and thus could result in a reduced claim if not fully assessed. Furthermore, the data required to be collected from the scheme can be rather daunting.

One thing is clear, with the increase in the compensatory awards, an accurate calculation reflecting the extent of an employee's loss of pension rights will be relevant in far more cases. Actuarial evidence will be prudent as a tribunal assessing an award must ensure a just and equitable order is made.

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