For the self-employed

The self-employed will also benefit from tax relief on pension contributions. However, there is clearly no possibility of an employer's contribution, and the self-employed are not eligible for the S2P.

The calculation of the pension element of a claim for the loss of earnings and pension is therefore similar to the worked example above. For the self-employed, the loss of future earnings is usually the more difficult and potentially controversial task.

Problems with the second approach

The second approach to estimating loss of pension outlined above also suffers from problems. It may under-estimate the loss because it ignores possible future growth in the funds invested (after allowing for inflation and charges for the management of the fund), although it may over-estimate the loss by ignoring any income tax that may arise on future pension payments.

However, when I have compared the outcome of using both approaches, I have been struck by the similarity in the amount of loss produced by each method and would therefore recommend the second approach outlined above.

Fatal Accidents

The dependent of the victim of a fatal accident can have a substantial claim arising from pension loss. Since any widow(er)'s pension or refund of the pension fund is disregarded in accordance with the Fatal Accidents Act 1976, the claim will be based on the *whole* of the pension, not merely a reduction following early termination of employment, and no credit need be given for any payment that the widow(er) may receive from the pension fund.

For Fatal Accident claims, the approach set out in the worked example above will not therefore be appropriate. It will be necessary to obtain a quote from the pension provider because the claim will be based on the loss of the *whole* pension, which could include many past years of contributions.

Ensure that a quote is also obtained from the Department for Work and Pensions for the State Pension, including additional State Pension (SERPS and/or S2P).

Also, bear in mind that an employee who is *not* a member of an Inland Revenue approved occupational pension scheme and who *has* contracted out of SERPS/S2P will have annual contributions made by the state, either to a Personal Pension Plan or a pre-1988 Retirement Annuity Contract.

Armed with quotations for the potential pensions of the claimant and the deceased (but not, as mentioned above, any pension payable to the claimant arising from a policy in the name of the deceased), it is then a relatively simple matter to calculate a dependency multiplicand (net of tax, if appropriate) from the age of retirement, and using the appropriate multipliers from the Ogden Tables, to arrive at the amount to be claimed.

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Claiming Loss of Pension in PI and Fatal Accident cases

The inclusion of a claim for loss of pension in the heads of claim in PI and Fatal Accident cases is easily overlooked. Especially for a younger claimant, loss of pension may not be at the front of the claimant's mind, or the mind of his solicitor. Even if it is, how does one calculate the amount to be claimed?

If the claimant is in employment and is a member of a final salary occupational pension scheme, calculating his loss of pension is relatively straight forward, albeit care must be taken to read the scheme rules so that the claimant's final salary and length of service are not under-estimated.

But what of the claimant who is in a Money Purchase occupational pension scheme, or who is self employed and has a Personal Pension Plan?

This article will consider approaches to valuing the loss of a Money Purchase pension.

Final Salary pension schemes vs. Money Purchase pension schemes

A final salary scheme provides a pension that is proportional to the member's final salary (as defined in the scheme rules), and to his length of service. It will usually require the member to contribute a fixed proportion of his pensionable earnings to the scheme (again, as defined by the scheme rules). It will also be necessary for the employer to contribute to the scheme, although the amount of the employer's contribution will not be a fixed proportion of the member's earnings.

Given a final salary and a length of service, the amount of pension payable can be calculated with precision. Regrettably, that is not the case with Money Purchase schemes.

In a Money Purchase scheme, the member will still contribute a fixed proportion of his pensionable earnings. Usually, the employer will also contribute a fixed proportion of the employee's earnings. On retirement, the fund that has accumulated is used to purchase an annuity although members may be able to draw from the fund for a period whilst deferring the annuity's purchase. The value of the pension will not be a fixed proportion of the member's earnings.

To estimate the amount that will eventually be paid as pension, it is necessary to estimate the performance of the investments in which the funds that have been paid in are held, future inflation, the future tax regime, the charges levied on the fund by its manager, the future life expectancy of the member, and annuity rates at the point in time in the future when the annuity is eventually purchased.

NIFA Claimants in employment or self employment

An employed claimant who is in a Money Purchase pension scheme may be in an occupational pension scheme arranged by his employer, and to which his employer may make a contribution, or he may have a Personal Pension Plan that has no connection with his employer. In either case he may or may not be contracted out of contributing to the State Second Pension (S2P), formerly SERPS, although members of occupational pension schemes that are approved by the Inland Revenue (i.e. most occupational pension schemes) will be contracted out.

Note that personal pension schemes that were started before 1988 may be Retirement Annuity Contracts, not Personal Pension Plans. There are differences between Personal Pension Plans and Retirement Annuity Contracts regarding the proportion of earnings that may be contributed and regarding the proportion of the funds that may be taken as a cash lump sum on retirement. However, the differences need not concern us here.

A self-employed claimant will be in the same position as an employee with a Personal Pension Plan. Again, he may or may not be contracted out of contributing to the S2P. This is discussed in more detail below.

NIFA Valuing the loss of pension – two approaches

There are two approaches to valuing the loss of a Money Purchase pension.

First approach

Perhaps the most obvious is to ask the claimant's pension provider to provide a quote of the amount of pension that the claimant might have received if he had been able to continue contributing until retirement, and a quote of the amount that he is likely to receive based on actual contributions. The loss will be the difference between the two figures.

The amount to be claimed may then be obtained by using that difference as the multiplicand for life from the age of retirement (net of tax, if appropriate), and a multiplier from the Ogden Tables.

Problems with the first approach

However, there are both practical and theoretical problems with this approach.

The practical problems are that pension providers are notoriously slow in providing such quotations, and may wish to make a charge. I am aware of requests for £500 for the provision of such a quote.

The theoretical problems are that the quote that will be provided will inevitably have to rely on a number of assumptions. Those assumptions must comply with the specifications of the Financial Services Authority (the FSA), which currently requires that for Stakeholder pensions it is assumed that the pension fund will grow at 7% per annum, and that retail price inflation will run at 2½%. As noted above, assumptions must also be made regarding the charges levied by the fund manager, the tax regime, life expectancy and annuity rates.

Of course, this approach is not consistent with the approach adopted by the Ogden Tables to provide a suitable multiplier, which disregard inflation and assume that an award will be invested in low risk bonds with a real rate of return (currently) of 2½% per annum.

Second approach

The second, simpler and cheaper, approach is to disregard the future growth of the pension fund, and future inflation, and the charges that will be levied on the scheme. That is, in effect, ignore the existence of the pension scheme altogether.

In essence, this approach assumes that all the funds paid into the scheme are for the member's future benefit, and that the value that has accumulated by his retirement will all be repaid to him by way of an annuity. In other words, the value of the loss of pension is equal to the amount that will be paid in.

This makes it simple to value the loss of pension. It can be included as part of the claim for loss of future earnings by not deducting the employee's own contributions to the scheme when arriving at a net earnings multiplicand.

Of course, the pension fund will also benefit from tax relief on the employee's contribution, and may have benefited from a contribution from an employer. Those two amounts should therefore be added to the multiplicand that is used to arrive at an amount to compensate for the loss of future earnings and pension.

NIFA For example: For an employee in an occupational Money Purchase scheme

For a man who has lost earnings of £20,000 per annum, who has no promotion prospects, and who is in his employer's Money Purchase pension scheme where he and his employer each contribute 5% of gross salary to his pension fund; and assuming that the pension scheme is approved by the Inland Revenue so that the members pay National Insurance at the lower contracted out rate:

First, ignore the pension scheme altogether and calculate the claimant's loss of net earnings. Based on the tax rates and allowances applicable in 2004/5, that will be as follows:

	£
Gross earnings	20,000.00
Personal allowance:	4,745.00
Taxable earnings	15,255.00
Income Tax	
Tax on first £2,020 at 10%	202.00
Tax on balance of £13,235 at 22%	2,911.70
Total income tax	3,113.70
National Insurance	
Nil on first £4,732	
9.4% on the balance of £15,268	1,435.19
Total tax and NI	4,548.89
Claimant's annual loss of net earnings (£20,000 - £4,548.89)	**15,451.11**

Note that the employee's contribution to the pension fund has not been deducted.

Next, add the tax relief on the claimant's contribution, and the whole of the employer's contribution, which would both have been added to the value of the pension fund:

Claimant's loss of net earnings, as left	15,451.11
Add: Tax relief at the employee's marginal rate on his 5% contribution to the pension scheme (£20,000 x 5% x 22%)	220.00
Add: Employer's contribution of 5% of gross earnings (£20,000 x 5%)	1000.00
Multiplicand for the employee's claim for loss of future earnings and pension	**16,671.11**

This has produced a multiplicand, which when multiplied by an appropriate multiplier from the Ogden Tables will produce the amount to be claimed for loss of future earnings and pension.

NIFA For an employee with a Personal Pension Plan

If the same employee had not been a member of an occupational pension scheme, but had been contributing to a personal pension plan, his pension would still benefit from tax relief on his own contribution, but may not benefit from an employer's contribution. However, he would pay National Insurance at 11.0%, not 9.4% as in the example above, and the difference of 1.6% between those two rates would be his contribution to the S2P.

Regrettably, it would not be appropriate to simply add the 1.6% difference to the loss of earnings and pension in the same manner as the employer's contribution was added in the example above. This is because the S2P is not simply proportional to earnings. Low paid employees who earn more than the NI Lower Earnings Limit (£4,108 per annum in 2004/5) are treated as if they earned at least the amount of the Lower Earnings Threshold, £11,600 in 2004/5. Earnings in excess of the Lower Earnings Limit will generate a greater S2P, but the rate at which the benefit accrues depends upon the earnings, and there is no further S2P earned on earnings in excess of the NI Upper Earnings Limit, which in 2004/5 is £31,720.

Calculating the amount of S2P that will be earned is beyond the scope of this article. However, the rules used to calculate S2P are available and the calculation can be performed.

If the claimant has contracted out of paying into SERPS/S2P, the government will, on an annual basis, pay the amount that would have been contributed to S2P into his Personal Pension Plan, or into a separate Pension Plan that is set up specifically for that purpose. The claimant should receive annual statements showing the amounts paid into his Pension Plan.

For a claimant who *has* contracted out of SERPS/S2P, it *would* be appropriate to treat the government contribution in the same manner as the employer's contribution in the example at the top of the page.