Horton v Henry - the wider implications

Kate Atkinson and Patrick Harte discuss the impact of the *Horton v Henry* case, which decided that a person's pension fund is secure in the event of bankruptcy

The Court of Appeal decided in the case of *Horton v Henry* that an income payments order cannot be applied to an unexercised right to draw a pension, putting to rest the question of whether trustees in bankruptcy can compel a bankrupt to draw their pension to gain access to additional cash. This means that the pension pots of those in financial difficulty will continue to be protected.

Sixty-one year old Mr Henry was adjudged bankrupt in December 2012 and Mr Horton was appointed as the trustee in bankruptcy three months later. According to the official receiver's schedule of creditors, Mr Henry had creditor claims in excess of £6.5 million. At the time of bankruptcy, Mr Henry had a Self-Invested Pension Policy (SIPP) worth £848,022.76 and three personal pension policies that each provided for a guaranteed annuity income of £2,450, when Mr Henry reached age 70. Prior to his discharge from bankruptcy, Mr Henry was entitled (but had not elected) to draw lump-sum proportions of cash from all of these arrangements. The Court of Appeal decided that none of these undrawn pension funds could be accessed by the trustee in bankruptcy, for example by requiring Mr Henry to elect for drawdown.

At first sight it might seem unfair that an individual with significant pension savings could have those assets safeguarded despite having substantial unpaid debts. However, in coming to this decision the court had to balance the needs of creditors, the state and enterprising individuals (specifically entrepreneurs, and the self-employed).

Encouraging pension savings among entrepreneurs

We have to understand the incentives that influence the behaviour of entrepreneurs. The best-case scenario for an entrepreneur is their business succeeds and they make significant gains in the future. This often means that all free cash is invested in the business rather than used to save for retirement. The worst-case scenario for an entrepreneur is that their business could fail (indeed, the commercial insurer RSA estimates that almost six in 10 start-up businesses will not survive beyond five years). When this happens, there is a risk that any pension savings that have been made by the entrepreneur could end up in the hands of creditors, again reducing the incentive to save for retirement.

Taken together then, the best and worst case scenarios for enterprising individuals (who, we should not forget, often fall outside auto-enrolment requirements) both act as a deterrent to accumulate pension savings.

Creditors' rights

Some might argue that the rights of creditors are not sufficiently protected following the Court of Appeal's judgment. There are, however, protections already in place under legislation. Under the Insolvency Act 1986, 'excessive pension contributions' can be clawed back from a bankrupt where those contributions have unfairly prejudiced a creditor.

Furthermore, over the last decade, the government has gradually eroded the amount an individual can save in a tax-free pension wrapper. In 2006, the lifetime allowance was £1.5 million, but 10 years later this allowance has fallen to £1 million. This means that where no special protections are in place, such as Fixed Protection, the extent to which an individual's retirement savings can be protected from creditors is significantly reduced from the position in 2006.

An arbitrary distinction?

If Mr Horton had accessed his pensions, the money would immediately be available to his creditors but because he hadn't, this money was protected. Because of this, it has been suggested that the court's ruling draws an unfair, arbitrary distinction between assets in a pension that have been accessed and those that have not. This distinction is, however, fundamental because it's a distinction between pension rights and pension payments. Any blurring of this distinction undermines the fact that exercise of a pension right is a choice, which only the policy holder or member can make. This issue hasn't been overlooked by legislation, with the Welfare and Pensions Reform Act 1986 expressly not including "rights…under an approved pension arrangement" from a bankrupt's estate.

Overall, while it is difficult to get the right balance between the rights and needs of the state, creditors, and individuals, the ruling in *Horton v Henry* goes some way to doing this, and in a way that also provides a measure of protection for entrepreneurs whose entire financial security is often inextricably linked to the success of their business. That is surely a good thing.

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