Response by the Association of Consulting Actuaries (ACA) to the consultation on the Phasing out of the Default Retirement

ACA General Comments: Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes. The ACA is the representative body of UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

The consultation document concentrates on the employment and workplace management aspects of the changes. These are not our area of expertise. However, removing the default retirement age will have consequences for the pension aspects of employees' remuneration and, potentially, on what is expected of pension schemes. It is in this regard that we are providing a response.

The fundamental difficulty is in trying to integrate pension provision, which is inherently age discriminatory, into pay and conditions that are meant to ignore age. When the Age Discrimination regulations (SI 1031, 2006) came into effect in 2006, the DWP published guidance to try and explain how this integration could work: we suggest the guidance is updated to allow for experience since that date and the additional issues raised by the removal of the default retirement age.

A1. The Government intends to remove the Default Retirement Age. Do you agree that Schedule 6 of the Age Regulations (which deals with notifications of retirement and the 'right to request' to work past retirement age) should also be removed?

Yes [ ] No [ ]

No comment.

A2. If you disagree, please explain why:

Although we have no comment to make on removing the requirement to have to request to work past retirement, we observe that it serves the useful purpose of making employers and employees consider the effect of continued employment on their pension arrangements and the design of their remuneration package post the default retirement age. Because pension schemes are likely to continue to maintain normal pension ages, it will be important for employers, scheme trustees or managers, and employees to be clear about how continued employment could affect their rights and responsibilites. Some of our concerns are covered under question C3 below.

Removal of the requirement to consult could create difficulties for employers. Disclosure regulations (SI 1655, 1996) require trustees to communicate with scheme members in the run up to their NPA, but employers may feel that they cannot have conversations with employees about their intentions to retire for fear of being discriminatory. To avoid the anomaly of trustees knowing when an employee is intending to retire, but the employer not knowing there is a good argument for retaining some sort of information requirement, although there is no need to retain the one set out in Schedule 6.

The removal of the consultation process could also make it more problematic to provide risk benefits, particularly when these are arranged via the pension scheme. This is covered under question E1.

B1. If Schedule 6 is removed, the laws on unfair dismissal and age discrimination will still apply. Do you have any concerns about how these laws would operate in the absence of Schedule 6?

Yes [ ]   No [ ]

B2. If you have concerns, please describe them:

C1. Thinking about retirement discussions between an employer and an employee, do you think it would be useful to have:

[ ] Formal guidance on how to discuss retirement in a mutually beneficial way

[ ] A statutory code of practice, including guidance, which covers retirement discussions

[ ] None of the above

[ ] Something else (please state below)

C2. Please explain your answer:

C3. If you believe that additional guidance or a code of practice would be helpful, what topics do you think should be addressed? For example flexible retirement options, changes to duties and working hours, etc.

It might be helpful if guidance was issued explaining how employers should treat pension provision if there is no default retirement age. Although employers will already have made decisions about this, there seems to be no consensus about where the line is drawn between what is permissible, and what might be viewed as discriminatory.

Employers establish and/or contribute to pension arrangements for their employees for many reasons, but one of the most fundamental is that the income provided by the arrangement substitutes for pay foregone on retirement from employment. Currently, most pension arrangements have a normal pension age (the age at which members are entitled to draw their accrued pension without requiring permission from their employer or the scheme trustees, or incurring a reduction for early payment) of 65.

The consultation requirement for employees who wanted to continue in work after the default retirement age enabled them to consider with their employers how any existing and potential future pension entitlements could be allowed for. If the consultation period is removed, then those involved in the provision of pension benefits need to be provided with an acceptable way of addressing the anomaly of someone still in employment being entitled to a pension in respect of the same employment. The guidance should provide a solution that avoids the need for employers and scheme trustees or managers to negotiate solutions with individual employees, although they should still be able to if they so choose.

For example, some schemes include an explicit rule that pension is only paid once a member has left employment. In fact, until the Finance Act 2004, to retain their tax favoured status, occupational pension schemes were not permitted to pay pensions to members still employed by the sponsoring employer. Scheme rules had to include a provision that they would not make any payments that contravened their tax favoured status so, implicitly, all schemes restricted payment of pension to those who had left employment. The guidance could clarify that it continues to be considered legitimate for employers and trustees to infer that this provision is included in all scheme rules.

The guidance should also address how employers should approach the pension aspects of employees' remuneration when they continue in work after their pension scheme's NPA. If the scheme is a defined contribution arrangement, we expect the appropriate contribution would continue to be paid, assuming employees choose to remain as members. It is less simple in defined benefit arrangements:

- If the defined benefit scheme has been closed to new entrants and the employer provides a defined contribution arrangement instead, guidance should make clear that it is sufficient for accrual in the defined benefit scheme to stop at NPA and for the employer to offer membership of the defined contribution scheme to those who choose to work after the DB scheme's NPA. (Although see point below about small DC funds.)
- If the defined benefit scheme is open to new entrants, then it seems reasonable for employees to continue to have access to DB accrual. The guidance should make clear that, if employers permit continued accrual, then this will substitute for late retirement enhancements (that is, there is no need for a 'better of' test).

The position of those who want to continue in work part time needs to be addressed separately. In that case it might seem appropriate for pension arrangements to consider paying partial pensions, to reflect the time no longer spent in paid remuneration. We agree this would be desirable, but it is not simple for pension arrangements to achieve this. For example:

- Administratively there are no particular difficulties for defined contribution arrangements to permit part of the accrued savings to be used to purchase an annuity, or for drawdown. However, in practice, the outcome could be that members are left having to manage residual funds that are too small to annuitise effectively. This can only be addressed if legislation restricting trivial commutation is amended.

- The problem is more difficult in defined benefit arrangements, where membership record keeping is more complex due to the nature of the accrual. In particular, often the rate of benefit accrual differs over time (for example, the NPA or the pension increase due might differ). So it is difficult to be clear what would be meant by paying (for example) half an accrued pension to a member who decided to reduce their working hours to 50% of the full time rate.

  If employees are permitted to move to 'full' retirement in steps (that is, gradually reducing the hours they work), then this would complicate the position further.

Because of the potential difficulties described, guidance needs to ensure that phased retirement can be achieved without imposing unwanted cost on employers. In particular, it should not require employers to arrange for schemes to pay partial pensions, unless they choose to do so. If employers choose to provide partial pensions, then there should be no legislative constraints, so they can adopt the most simple route through. Any guidance felt necessary should facilitate this. For example, where employers agree to provide partial pensions, they should be able to limit this flexibility so that no more than one partial pension is payable, and guidance should permit trustees to use existing mechanisms, such as pension credit legislation, to arrangement for payment.

D1. Do the proposed transitional arrangements strike the right balance between the policy aim of quickly phasing out the Default Retirement Age (and realising the benefits of doing so) and respecting the position of employers who have already made plans on its use?

Yes [ ] No [ ]

D2. If no, please explain your answer:

E1. Responses to an earlier call for evidence on the Default Retirement Age raised possible impacts on insured benefits and Employee Share Schemes if the DRA is removed. If relevant, please describe any concerns you have below:

Employers who provide occupational pension schemes for their employees sometimes provide contingent benefits via the scheme, rather than directly to employees. Sometimes these will be financed via an insurance policy, generally in the name of the scheme trustees, but in other cases the benefit will be directly funded by the scheme. In both cases, there is no exemption for a cut off age.

Death benefits

When a member dies, most pension schemes provide benefits to the member's dependants, but the benefit will differ depending on whether death occurs before and after the scheme's normal pension age. If members remain in employment after reaching the scheme's NPA, particularly if he or she has started to draw pension, then it might be more difficult to determine the appropriate death benefit. For example, on death before NPA, members' dependants typically receive a lump sum calculated as a multiple of salary; on death after NPA the lump sum would depend on the pension paid. It would be inappropriate to pay both lump sums.

Ill health benefits

If not provided directly by a pension scheme, ill health benefits are often integrated with them. For example, commonly, if someone leaves work due to ill health prior to a scheme's NPA, an insured income will be paid until NPA, when the shceme pension will commence. If someone works after NPA, but then becomes unable to work due to ill health, it would be reasonable to pay the scheme pension immediately, rather than rely on insurance.

E2. Is any action, such as additional guidance, needed to address either of these issues?

[ ] Yes – insured benefits

[ ] Yes – share schemes

[ ] Yes – both

[ ] No

Response from:

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