ALLEN & OVERY

Ill-health early retirement

Certain issues crop up time and time again in situations where a member is suffering from ill-health. Here we take a look at some of the more common pitfalls faced by trustees and pensions managers.

Failure to follow the scheme rules

The test for whether or not a member qualifies for ill-health early retirement (IHER) will be set out in the scheme's rules, and a failure to follow the precise wording of the test when making a decision on an IHER application will expose that decision to challenge in front of the Pensions Ombudsman (TPO). It is, therefore, crucial that trustees carefully check the ill-health rule itself (rather than any summary of the ill-health provisions, such as in a booklet) and that they are mindful of any nuances and/or qualifications in the rule.

Some of the most common mistakes in relation to applying ill-health rules include:

- Applying the wrong incapacity test – does the member have to be permanently and completely incapacitated, or is the test of a lower standard?
- Failing to apply the right employment test – is it based on the member's inability to perform any work, or only their current job; or does the rule only require that general earning capacity be reduced?
- Failing to award a benefit on alternative grounds – if there are alternative parts to the rule, a member who does not meet the qualifying conditions under one limb (eg total incapacity) might still be eligible for a reduced benefit under another limb (such as reduction in earning capacity).
- Failing to consider whether the rule automatically entitles a member to a pension or leaves this to the employer's or trustees' discretion.

It should be noted that, for an IHER pension to be an authorised payment for tax purposes, a doctor must conclude that the member is (and will continue to be) incapable of carrying on the member's occupation because of a physical or mental impairment. A scheme's rules may set out a more stringent test, but an IHER pension must at least meet this requirement in order to be an authorised payment.

There is also a separate tax test, known as the 'severe ill-health condition', which is an exemption to the annual allowance charge. This is a different test to the other tax test mentioned above. Trustees should consider whether they wish to ask a medical adviser to comment on whether the severe ill-health condition is met, as well as the test in the scheme rules.

Wrong decision-maker

While it may seem obvious that the decision must be made by the correct person, it is remarkably easy to get this wrong. It is not uncommon for the decision to be taken by the wrong person and when that happens, TPO will normally direct that the decision be re-taken by the correct decision-maker.

Typically, a scheme's rules will provide for the trustees to make the decision as to whether or not an ill-health pension should be granted. The trustees will nearly always be required to make that decision after having sought an opinion from a medical adviser. However, trustees have, in a number of TPO complaints, overlooked this decision-making obligation and

have effectively delegated the decision to the medical adviser by blindly following the adviser's recommendation. Where trustees have a decision-making responsibility, they must come to their own conclusion, considering all the evidence (including the medical advice) and applying it to the criteria laid down in the rule – they should not simply delegate the decision to the medical adviser. It is also worth noting that, in some cases, the decision-making obligation may be split, eg the employer deciding whether the member is suffering from incapacity and the trustees deciding the extent of such incapacity and which pension should be granted.

Case study: Ms B (2015 Pensions Ombudsman decision)

Facts

In this case, a member made a retrospective application for ill-health early retirement from active status. The scheme rules relating to incapacity pensions referred to 'any member who…(ii) is in the opinion of the employer suffering from incapacity; and (iii) is determined by the trustee company to be suffering from total incapacity or partial incapacity'.

The trustee instructed the employer not to 'venture an opinion on whether the member fulfils criteria for incapacity retirement; this is a decision for the trustee company'. It then refused the application on the basis that there were further, untried, treatments available to the member.

Decision

The employer and trustee had misconstrued their roles. On a correct construction of the rules, it was the employer's job to decide if the member was incapacitated (which it had failed to do) and, if so, it was then for the trustee to decide whether the incapacity confirmed by the employer was total or partial. In addition, the trustee's decision was flawed, in any event, as the medical evidence it relied on did not consider whether trying further treatments would potentially enable the member to return to work, meaning that she might not be suffering from total or partial incapacity.

The complaint was upheld and the case was remitted back to the employer and the scheme for a fresh decision. The member was awarded £500 as compensation for distress and inconvenience caused by the employer and trustee's maladministration.

Incorrect questions being asked of the medical adviser

If the trustees have not properly examined the test for an ill-health pension as set out in the scheme's rules, they may well ask incorrect questions of the medical adviser or ask for an opinion based on an incorrect test of incapacity. In such cases, the opinion received from the medical adviser may be inaccurate or unreliable, or fail to address relevant issues.

Trustees need to be clear when they brief the medical adviser on precisely what needs to be established for an IHER pension to be granted and what information they need from the adviser to be in a position to make the necessary decision. If the medical adviser's report doesn't adequately address all the questions, then the trustees should seek further information or clarification. It is also important, when preparing the instructions to the medical adviser, to be clear about the time period the opinion has to cover; for example, the report will normally need to consider whether the member was suffering from incapacity at the date he or she stopped work, rather than at the date on which the opinion is given.

Case study: Ms Tracy (2015 Pensions Ombudsman decision)

Facts

In this case, a member's application for ill-health early retirement was refused because the scheme's medical advisers were not willing to certify that her incapacity was permanent, on the basis that it was 'premature' to decide that question when she still had ten years of potential pensionable service to normal pension age.

Decision

The DPO held that the medical adviser's decision-making process was flawed. The scheme rules required that the medical adviser consider whether, on the balance of probabilities, the incapacity was likely to be permanent. By concluding that it was premature to decide that question, the medical adviser was incorrectly deferring the decision. The DPO said that the medical adviser should have considered: (i) whether the member's condition was likely to improve as a result of the treatment she was receiving; (ii) when, as a result, she was likely to be able to resume doing her job; and (iii) the speed with which any improvement might be expected, within the timescale of the ten years remaining until normal pension age. In this case, there was no evidence that these factors had been taken into consideration. The DPO, therefore, remitted the case back to the employer and trustee for a fresh decision.

The prospect of further treatment

Most scheme rules require a medical adviser to say whether a member is permanently incapable of discharging his or her employment duties. Where there is the potential for a member to try new or further treatment, TPO has highlighted the need to obtain evidence on the likely success of untried treatments, and the timescale for these, as both may be relevant to whether a scheme's incapacity test is met.

TPO's view is that the fact that untried treatments exist should not prevent a medical adviser from reaching a judgement on permanence. If, when the medical adviser is considering the matter, further untried treatment is available and accessible to the member, then the question is whether any untried treatment would, on the balance of probabilities, improve a member's condition so that any incapacity would not be permanent.

When considering the practicability of further treatment, trustees should take into account the circumstances of the member's condition.

Information for seriously ill members

In one case, a terminally ill member was sent information about his benefits but not informed that if the benefits were not taken before his death, the benefits payable would be less generous. He died months later without taking benefits. TPO found that the trustees should have satisfied themselves that the member had received the letter and understood the information. The trustees breached a fiduciary duty to provide the member with relevant information so that he could make an informed decision about his benefit options. The trustees were ordered to pay the estate the sum it would have received if the member had taken benefits (plus interest), and to pay the spouse the pension she would have received (plus arrears), and compensation for distress and inconvenience.

Delay in reaching a decision

Time is frequently critical in ill-health cases and a failure to take a decision swiftly (once all the relevant evidence has been obtained) will often result in an adverse determination by TPO. Speed can be of critical importance in

some situations, such as where the member is in the final stage of a terminal illness and is able to elect for a lump sum in exchange for an entire pension (serious ill-health commutation). In these cases, delay in dealing with the application might amount to maladministration.

Procedure and recording decisions

If a decision is challenged, the decision-making process will need to be able to withstand intense scrutiny. Trustees should ensure the decision is made correctly and that there is a comprehensive paper trail – a simple note of the final decision is not enough. Records should include all the information gathered, which factors were considered, and which of those carried greater or lesser weight (and why). If the scheme has a policy or guidelines for the process, a note should be taken stating that the standard procedure was checked, and whether it was followed or whether the decision-makers departed from it (stating their reasons for doing so). The reasons for the final decision should be recorded in full, including details of which factors carried most weight.

In one determination where the DPO upheld a complaint that a decision on a member's IHER application had not been properly reached (as insufficient evidence was gathered prior to making an assessment), the DPO set out a non-exhaustive list of expectations in this area:

- There should be a formal record of any delegation of powers, setting out clear duties and responsibilities.
- Any decision-making body must clearly identify under which rule it is working.
- Where advice is sought from an expert, clear instructions must be given to the expert explaining the tests to be applied.
- If there is any omission, ambiguity or possible misunderstanding over the evidence and/or the expert's opinions, the decision-maker must follow this up prior to making the decision.
- Expert opinions feed into the process, but any decision must be made by the body with power to do so after full consideration of all the evidence and applicable rules.
- A record of the reasoned decision must be kept, clearly showing at a minimum the facts found, the expert evidence taken into account, its findings and the date of the decision, and the name of the decision-maker and for whom that person is acting.
- A reasoned decision must be given to the member and any statutory appeal right should be clearly signposted.

In this case, the decision-maker could not demonstrate that it had complied with these requirements. The DPO was not satisfied that an informed decision had been taken, ordered the decision to be reconsidered and awarded compensation for distress and inconvenience.

For more information on avoiding and managing pensions disputes, please visit our Pensions in Dispute site at **www.allenovery.com/pensionsindispute**.

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