RE: THE BOARD OF THE PENSION PROTECTION FUND

NORMAL PENSION AGE

==========

O P I N I O N

==========

Introduction

1. I am instructed on behalf of the Board of the Pension Protection Fund ("the Board"), a statutory corporation established under the Pensions Act 2004 ("the 2004 Act").[1] The main function of the Board is to provide compensation to members of eligible defined benefit pension schemes when there is a qualifying insolvency event in relation to the employer and there are insufficient assets in the pension scheme to cover the Pension Protection Fund level of compensation.

2. I am asked to advise on the correct interpretation of the definition of "normal pension age" contained in paragraph 34(1) of Schedule 7 to the 2004 Act. Paragraph 34(1) provides as follows:

> "In this Schedule "normal pension age", in relation to the scheme and any pension or lump sum under it, means the age specified in the admissible rules as the earliest age at which the pension or lump sum becomes payable without actuarial adjustment (disregarding any admissible rule making special provision as to early payment on the grounds of ill health)."

The "admissible rules" for this purpose are, in essence, the scheme rules disregarding any rule changes over the previous three years which, taken together with discretionary increases over the same period, have had the effect of increasing the call on the Board for compensation.

[1] I understand that this Opinion may be published on the Board's website. In case it is, I should emphasise that, in giving this Opinion, I do not accept responsibility to anyone other than the Board.

3. The definition of "normal pension age" is of critical importance in determining the compensation payable by the Board. Broadly speaking, members who have attained "normal pension age" immediately before the commencement of a Pension Protection Fund assessment period will be entitled to 100% compensation. Members who have not attained "normal pension age" before the commencement of an assessment period will only be entitled to 90% compensation subject to a cap.

4. In most schemes and in the absence of special enhanced early retirement provisions, the application of the definition of "normal pension age" will be relatively straightforward. It is a requirement of Inland Revenue approval that the rules of a scheme should specify the age at which members will normally retire.[2] Scheme rules will usually term this "Normal Retirement Date", "Normal Pension Age" or "Retiring Age" and this will ordinarily be the "normal pension age" for the purposes of Schedule 7 to the 2004 Act.

5. However, some schemes provide that members may, on fulfilling certain contingencies, become entitled to early receipt of a pension without actuarial reduction (I will refer to these as "special provisions" as this reflects the phraseology used in both Schedule 7 paragraph 34 and s.180 Pension Schemes Act 1993). The most common situations in which this arises in practice are cases of permanent ill health and redundancy but, in theory at least, there is no limit on the circumstances in which special provisions may operate.

6. The principal question which arises is whether special provisions operate to reduce the "normal pension age" (for Schedule 7 purposes) of a member entitled to such a pension. If so, such a member would be entitled to Pension Protection Fund compensation at the 100% level. A

[2] See IR12 (2001) paragraph 6.5.

further question, which has assumed increasing importance in this context, is whether all contingent early retirement pensions, or only some, count as "special provisions" for this purpose. I will turn to this issue after considering the main question.

Conclusion on the principal question

7. In my opinion, special provisions (of whatever sort) do not operate to reduce "normal pension age" for Schedule 7 purposes.

Analysis

8. In my view, the critical phrase in the definition of "normal pension age" is that contained in the parentheses at the end:

> "(disregarding any admissible rule making special provision as to early payment on the grounds of ill health)".

This makes it clear that special provisions based on ill health do not operate to reduce "normal pension age".[3] If read literally, these words might by necessary implication lead to the conclusion that all other types of special provision do operate to reduce "normal pension age".

9. However, in my opinion, it is clear that the words "or otherwise" have been accidentally omitted from the end of the parentheses and that Parliament's intention was that special provisions of all types should not operate to reduce "normal pension age". Although it would obviously be preferable for the Schedule 7 paragraph 34(1) definition to be appropriately amended in due course, the Court will read in the words "or otherwise" as part of the process of statutory construction. The Court's interpretative function extends to reading in omitted words at least where (as here) the omitted

[3] Although, as mentioned below, the effect of Schedule 7 paragraph 3(7) is to entitle ill-health early retirees to the 100% level of compensation in any event.

words can be precisely identified: see **Kammins Ballrooms Co Ltd v Zenith Investments (Torquay) Ltd** [1971] AC 850, 879-882; **R v Schildkamp** [1971] AC 1; **Jones v Wrotham Park Estates** [1980] AC 74, 105-106.

10. The accidental omission of the words "or otherwise" from paragraph 34(1) is, in my view, apparent from three features of Schedule 7, namely:

(1) Paragraph 34(2) contains the following provision which is plainly ancillary to paragraph 34(1):

> "Where different ages are specified in relation to different parts of a pension or lump sum –
>
> (a) this Schedule has effect as if those parts were separate pensions or, as the case may be, lump sums, and
>
> (b) references in relation to a part of the pension or lump sum to the normal pension age are to be read as references to the age specified in the admissible rules as the earliest age at which that part becomes payable under the scheme without actuarial adjustment (disregarding any special provision as to early payment on grounds of ill health or otherwise)".

Paragraph 34(2) can come into play in a number of situations encountered in practice, for example:

(i) where a scheme comprises different sections (perhaps a "Staff" section and an "Executive" section) under which benefits accrue by reference to different retirement ages and a member switches from one section to the other; and

(ii) where a **Barber** equalisation amendment[4] has been made, a male member with service before 17 May 1990 may have accrued benefits by reference to three different retirement ages: for example, 65 in relation to service up to 17 May 1990; 60 in relation to the Barber "window period" from 17 May 1990 to the date of the equalisation amendment; and 63 thereafter.

The purpose and effect of paragraph 34(2) is to treat the different tranches of these pensions as separate pensions for Schedule 7 purposes. In my view, it is inconceivable that Parliament intended "normal pension age" to operate differently in relation to such composite pensions to the way in which it does in relation to pensions accrued by reference to a single retirement age. Yet the words "or otherwise" appear in the paragraph 34(2) definition but not in the paragraph 34(1) definition. Of course, if this point were considered on its own, the explanation might be that it is paragraph 34(2) and not paragraph 34(1) which is erroneous but the next feature strongly suggests that that is not so.

(2) In relation to persons who have rights under a scheme attributable to a pension credit[5] ("a pension credit member"), levels of Pension Protection Fund compensation are determined by reference to "normal benefit age", defined in Schedule 7 paragraph 37(1) as follows:

> ""Normal benefit age" in relation to the scheme and a person with rights to a pension or lump sum under it attributable (directly or indirectly) to a pension credit,

[4] i.e. an amendment to equalise retirement ages between male and female members following the decision of the European Court of Justice in **Barber v Guardian Royal Exchange** [1990] PLR 83.

[5] Broadly speaking, these are rights resulting from pension sharing on divorce.

> means the age specified in the admissible rules as the earliest age at which that pension or lump sum becomes payable without actuarial adjustment (disregarding any scheme rule making special provision as to early payment on grounds of ill health or otherwise)".

It will be noted that, by reason of the inclusion of the words "or otherwise", special provisions do not operate to reduce "normal benefit age" in relation to pension credit members. The structure of Schedule 7 is such that pension credit members receive *mutatis mutandis* the same treatment as other members: see paragraph 5(1) and (6) where such members have attained "normal benefit age" and paragraph 21(1) and (2) where they have not. There is no discernible policy reason for treating pension credit members and other members differently in relation to special provisions and it seems evident that "normal pension age" and "normal benefit age" were intended to be interchangeable concepts.

(3) If the paragraph 34(1) disregard is read literally as being confined to special provisions based on ill health, its principal purpose is to prevent enhanced ill-health early retirees receiving the 100% level of compensation. However, Schedule 7 paragraph 3(7) provides expressly that such members should receive the 100% level of compensation (presumably on compassionate grounds). The paragraph 34(1) disregard makes better sense if it applies to the full range of special provisions and paragraph 3(7) operates as a carve-out from the disregard.

11. My conclusion based on the above contextual analysis is reinforced by two further considerations.

12. First, an interpretation of paragraph 34(1) which disregards all special provisions coheres more with one of the principal changes wrought by the

Pension Protection Fund compensation provisions. Prior to the 2004 Act, in the event of a scheme wind up in deficit, pensioners in payment (of whatever age) would obtain priority over non-pensioners by virtue of the statutory priority order prescribed by s.73 Pensions Act 1995 (coupled with the 1996 Winding-up Regulations). Thus, depending on the degree of shortfall, an early retiree aged 51 might receive 100% of his entitlement (excluding pension increases) whilst an active member aged 63 might receive only 10% of his entitlement (or even nothing). This was widely perceived as being unfair. Consequently, one of the effects of the Pension Protection Fund compensation provisions (together with the related amendments to the s.73 priority order introduced by s.270 2004 Act) is that all members who are under "normal pension age" receive the same level of compensation regardless of whether they are currently in receipt of a pension.

13. A purposive interpretation of paragraph 34(1) would treat the disregard as applying to all special provisions. This is because (as observed in paragraph 5 above) special provisions can in theory apply in circumstances where no preferential treatment of the relevant early retiree is merited. It makes much more sense to read the paragraph 34(1) definition as according no preferential treatment to early retirees in general whilst paragraph 3(7) accords preferential treatment to ill-health early retirees on compassionate grounds (subject, it may be noted, in certain circumstances to later review by the Board under ss.140-142 2004 Act).

14. Secondly, a literal construction of paragraph 34(1) gives rise to potential difficulties in the performance of the Board's obligation under s.143 2004 Act to obtain an actuarial valuation where a qualifying insolvency event has occurred in relation to the employer in an eligible scheme. By virtue of s.127(2), the Board has a duty to assume responsibility for the scheme

if (*inter alia*) the value of the scheme's assets at the relevant time are less than the amount of its protected liabilities. For this purpose the scheme's "protected liabilities" are, broadly speaking, the amount of Pension Protection Fund compensation prospectively payable under Schedule 7. Thus, the actuary must be able to determine at the date of the valuation whether non-pensioner members are above or below "normal pension age". On the literal construction of paragraph 34(1), such a member's "normal pension age" may depend on future contingencies the outcome of which cannot be predicted. Since these potential difficulties might impede the Board in performing its obligations under s.143, it seems unlikely that Parliament could have intended such an interpretation of paragraph 34(1).

What are "special provisions" for the purposes of the paragraph 34(1) disregard?

15. In my opinion, the expressions "special", "early" and "on the grounds of ill-health [*or otherwise*]" in paragraph 34(1) collectively indicate a provision pursuant to which a member or category of members has the right to draw an unreduced pension at an age earlier than that otherwise provided for on fulfilment of a contingency over and above the attainment of that earlier age. Thus, rules providing for unreduced early retirement pensions in the event of permanent ill-health or redundancy or with employer consent or trustee consent would all constitute "special provisions" for the purposes of paragraph 34(1).

16. It follows, however, that rules providing for the payment of an unreduced early retirement pension which is conditional only on surviving to a particular age do not count as "special provisions" for this purpose. Thus, if the rules of a scheme state that Normal Retirement Date ("NRD") is age 65 but some or all of the members have an unqualified right to draw an unreduced pension at 62 (i.e. a flexible retirement provision), this would

not constitute a special provision for paragraph 34(1) purposes and members of that scheme who had attained the age of 62 prior to the beginning of an assessment period would be entitled to 100% compensation.

17. In this context, I have been referred to potential difficulties in relation to the ways in which retirement ages have in practice been equalised following the decision in **Barber**. Assume there are two defined benefit pension schemes, scheme A and scheme B. Prior to 17 May 1990 both schemes had rules which set the NRD of males at age 65 and females at age 60. Following **Barber**, both schemes decided to equalise their NRDs at age 65 with effect from 17 May 1994 but they did it in different ways. In scheme A, the definition of NRD was amended so as to provide that, for females, all benefits accrued in respect of service before 17 May 1994 would have an NRD of age 60 whilst benefits accrued after 16 May 1994 would be based on an NRD of age 65. For males, NRD would be age 65 except for benefits accrued during the four-year window from 17 May 1990 to 16 May 1994 for which the NRD would be age 60. In scheme B, however, the definition of NRD was simply changed to age 65 for all service. Nevertheless, in order to ensure that retirement ages were properly equalised in accordance with **Barber** and subsequent ECJ decisions, the early retirement rule was amended so that females would be entitled to draw their benefits at 60 with no actuarial reduction save in respect of benefits accrued after 16 May 1994 which would be subject to reduction if drawn before 65. Similarly, the early retirement rule entitled male members to draw their benefits at 60 with no actuarial reduction in respect of benefits accrued during the four-year **Barber** window but otherwise reduced if drawn before 65. It would obviously be absurd if these two different methods of equalising retirement ages, both perfectly legitimate in themselves, resulted in different levels of compensation being

paid for Pension Protection Fund purposes. In my view, there is no difference in the level of compensation payable in these two cases. There is no difficulty in relation to scheme A, as indicated in paragraph 10(1)(ii) above. So far as scheme B is concerned, the right to draw an unreduced pension in respect of "Barber service" is contingent only on surviving to the age of 60. Accordingly, the relevant rules do not constitute "special provisions" for paragraph 34(1) purposes.

18. More difficulty arises in relation to early retirement provisions containing service qualifications. Assume that a scheme has an NRD of age 65 but the rules entitle a member to draw an unreduced pension at or after age 60 if he has completed 25 years' service. At first sight, this would appear to be a "special provision" as the member must fulfil a contingency over and above surviving to the age of 60+ in order to qualify for the pension. However, taking into account preservation legislation, it can be seen that in truth the need for the member to satisfy an additional contingency is illusory: in fact, the only condition is surviving to the age of 60+. The analysis runs as follows:

(1) If member X joins at age 37 and it is assumed that he will remain in pensionable service, it can be seen that the only contingency which he must satisfy in order to become entitled to the unreduced early retirement pension is surviving to the age of 62. For the reasons given above, on the basis of that assumption, the relevant rule is not a "special provision" for the purposes of paragraph 34(1).

(2) For the purposes of the preservation legislation, the benefits referred to in (1) above are "long service benefit" as defined in s.70(1) Pension Schemes Act 1993, which provides as follows:

> ""Long service benefit", in relation to a scheme, means the benefits which will be payable under the scheme, in accordance with legal obligation, to or in respect of a member of the scheme on the assumption –
>
> (a) that he remains in relevant employment, and
>
> (b) that he continues to render service which qualifies him for benefits,
>
> until he attains normal pension age…".

For this purpose "normal pension age" is defined in s.180 of the 1993 Act as follows:

> "(1) In this Act "normal pension age", in relation to a scheme and a member's pensionable service under it, means…
>
> (b) …the earliest age at which the member is entitled to receive benefits…on his retirement from such employment.
>
> (2) For the purposes of subsection (1) any scheme rule making special provision as to early retirement on grounds of ill-health or otherwise is to be disregarded".

Confusingly, this definition raises the question whether the scheme early retirement provision is a "special provision" for the purposes of s.180(2). However, because the statutory assumption in s.70(1) is that pensionable service continues, the answer is that it is not: for the reasons explained in (1) above, in reality the only condition to be satisfied by member X is surviving to the age of 62. Accordingly, member X's "normal pension age" for preservation purposes is 62. This accords with the guidance in relation to s.180 contained in paragraph 13 of Joint Office Memorandum No. 78.

(3) The assumption of continued pensionable service referred to in (1) above may of course not be valid. However, if member X leaves pensionable service and becomes entitled to a deferred pension, the effect of the preservation legislation must then be taken into

account. The effect of ss.71(3), 72(1) and 74(1) of the 1993 Act is to require that member X's short service benefit be payable on an unreduced basis from age 62 even though he will not have completed 25 years' service.

(4) Accordingly, member X will be entitled to draw an unreduced pension at age 62 whether or not he in fact accrues 25 years' service. It follows that, in reality, the only contingency which he must satisfy in order to qualify for the unreduced early retirement pension is surviving to age 62 and therefore the relevant rule does not count as a "special provision" for Schedule 7 paragraph 34(1) purposes.

19. In my view, the same applies whatever form the service qualification takes. In addition to the form of rule considered above, other common forms are:

(i) a right to draw an unreduced pension after z years' service, i.e. at age of entry + z if that is before NRD; and

(ii) a so-called "golden number" rule, e.g. the right to draw an unreduced pension when the aggregate of the member's age and years of service is at least 85.

In all these cases the only true contingency is attainment of a particular age. In the case of (i), it is entry age + z. In the case of the "golden number rule" in (ii), it is the average of entry age and 85. These two variations do, however, raise a subsidiary issue. It could be argued that the relevant qualifying age in the case of individual members is not in terms "specified in the admissible rules" as required by paragraph 34(1). Nevertheless, as demonstrated above, the relevant age can be

ascertained pursuant to the rules when any individual member joins and in my view that is sufficient to satisfy the requirements of paragraph 34(1). I see no policy reason for distinguishing between service-related early retirement provisions which expressly set out the relevant qualifying age and those which do not.

Andrew Simmonds QC
Lincoln's Inn
16 January 2006

2006

RE: THE BOARD OF THE PENSION PROTECTION FUND

NORMAL PENSION AGE

==========

O P I N I O N

==========

Mrs Naomi L'Estrange
Head of Legal Services
Board of the Pension Protection Fund
Knollys House
17 Addiscombe Road
Croydon
Surrey
CR0 6SR