EVERSHEDS SUTHERLAND

Looking beyond furlough

Pensions considerations on redundancy

As the government's furlough scheme begins to wind down, many employers will face the harsh economic reality of fighting to keeping their businesses afloat in the worst economic crisis since the 1930s. In many cases, redundancies will be the only option. The pension costs associated with redundancies can be significant and should be factored into strategy and budgets at the outset of any contemplated redundancy programme.

Enhancements under the pension plan

Many defined benefit pension plans offer immediate enhanced pension rights on redundancy (provided the member is over 55, sometimes 50). Often, these pensions are paid unreduced despite being paid early. Sometimes, the members' pensionable service is increased by either a fixed amount (i.e. five or ten years) or prospectively, to take into account the pensionable service the member would have achieved if they had remained in employment up to normal retirement date.

This can be extremely expensive. Employers should seek legal advice on whether such enhanced rights could be triggered by redundancies and obtain actuarial input to determine the consequent funding strain. Trustees are likely to require a cash injection into the plan to pay for such enhancements, particularly for immediate pensions.

Furthermore, any redundancy exercise will naturally raise concerns for trustees regarding the strength of covenant that will be offered to the pension plan in the short and medium term. Trustees may need to consider whether recovery plans and any security or guarantees need revisiting. Where the pension plan is still open to accrual, the company will also need to ensure that the redundancy arrangements won't inadvertently trigger a section 75 debt on the employer.

Action: at the outset of any redundancy exercise, a company sponsoring a defined benefit arrangement should seek legal advice on the potential effects of a proposed redundancy exercise on any enhancements under their pension plan. The company should look to involve trustees early in the process.

Pensions promises under TUPE

Companies should also consider whether any of the employees at risk of redundancy may have enhanced pensions redundancy rights arising from historic transfers. Generally, rights under an occupational pension plan do not pass on a business transfer under the Transfer of Undertakings (Protection of Employment) Regulations (commonly known as TUPE).

However, two ECJ cases (known respectively as Beckmann and Martin) confirmed that the TUPE exemption does not apply to pension rights payable on early retirement, such as pensions paid on redundancy. These obligations can result from business acquisitions or from contracting with the public sector on outsourcing agreements.

Occasionally, employment contracts may also contain additional enhanced pension rights on redundancy.

Action: Consider whether any of the employees at risk of redundancy could have additional pensions rights, either contractually or under TUPE.

Discrimination issues

Excluding employees from a redundancy exercise simply because enhancements under the pension plan would be too costly could be a high-risk strategy leading to complaints of discrimination, particularly on the grounds of age. However, certain factors closely connected to pensions, such as length of service, may be legitimately taken into account in redundancy decisions if correctly justified.

Action: Seek legal advice early to ensure any pensions considerations are appropriately and fairly factored into the redundancy process.

Next steps

Redundancies may very well become part of the "new normal" in the post COVID-19 world. It is critical that companies consider the complex and potentially costly pensions aspects of redundancy exercises at the outset of any such programme. Trustees will also need to understand the effect of any such redundancy exercises on their plan and the wider employer covenant afforded to the plan in the longer term.

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