

## Equalisation of pension benefits

### Common sense and (perhaps) cost savings

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#### Briefing note

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Author: Kris Weber

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#### In a nutshell

The question of ‘how to properly equalise pension benefits’ is something that the industry has been grappling with ever since the Barber judgment of the ECJ back in May 1990. Most recently the emergence of substantial deficits – and the insolvent winding-up of many thousands of schemes – has thrown into sharp relief the question of members’ precise entitlements where their benefits have been equalised, with a knock-on effect on the extent of employers’ obligations to fund their schemes.

Many of the issues have centred around so-called “split NRD members” whose equalised benefits are calculated by reference to more than one retirement age. The recent judgment of the Court of Appeal in Foster Wheeler has restored an element of pragmatism to this saga, and provides a welcome move away from the rigid approach that the courts had previously favoured. The judgment will impact upon the way in which many remaining DB schemes are administered by their trustees, and potentially provides attractive cost-savings to scheme employers at the same time.

#### Background

In Barber the ECJ confirmed that the concept of ‘equal pay for equal work’ should apply to benefits from occupational pension schemes (which it said were deferred pay) as well as to employees’ remuneration itself. Such schemes in the UK had traditionally based their retirement ages on the state pension age (at that time 60 for women and 65 for men). The value of a pension differs, depending on the age by reference to which it is calculated. As a consequence the use of differential NRDs became unlawful overnight.

The ECJ went on to say that, for the period from Barber until the date retirement ages were equalised (commonly known as the Barber Window), the better of male or female benefits must be provided. This is referred to as ‘levelling up’ and generally requires men to be given benefits on the basis of the female NRD of age 60. Thereafter schemes could, it said, either maintain these benefits or ‘level down’ by using the less generous male NRD of age 65. Most schemes, perhaps unsurprisingly, chose the latter approach.

#### The problem of “split NRD members”

First, if a scheme member has benefits earned with an NRD of age 60, he or she cannot properly be prevented from drawing them at this age, even if his NRD has since been changed to 65. Secondly, until April 2006, pension scheme tax approval required all benefits to be taken at the same age (and even now, most schemes have chosen to retain such a requirement). So, most lawyers agreed, the right to draw benefits at 60 also attached to those earned after the member’s NRD became 65, even if the scheme rules ostensibly required employer consent to benefits being paid before this new NRD.

Next, many pension schemes contained (and still contain) provisions allowing early retirement on unreduced pension from age 60 onwards, if employer consent is given. This can be a useful tool in terms of remuneration policy and workforce management, particularly if used sparingly. The difficulty arises if that need for consent (to draw

benefits before age 65) is removed (for entirely different reasons) by overriding European law. Many members can enjoy potentially large windfall gains when their benefits are paid on an unreduced basis at 60, despite having earned them with the expectation that they would not be paid in full until age 65.

At its most extreme, a scheme member with just one day of Barber Window service could acquire the right to have all benefits earned since that date paid unreduced from age 60, despite having an NRD of 65 for two or more decades of scheme membership. And windfall gains for members can equate to significantly-increased funding obligations for scheme employers, just when their own viability may be at stake and they can least afford to be ploughing huge amounts of money into their pension schemes.

### **The solution according to Foster Wheeler**

One possibility the Court of Appeal considered was to require schemes to treat “split NRD members” as having two separate entitlements, namely to a tranche of pension at age 60 and to a separate tranche at age 65. This would require inferring into a scheme the ‘new’ (post- A-Day) pensions tax regime, under which schemes are no longer required to insist that all benefits be paid from the same age. Although this approach had been favoured by the Court of Appeal in a previous judgment called Cripps, in Foster Wheeler it was dismissed as being unworkable on a mandatory basis.

Instead the Court of Appeal laid down a more principles-based approach, focusing not on a one-size-fits-all approach for all schemes but instead a generic policy of “minimum interference”. First, the provisions of the scheme rules (as amended to equalise benefits) should be adhered to, to the maximum extent possible. Secondly, if it was necessary to depart from them, the scheme (its substance as well as its form) should suffer the minimum disruption necessary to comply with Barber. This means minimising not just the extent of rule changes, but also (and primarily) the overall impact upon members’ intended entitlements. So, in general terms, if a way can be found to actuarially reduce NRD 65 benefits that are paid before age 65, it should be found.

### **Impact on trustees, and action points for employers**

A much more subjective approach can therefore be taken to equalisation. Whilst the lack of an objectively ‘correct’ way of equalising benefits for all schemes might result in some legal uncertainty, it will also prevent clearly unintended effects arising from a combination of a scheme’s rules and overriding European law. Although some legal work may well be required to assess whether a particular scheme’s long-standing approach is still the most suitable, there are potentially large (and perfectly proper) cost savings ‘up for grabs’ as a result of the Court of Appeal’s decision. Employers in particular may wish to commission equalisation reviews, to assess the extent to which their schemes may no longer be quite as costly as was previously thought to be the case.

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#### **More information**

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Kris Weber

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+44 (0)20 7203 5077

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[kris.weber@charlesrussell.co.uk](mailto:kris.weber@charlesrussell.co.uk)

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