



## BRIEFING PAPER

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# Bankruptcy and the treatment of pensions

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### Contents:

1. Bankrupt's estate
2. Types of pension
3. The treatment of pensions on bankruptcy
4. Income Payments Orders (IPOs)



# Contents

|                                                   |          |
|---------------------------------------------------|----------|
| <b>Summary</b>                                    | <b>3</b> |
| <b>1. Bankrupt's estate</b>                       | <b>4</b> |
| <b>2. Types of pension</b>                        | <b>5</b> |
| <b>3. The treatment of pensions on bankruptcy</b> | <b>6</b> |
| 3.1 Bankruptcies made before 29 May 2000          | 6        |
| 3.2 Bankruptcies made after 29 May 2000           | 7        |
| Approved arrangements                             | 7        |
| Unapproved schemes                                | 7        |
| <b>4. Income Payments Orders (IPOs)</b>           | <b>9</b> |
| 4.1 Background to the case law                    | 10       |
| Case of Raithatha v Williamson                    | 10       |
| Case of Blight v Brewster                         | 10       |
| Case of Horton v Henry                            | 11       |

## Summary

This note provides an outline of the treatment of pensions on bankruptcy.

Prior to the reforms introduced by the [Welfare Reform and Pensions Act 1999](#) (WRPA 1999), an individual's rights under his/her pension constituted 'property' within the meaning of section 436 of the [Insolvency Act 1986](#) and, with certain exceptions, thus formed part of the bankrupt's estate and vested in his/her trustee in bankruptcy (pursuant to section 306 of the IA 1986).

The WRPA 1999 reversed this so that, with respect to any individual made bankrupt on a petition presented on or after 29 May 2000, the debtor's pension under an approved scheme was (with two partial exceptions) removed altogether from the assets available to his/her creditors. The two exceptions were as follows:

- First, if the debtor had made excessive pension contributions the trustee in bankruptcy could apply (pursuant to section 342A of the IA 1986) to recover these excessive contributions for the benefit of the estate;
- Secondly, if the pension was in payment during the period that the individual remained an undischarged bankrupt, such payments could be taken into account in assessing the individual's overall income for the purposes of determining whether to make an Income Payments Order (pursuant to section 310 of the IA 1986).

Following the Court of Appeal decision in the case of [Horton v Henry](#) (7 October 2016), it is now settled law that neither the court nor the trustee has the power to compel the bankrupt to draw down or otherwise take his or her pension rights.

# 1. Bankrupt's estate

Bankruptcy is an option for any individual who cannot pay their debts "as and when they fall due". Under the [Insolvency Act 1986](#) (IA 1986) a court makes a bankruptcy order only after a bankruptcy petition has been presented. It is usually presented either by:

- the debtor themselves (known as a 'debtor's petition'); or
- one or more creditors who are currently owed £5,000 or more by the debtor and that amount is unsecured (known as a 'creditor's petition'); or
- the supervisor or anyone bound by an Individual Voluntary Arrangement (IVA)

For the purposes of this note, it is assumed that the bankrupt is subject to a creditor's petition (i.e. a compulsory bankruptcy order).

Bankruptcy and the sale of property are determined by provisions of the IA 1986 (as amended), the [Insolvency \(England and Wales\) Rules 2016](#) and the [Enterprise Act 2002](#) (EA 2002).

Once a bankruptcy order has been made by the court, an official receiver will be appointed trustee in bankruptcy (unless a private sector insolvency practitioner is appointed). As at the date of the bankruptcy order, the bankrupt's estate vests in the trustee (see **Box 1** below).

## Box 1: Vesting of bankrupt's estate in trustee

Section 306 of the IA 1986 states:

- (1) The bankrupt's estate shall vest in the trustee immediately on his appointment taking effect or, in the case of the official receiver, on his becoming trustee.
- (2) Where any property which is, or is to be, comprised in the bankrupt's estate vests in the trustee (whether under this section or under any other provision of this Part), it shall so vest without any conveyance, assignment or transfer.

The function of the trustee is to get in, realise and distribute the bankrupt's estate in accordance with the IA 1986. In the carrying out of that function and in the management of the bankrupt's estate the trustee is entitled, subject to the IA 1986, to use his own discretion.

The bankrupt has 21 days from the date of the bankruptcy order in which to provide the trustee with information relating to his/her financial affairs, including a full list of their assets (including property, pensions, insurance policies etc.) and a full list of their debts.

## 2. Types of pension

There are basically four types of pension that a bankrupt may have already or could be entitled to receive in the future:

- State pension – this will include any payment from the State Second Pension (S2P) (formerly known as the State Earnings Related Pension Scheme or SERPS).
- Occupational pension – this is a scheme set up by an employer to provide members with retirement and death benefits. (Contributions may have been made by the employer, the employee, or both.)
- Personal pension plan – this is a personal pension policy the bankrupt may have taken out with an insurance company to pay him/her benefits in later life. (Retirement annuity contracts are similar to personal pension plans and are treated in the bankruptcy in a similar way.)
- Group personal pension – this is a personal pension policy taken out with a pension provider, often on favourable rates and terms negotiated by an employer or trade association. After a bankruptcy order is made, a group personal pension is dealt with in the same way as other personal pension plans.

It is not unusual for the bankrupt to have more than one type of pension or to have several pensions of the same type.

### 3. The treatment of pensions on bankruptcy

The treatment of pensions on bankruptcy changed with the introduction of the [Welfare Reform and Pensions Act 1999](#)<sup>1</sup> (WRPA 1999). A distinction is made between bankruptcies made before and after the 29 May 2000.

#### 3.1 Bankruptcies made before 29 May 2000

Prior to the reforms brought in by the WRPA 1999, a bankrupt's rights under his/her pension scheme constituted 'property' within the meaning of section 436 of the IA 1986 and, with certain minor exceptions, formed part of the bankrupt's estate (under section 283 of IA 1986) and vested in his trustee in bankruptcy (pursuant to section 306 of the IA 1986).

It follows from this that if an individual was made bankrupt on a bankruptcy petition presented before 29 May 2000, his/her trustee in bankruptcy may claim part or all of their pension, whether they are receiving it now or it is due in the future (i.e. uncrystallised pension rights). In respect of a personal pension plan, this means that from the date of the bankruptcy order all rights and benefits (except rights arising where the policy was used to contract out of SERPS) vest in (i.e. transfer to) the bankruptcy estate. The trustee in bankruptcy has the same rights under the policy as the individual had before becoming bankrupt. In other words, the trustee cannot claim the pension benefits until the bankrupt reaches the earliest retirement age allowed by the policy.

#### **Box 2: Some occupational pension schemes have 'forfeiture clauses'**

Under a forfeiture clause, if a person is made bankrupt they automatically lose their pension rights, and their trustee in bankruptcy cannot claim the pension as an asset of the bankruptcy.

If the occupational pension scheme in question has no valid forfeiture clause, then the trustee in bankruptcy will be able to claim pension benefits for the bankruptcy estate.

Further, in order to protect scheme members, many pension schemes included forfeiture clauses. Although these varied from scheme to scheme, the purpose of them was automatically to forfeit the member's entitlement to scheme benefits on his bankruptcy and for the trustees to have a discretion to distribute payments (up to the value of those benefits) to the member or his family (known as protective trusts).<sup>2</sup>

It is important to note that if a trustee in bankruptcy has claimed pension benefits under a personal pension or an occupational pension, this may include any lump sum as well as regular pension payments.<sup>3</sup>

<sup>1</sup> In respect of Northern Ireland, the [Welfare Reform and Pensions \(Northern Ireland\) Order 1999](#)

<sup>2</sup> Nabarro's "*Pension Law Handbook*", 12<sup>th</sup> edition, Jennifer Bell and Susan Jones, Bloomsbury Professional, para. 1.54

<sup>3</sup> In certain circumstances the bankrupt may be able to 'buy back' the benefits under the scheme from the official receiver

## 3.2 Bankruptcies made after 29 May 2000

The WRPA 1999 provides that where a bankruptcy order is made against a person on a petition presented after 29 May 2000, any rights of the bankrupt under an approved pension arrangement<sup>4</sup> are excluded from the bankrupt's estate.<sup>5</sup> This means they cannot be claimed by the trustee in bankruptcy for the benefit of the creditors.<sup>6</sup> Significantly, the WRPA 1999 also made forfeiture clauses ineffective as from 6 April 2002.

### Approved arrangements

Approved pension arrangements include pension schemes registered with HMRC under section 153 of the [Finance Act 2004](#), together with certain occupational pension schemes set up by governments outside the UK and certain retirement annuity contracts.<sup>7</sup>

If the official receiver is satisfied that the pension in question is an approved pension arrangement, they will write to the bankrupt confirming that the pension does not form part of the bankruptcy estate. This change in legislation obviously provides valuable protection to a bankrupt with an approved pension. However, this concession was not without the following reservations.

If the debtor had made excessive pension contributions the trustee in bankruptcy could apply pursuant to new section 342A of IA 1986 to claw these excessive contributions back for the benefit of the estate. (This could cover contributions paid up to five years prior to bankruptcy, personally, or via a company.)

In effect, this new statutory provision enables a trustee to seek an order of the court recovering excessive contributions made into a pension scheme, where it has unfairly prejudiced the individual's creditors. "Excessive" is described as an amount which is excessive in view of the individual circumstances when those contributions were made. A key factor will be whether the debtor was insolvent at the time the contribution was made or in consequence of it.<sup>8</sup>

It should also be noted provisions contained in the IA 1986 relating to Income Payments Orders (IPOs) were amended by the WRPA 1999. As a result, if a pension was in payment during the period that the debtor remained an undischarged bankrupt, such pension payments could be taken into account in assessing the debtor's overall income for the purpose of the court determining whether to make an IPO pursuant to section 310 of the IA 1986 (see below).

### Unapproved schemes

If an unapproved pension policy does form part of the bankruptcy estate for the purposes of the WRPA 1999, the trustee in bankruptcy can claim the lump sum and the regular pension payments even after the bankrupt has been discharged from bankruptcy. However, in certain circumstances, it may be possible for the bankrupt to 'buy back' his/her interest in the pension policy from the trustee in bankruptcy.

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<sup>4</sup> Approved by HM Revenue and Customs

<sup>5</sup> Section 11(1) of the *Welfare Reform and Pensions Act 1999*

<sup>6</sup> In practice, if the official receiver is in any doubt as to whether a pension scheme has been approved by HM Revenue and Customs, they will write to the pension provider for confirmation

<sup>7</sup> See section 11(2) of the *Welfare Reform and Pensions Act 1999* as amended by [SI 2006/754](#), regulation 15

<sup>8</sup> Trustee to pursue excessive contributions claim, even where the pension has been subject to a pension sharing arrangement

**Box 3: Exclusion Order**

It is important to note that if the pension scheme is unapproved, in certain circumstances the bankrupt may still be able to exclude it from the bankruptcy estate by applying to court for an Exclusion Order or by making a qualifying agreement with the trustee in bankruptcy.

It should be that the bankrupt's state pension or any payments from the State Second Pension (S2P) (formerly known as SERPS) do not form part of the bankruptcy estate.

## 4. Income Payments Orders (IPOs)

If appropriate, the trustee in bankruptcy may apply to the court for an Income Payments Order (IPO), effectively requiring the bankrupt to make contributions towards his/her bankruptcy debts from their income.

### Box 4: Trustee application for an Income Payments Order (IPO)

An IPO allows a trustee to claim a bankrupt's excess income for a period of up to three years and, under section 310(7) of the IA 1986, an IPO can apply to any:

"[...] payment in the nature of income which is from time to time made to him [the bankrupt] or to which he from time to time becomes entitled".

However, the court will only make an IPO if it is satisfied that the bankrupt would be left with sufficient income to meet the reasonable domestic needs of his/her family. Once an IPO is made, it can be varied by the court if the bankrupt's circumstances change and they have an increase or decrease in income.<sup>9</sup>

An alternative to an IPO is an Income Payments Agreement (IPA). This is a written agreement between the bankrupt and his/her trustee in bankruptcy. Under an IPA, the bankrupt agrees to pay a specified amount of their income to the trustee for a specified period of time. An IPO or IPA normally lasts for 3 years from the date the order. This means that an IPO or IPA may continue long after the bankrupt has been discharged from bankruptcy.

As already mentioned, provisions of the WRPA 1999 does not affect the trustee in bankruptcy's ability to apply for an IPO or IPA in respect of a bankrupt's income. Even though the trustee in bankruptcy cannot claim the bankrupt's approved pension (or any part of it), if the bankrupt receives payments from a pension before their discharge, then the payments can be included in any calculation for an IPO or IPA.

For an approved pension under the WRPA 1999, this means that any pension already drawn by a bankrupt and thus forming part of 'income' for the purposes of section 310 of the IA 1986 (or excessive annuity payments) could be validly pursued by a trustee in bankruptcy.

Interestingly, the Court of Appeal's decision in [Horton v Henry](#)<sup>10</sup> has clarified two conflicting lines of case law, holding that an IPO (sought by a trustee in bankruptcy over a bankrupt's income) cannot extend to an as yet unexercised right to draw a pension. Even where a bankrupt can demand immediate payment of an uncrystallised pension, a trustee in bankruptcy cannot compel them to do so.

The background to the relevant caselaw is outlined below.

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<sup>9</sup> An alternative to an IPO is an Income Payments Agreement (IPA). This is a written agreement between the bankrupt and his/her trustee in bankruptcy. Under an IPA, the bankrupt agrees to pay a specified amount of their income to the trustee for a specified period of time. An IPO or IPA normally lasts for 3 years from the date the order. This means that an IPO may continue long after the bankrupt has been discharged from bankruptcy.

<sup>10</sup> [\[2016\] EWCA Civ. 989](#)

## 4.1 Background to the case law

### Case of *Raithatha v Williamson*

#### Box 5: Outline of High Court case of *Raithatha v Williamson*

A trustee in bankruptcy sought an IPO with respect to a bankrupt (aged 59) who had a pension fund valued at £990,000, although eligible to draw down this pension (being above the minimum age of 55) the bankrupt had chosen not to do so.

It was accepted by both parties that, without taking the pension into account, the debtor's income did not exceed his reasonable domestic needs so that the court could not make an IPO.

In the 2012 High Court case of *Raithatha v Williamson*<sup>11</sup>, on a preliminary issue as to whether an IPO could be made at all in such circumstances, Mr Bernard Livesey QC, sitting as a Deputy Judge of the Chancery Division, held that the court could make an order pursuant to section 310 of IA 1986 effectively compelling the bankrupt to draw down his pension, so that a surplus income was thereby created on which an IPO could bite.

Moreover, the judge accepted that the debtor could be compelled to exercise his rights under his pension scheme, in accordance with the wishes of the trustee. In effect, the trustee could apply for an IPO against the bankrupt's pension benefits – both the annuity income and the lump sum.<sup>12</sup>

Crucially, the Court held that there could be no logical reason why legislation should distinguish between a bankrupt who had drawn pension benefits and was therefore susceptible to an IPO and one who was entitled to draw benefits but had chosen not to do so. The case was initially appealed but the parties settled before it came to court, leaving the law in this area unclear.

### Case of *Blight v Brewster*

The 2012 case of *Blight v Brewster*<sup>13</sup> was not a bankruptcy case. However, it does demonstrate a mechanism by which the court, in matrimonial proceedings, could order that the defendant be forced to draw down the lump sum from a pension to meet payments due under a matrimonial order. Prior to the Court of Appeal judgment in *Horton v Henry*, this case was thought by some to support the enforceability of the decision in *Raithatha v Williamson* by determining that, whilst a bankrupt could not be forced to elect to take their pension entitlement, a court could enable someone else to make the required election on his behalf.

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<sup>11</sup> *Raithatha v Williamson* [2012] EWCH 909 (Ch)

<sup>12</sup> However, it wasn't made clear whether this decision could be extended to cover occupational schemes where the decision to take benefits is not made by the member, but at the discretion of the scheme trustees / sponsoring employer

<sup>13</sup> *Blight v Brewster* [2012] EWHC 165 (Ch)

## Case of Horton v Henry

Shortly before Christmas 2014, the High Court handed down its judgment in the case of *Horton v Henry*.<sup>14</sup> On an application by the trustee in bankruptcy, the Court was asked to consider two issues:

- whether the court had power under s.310 of the IA 1986 to make an IPO in respect of a pension which is not in payment; and
- if there is such a power, what amount, if any, should be retained by the bankrupt rather than paid to the trustee

Whilst Mr Robert Englehart QC, sitting as a Deputy of the Chancery Division, found that the earlier judgment in *Raithatha v Williamson* could not be distinguished on its facts from the present case, he felt unable to follow that decision. The judge held that, sums that would be due in future under an uncrystallised pension policy (notwithstanding that the debtor was “entitled” to call the pension down), were not sums which the bankrupt was entitled (within the meaning of section 310(7) of the IA 1986). Further, there was no power available to the court to force the bankrupt to make the various elections he would have to make to crystallise entitlement to sums under the pension policies. He was also of the view that giving a trustee in bankruptcy the ability to determine how the contractual rights under a SIPP or personal pension should be exercised would conflict with the intention behind the WIPA 1999, which excludes a bankrupt’s rights under a pension scheme from his / her estate in bankruptcy. Given that there are now two conflicting High Court judgments on this issue, Mr Robert Englehart QC gave the trustee in bankruptcy permission to appeal.

The trustee lost this appeal. In giving judgment on 7 October 2016, the Court of Appeal upheld the High Court’s decision holding that, for the purposes of the insolvency legislation, a bankrupt’s income does not include uncrystallised pension benefits: a trustee in bankruptcy cannot compel a bankrupt to draw a pension (even where he is over the age of 55 and could demand immediate payment):

“The contractual right to elect, by service of a notice on the pension provider, to receive a lump sum or income payment, in the pension context is very different in character from any actual payment or to the right to receive that actual payment, once the relevant election has been made ...payment does not mean a chose in action or a bundle of rights which, if and when exercised, and only when, give rise to the making of payment or the entitlement to a payment.”

It is now settled law that neither the Court nor the trustee has the power to compel the bankrupt to draw down or otherwise take his or her pension rights.

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<sup>14</sup> *Horton v Henry* [2014] EWHC 4209 (Ch), [2014] All ER (D) 193 (Dec)

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