FORENSIC accounting update

September 2016

Valuing pension income

Pensions are essentially earnings receivable in the future rather than now. They are a perennial "hot topic" as the cost of providing pension benefits has caused concern to many businesses.

Expert accountants' role

Assessments of lost pension rights are needed in **personal injury cases** in which they may be an important part of future loss and **employment disputes** in which they may be a significant element of an employee's total pay and benefits package. In **matrimonial disputes**, it may be appropriate in some circumstances to consider valuations of pension benefits other than the cash equivalent transfer values determined by pension providers.

Types of pension

The basic State retirement pension will form the first layer of many people's pension income. Other layers may comprise income from schemes funded by individuals and/or employers.

Many public sector bodies and a diminishing number of larger businesses operate "defined benefit" schemes in which the annual pension is based on the employee's salary at retirement and the length of service. Employers make up the difference between total employees' contributions and the total contributions required to provide the benefits. For many schemes, this difference has increased significantly in recent years.

The other broad category of scheme is the "defined contribution" scheme in which the employee, and often the employer, contribute to a fund which can be used to buy an annuity on the retirement of the member to provide pension income or which can be "drawn down" by the member. This is the primary form of pension provision for the self-employed and many private sector employees. Defined contribution schemes include personal pension plans and "stakeholder" pension schemes.

Valuation methods

Where a Claimant has been a member of a defined contribution scheme, one way of quantifying loss of pension benefits is to seek quotations from insurance companies. This method can be used in relatively straightforward cases where contributions are not expected to vary. In personal injury cases involving the same type of scheme, where the loss of earnings extends over only a few years, the Courts have taken the view that the contributions by the employer and the tax relief on the Claimant's contributions over the period of loss could be used as a "proxy" for the loss of pension benefits, on the basis that these comprise the Claimant's pension-related benefits.

In more complex personal injury cases, the value of the pension loss is the difference between the present capital value of the pension which the Claimant would have received and the present capital value of the pension which he or she will now receive from the normal retirement date. In the case of defined benefit schemes, these values are computed by reference to the potential and actual pension incomes, converted into capital sums by the application of actuarially derived multipliers. In the case of defined contribution schemes, the focus is on the present value of the pension fund on retirement, computed by the application of specific growth rates to assumed contributions.

Employment Tribunals have historically taken a similar approach to the valuation of pension rights to that used in personal injury cases, in that official guidance indicated that cases relating to the loss of employment over a relatively short time span should use a valuation method based on contributions to the Applicant's scheme, whereas longer-term losses should be computed using an actuarially based approach. The official guidance has recently been withdrawn, however, and consultations are under way on the methodology to be used in future cases.

In matrimonial cases, the primary focus for non-State pension rights is normally on the capital value of the pension rights accrued on divorce, i.e. not on those to be accrued to the retirement date.

Conclusion

Valuing future pension income has become more difficult as the types of pension proliferate and as the defined benefit schemes which provide a predictable income in retirement are in the private sector being replaced by defined contribution schemes. Developments in this area make it important to ensure that all the "angles" are covered.

To obtain further details of our activities or to benefit from the firm's experience and expertise, please contact George Sim or Rakesh Kapila.

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