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Future right to pension benefits not available to creditors in bankruptcy

Robert William Leslie Horton (Trustee in bankruptcy of Michael Henry) v. Michael Gerard Henry
[2016] EWCA Civ 989

Article by David Bowden

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The Court of Appeal has ruled on a challenge raised by a trustee in bankruptcy. The trustee had applied for an income payment order from the bankrupt. The bankrupt had 4 personal pensions which had funds of over £850,000. Although the bankrupt is 61, he relied on support from his wife and family. The retirement dates under these pensions were either 67 or 70 years of age. The rights to draw benefits under these pensions had not yet crystallised. The Court of Appeal upheld the decision of the judge below and refused to grant an income payment order. It noted that the law had been changed in 1999 to align the position in relation to occupational pensions (which had been excluded from distribution to bankruptcy creditors) with personal pensions. The funds in the pensions were not therefore available to be distributed to the bankrupt's creditors. The ruling in a previous case on this point in *Raithatha* was over-ruled.

Robert William Leslie Horton (Trustee in bankruptcy of Michael Henry) v. Michael Gerard Henry
[2016] EWCA Civ 989 7 October 2016
Court of Appeal, Civil Division (Gloster & McFarlane LJJ and Sir Stanley Burnton)

What are the facts?
Mr Henry presented a petition for his own bankruptcy and was adjudicated bankrupt by order dated 18 December 2012. The claims lodged with the Official Receiver totaled £6.5million. The bankrupt disputed most of the claims but admitted indebtedness of over £387,000. The bankrupt was born in October 1954. He had 2 sets of pensions:

- Self Invested Personal Pension ('SIPP') with Suffolk Life with an underlying asset value in October 2014 of over £848k. This had a minimum retirement age of 67, and
- 3 pension policies now administered by Phoenix Life. These had no fund value, but were said to provide a guaranteed annuity income of £2450.68 per policy with a retirement age of 70.

Mr Horton was appointed to be the trustee in bankruptcy. He applied for an income payments order from the court seeking money from these pensions of the bankrupt. The bankrupt said no funds were available from these pensions for the trustee to distribute to creditors because he had not yet started to drawn down on any of the pensions. The bankrupt said he relied on his wife and family to support him. The bankrupt (now aged 61) said his intention was to leave his pension assets to his children.

What does the Insolvency Act 1986 say?
Section 310 of the Insolvency Act 1986 ('IA') makes provisions for income payments orders ('IPOs') and says as follows.

> **'310 Income payments orders.**
> *(1) The court may. . . make an order ("an income payments order") claiming for the bankrupt's estate so much of the income of the bankrupt during the period for which the order is in force as may be specified in the order.*
> *(1A) An income payments order may be made only on an application instituted—*
> *(a) by the trustee, ….*
> *(2) The court shall not make an income payments order the effect of which would be to reduce the income of the bankrupt when taken together with any payments to which subsection (8) applies below what appears to the court to be necessary for meeting the reasonable domestic needs of the bankrupt and his family.*
> *….*
> *(5) Sums received by the trustee under an income payments order form part of the bankrupt's estate.*
> *…*
> *(7) For the purposes of this section the income of the bankrupt comprises every payment in the nature of income which is from time to time made to him or to which he from time to time becomes entitled, including any payment in respect of the carrying on of any business or in respect of any office or employment and (despite anything in section 11 or 12 of the Welfare Reform and Pensions Act 1999) any payment under a pension scheme but excluding any payment to which subsection (8) applies..*'

What did the Pensions Law Review Committee recommend?
This committee chaired by Professor Sir Roy Goode QC issued its report in 1993 '*Pension Law Reform: The Report of the Pensions Law Review Committee*' **Cmd 2342-1.** The report recommended that pension rights (as opposed to the pension payments themselves) should not be counted as an asset in bankruptcy. These recommendations were accepted by the Government in its White Paper called '*Security, Equality, Choice: The Future for Pensions'* **Cmd 2594**. The Committee's recommendations formed the basis for sections 91 to 95 of the Pensions Act 1995. However, the

provisions on bankruptcy in the Pensions Act only applied to occupational pension schemes rather than defined contribution schemes or SIPPs.

What changes were made by the Welfare Reform and Pensions Act 1999?
Section 11 of the WRPA 1999 endeavoured to fill this gap and apply the same protection that applied to defined benefit occupational pension schemes to other pension schemes. The WRPA provided statutory protection on bankruptcy for pension rights in approved schemes. Where a bankruptcy order is made against a person, any rights that he has in an approved pension arrangement are to be excluded from his estate for the purposes of the bankruptcy proceedings. It provides as follows:

> '***11. Effect of bankruptcy on pension rights: approved arrangements.***
> *(1) Where a bankruptcy order is made against a person on a petition presented after the coming into force of this section, any rights of his under an approved pension arrangement are excluded from his estate.*
> *(2) In this section "approved pension arrangement" means—*
> *(a) an exempt approved scheme;*
> *(b) a relevant statutory scheme;*
> *(c) a retirement benefits scheme set up by a government outside the United Kingdom for the benefit, or primarily for the benefit, of its employees;*
> *(d) a retirement benefits scheme which is being considered for approval under Chapter I of Part XIV of the Taxes Act;*
> *(e) a contract or scheme which is approved under Chapter III of that Part (retirement annuities);*
> *(f) a personal pension scheme which is approved under Chapter IV of that Part;*
> *(g) an annuity purchased for the purpose of giving effect to rights under a scheme falling within any of paragraphs (a) to (c) and (f);*
> *(h) any pension arrangements of any description which may be prescribed by regulations made by the Secretary of State.*
> *(3) The reference in subsection (1) to rights under an approved pension arrangement does not include rights under a personal pension scheme approved under Chapter IV of Part XIV of the Taxes Act unless those rights arise by virtue of approved personal pension arrangements.*
> *…*
> *(12) For the purposes of this section a person shall be treated as having a right under an approved pension arrangement where—*
> *(a) he is entitled to a credit under section 29(1)(b) as against the person responsible for the arrangement (within the meaning of Chapter I of Part IV), and*
> *(b) the person so responsible has not discharged his liability in respect of the credit*.'

The Explanatory Note which accompanied the Bill which led to the WRPA clearly stated that '*Pension income actually in payment is included in the calculation of the bankrupt's income. The revised wording makes it clear that pension "*rights*" in approved schemes, and in those unapproved schemes that would be protected on bankruptcy, do not extend to pension "*income*". This ensures that income payments orders can still be made in respect of pension income.*'

What had happened in the *Raithatha* case?
This was a decision of Deputy Judge Bernard Livesey QC. In *Raithatha v. Williamson* **[2012] EWHC 909 (Ch)** he ruled that a bankrupt's present entitlement to compel payment of pension benefits fell to be included in the assessment of his income under IA s310(7).

What ruling did the judge below make?
At first instance, Deputy Judge Robert Englehart QC declined to follow *Raithatha*. In his ruling **[2014] WHC 4209 (Ch)** he dismissed the application of the trustee in bankruptcy for an IPO saying that income which might become payable to the bankrupt from his personal pension policies did not fall within IA s310.

What were the issues on this appeal?
There were these 3 issues on the appeal:

- whether IA s.333(1) read in conjunction with IA s.310 enables a trustee in bankruptcy to require a bankrupt who has reached the age at which he is contractually entitled to draw down or crystallise his pension (but has not done so), to elect to do so, so that the trustee may apply for an IPO under section 310 in relation to the funds drawn down, or to be drawn down,
- if so, what criteria apply to determine the manner in which (and the extent to which) the bankrupt may be required by the trustee to draw down his pension, and

- how (if such a power exists) it should be exercised having regard to the bankrupt's reasonable domestic needs.

As the appeal was dismissed on the 1st ground, it was not necessary for the Court of Appeal to rule on the other 2 issues.

What submissions did the trustee in bankruptcy make?
The trustee made 2 submissions. Firstly that even if the pension rights had not crystallised, the trustee was entitled under IA s333(1) to require the bankrupt to exercise such rights and elect to receive payment. Secondly properly construed IA s.310(7) is to be interpreted as meaning that once a bankrupt pension holder had reached the required pension age, he was accordingly entitled to draw down his pension on request. This meant that his right to elect vested and any subsequent payments which would be made to him by the pension provider were within the scope of IA s.310(7).

What submissions did the bankrupt make?
The bankrupt submitted that the judge below came to the correct decision, that *Raithatha* was wrongly decided and should be over-ruled and that the uncrystallised pensions were not available to creditors on the trustee's application for an IPO. The bankrupt had also issued a Respondent's Notice seeking to affirm the judgement below on other grounds. If the appeal had been allowed, this Notice sought that in making any IPO, the court should have regard to:

- tax that would fall due on the payments,
- the legal costs incurred by the trustee's lawyers which the bankrupt would have to meet if costs were awarded against him,
- the bankrupt's evidence that he had never had enough to live off for the rest of his life absent the generosity of his family, and
- allowance needed to be made for his future expenditure.

What ruling did the Court of Appeal give?
Lady Justice Gloster in giving the unanimous ruling of the Court of Appeal was emphatic in dismissing both submissions made by the trustee in bankruptcy in relation to the construction of the IPO power in IA s.310. She ruled that '*it cannot be said that the trustee has "functions" in relation to property which is expressly excluded from the estate*' and she went on to note that to hold otherwise '*would drive a coach and horses through the protection afforded to a bankrupt's pension rights'* by the IA 1986.

Although a judgement creditor may by injunction compel a judgement debtor to make an election to draw down his pension, she ruled that this '*does not support the argument that post-bankruptcy a trustee can require a bankrupt to make such an election'*. She noted that the Court of Appeal had not been '*referred to any authority which supported the proposition that a bankrupt could be required by a demand made by the trustee under section 333 to take steps to obtain property excluded from the estate*'. She ruled that the trustee's submission on the construction of IA s.333 was '*wholly unrealistic*'.

She ruled that IA, Pensions Act 1995 and WRPA drew a '*clear distinction between, on the one hand, rights under a pension scheme and on the other hand payments made under such a scheme'*. She noted that since the WRPA was enacted that '*rights under a pension scheme do not vest in the trustee on the bankruptcy'* and that a *'capital sum received from a pension scheme after the bankruptcy could not be the subject of a claim in respect of after-acquired property under section 307'*.

Gloster LJ observed that:

> '*In my judgment, Parliament has decided to draw the balance between, on the one hand, the interests of the State in encouraging people to save through the medium of private pensions (so that in old age or infirmity they will not be a burden on the resources of the State), and, on the other, the interests of creditors in receiving payment of their debts, by the mechanism of sections 342A to 342C of the Insolvency Act which enable a trustee to claw back excessive pension contributions made by the bankrupt where such contributions have unfairly prejudiced the bankrupt's creditors*.'

As to whether it could be said that there was '*unfair prejudice'* to creditors if the bankrupt had made '*excessive*' pension contributions in the months or years leading up to the bankruptcy, she noted that

'*the court may nonetheless be entitled to conclude that the excessive contributions have unfairly prejudiced the bankrupt's creditors, and make an appropriate order restoring the position to what it would have been had the excessive contributions not been made*.' However she said the trustee's submissions went too far because if they had been correct the effect would be that the trustee could '*side step the hurdles of section 342A in order to scoop the bankrupt's uncrystallised pension fund*'. On this she ruled that '*it is a matter for Parliament to decide where the line should be drawn between protecting the interests of creditors on the one hand and safeguarding the savings of private pension holders on the other*'.

Gloster LJ said that the words '*becomes entitled'* were '*hardly apt to describe rights under a pension scheme which is not yet in payment*'. Finally she noted that prior to s11 of the WRPA coming into effect '*rights under a personal pension plan….vested in the trustee on the making of a bankruptcy order*'. However as the WRPA changed the law '*rights under registered personal pension schemes no longer form part of the bankrupt's estate which vests in the trustee, in the absence of express statutory language conferring such a power*'. She noted that '*an extension to all registered pension schemes was proposed by the Government*' in its 1998 White Paper and that the aim of the WRPA '*which followed was accordingly to extend the protection in relation to occupational schemes to all registered pension schemes'*.

As to *Raithatha,* Gloster LJ said that she could not accept the reasoning on Deputy Judge Livesey QC and whilst she refrains from expressly overruling *Raithatha*, she clearly does so observing that '*he failed to appreciate the fundamental changes brought about by section 11 of the WRPA*'.

Will there be a final appeal?
As Lady Justice Gloster's ruling is so clear analysing the statutory background as to how pensions were excluded from bankruptcy, it would seem there is little scope for further argument on this issue. It is unlikely that there will be a final appeal.

What action should insolvency practitioners take in the light of this ruling?
This decision restores some clarity once again in relation to pensions and insolvency. The changes made by the WRPA mean that a future right to pension rights which have not yet vested are not available for distribution to creditors. Creditors cannot therefore force a bankrupt to crystallise or draw down his or her pension.

The judgement deals with approved pension schemes and Gloster LJ is careful to limit her analysis to these. This means that the position under FURBS (funded unapproved retirement benefit schemes) cannot be guaranteed to be the same. Section 12 (rather than s11) of the WRPA deals with FURBS and provides that regulations were to be made providing how FURBS were to be treated in bankruptcy. Anyone with a FURB can apply to court for an order that some or all of his unapproved pension rights be excluded from distribution to his creditors but the FURB must be sole or main means of pension provision to enable a court to consider granting such an order.

Here the debtor forced the issue by presenting his own petition. Where insolvent debtors are close to approaching retirement date(s) under either defined benefits or defined contribution pension schemes, they may be better off in the long run seeking a bankruptcy order before these retirement dates crystallise.

10 October 2016

David Bowden is a solicitor-advocate and runs David Bowden Law which is authorised and regulated by the Bar Standards Board to provide legal services and conduct litigation. He is the cases editor for the Encyclopedia of Consumer Credit Law. If you need advice or assistance in relation to consumer credit, financial services or litigation he can be contacted at info@DavidBowdenLaw.com or by telephone on (01462) 431444.