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The abolition of the default retirement age and the implications for pensions

In brief

- With effect from 6 April 2011, employers can no longer rely on a default retirement age of 65.
- Pension schemes will continue to be able to use a normal pension age for the calculation of benefits.
- The removal of the default retirement age is likely to lead to more late retirements, and may also lead to more interest in flexible retirement options.

Next steps

- Trustees and employers should consider reviewing their current late retirement strategy and decide what benefits to offer for both existing and new pension accrual.
- Trustees providing risk benefits through an occupational pension scheme should also consider taking legal advice on whether they can rely on the exemption for risk benefits contained in recent regulations.
- Trustees should review wording in retirement letters and other member communications to ensure they are clear and correctly reflect the options available to members.

With effect from 6 April 2011, employers can no longer rely on the default retirement age (DRA) of 65. This briefing note focuses on what the abolition of the DRA means for the provision of pensions for older employees.

Background: employment without the DRA

The DRA has been removed with effect from 6 April 2011, except in the case of employees who received a notification of the employer's intention to dismiss them before 6 April 2011 and who will have reached age 65 before 1 October 2011. If employers wish to continue to retire their employees at age 65, they will need to set their own compulsory retirement age and provide an objective justification for doing so. This would involve the employer showing that requiring individuals to retire at this age is a 'proportionate means of achieving a legitimate aim'. So far, we understand that few employers have indicated that they are likely to set their own compulsory retirement age.

Working without a DRA will present employers with a range of challenges across a number of employment areas, including recruitment, performance management and sickness absence. However, this briefing note focuses only on the pensions implications.

Age exemptions for pension schemes

The Department for Business, Innovation and Skills (BIS) has indicated its view that 'the removal of the DRA does not affect occupational pension schemes'. In one sense, this is true, but employers with occupational schemes would be unwise to take this statement at face value as action may be required.

What is true is that the removal of the DRA does not prevent pension schemes operating with a normal pension age (NPA). Under the Equality Act (Age Exceptions for Pension Schemes) Order 2010, occupational pension schemes are permitted to have a NPA by reference to which benefits are calculated. Early retirement reduction factors and late retirement increase factors can be applied to pension benefits where an employee retires before or after the NPA.

Schemes are also able, under current legislation, to operate a maximum age for admission to a pension scheme, to use age criteria in actuarial calculations and to operate age-related money purchase contributions (amongst other exemptions). The removal of the default retirement age does not change any of these exemptions for occupational pension schemes.

What the removal of the DRA will change, however, is that many more employees may now consider working beyond the scheme's NPA. To date, many employers and trustees may have given little or no thought to their pension arrangements for workers over age 65; with more employees likely to be affected, now is the time to consider reviewing late retirement arrangements.

Defined benefit schemes

Employers with defined benefit (DB) schemes will need to consider how they will treat pensions that have already accrued where the member continues working after NPA and also what additional benefits the member will be able to accrue after NPA. A general discussion of possible options is set out below; however, legal and/or actuarial advice should be sought as appropriate for an individual scheme.

The options for benefits that have already accrued include:

- Providing late retirement increases on benefits; or
- Continuing to link the member's benefits to their final pensionable salary on their eventual retirement.

Many schemes currently operate generous late retirement factors, which could mean that late retirement increases may be more advantageous to the member than a link to final pensionable salary, especially if the member does not see much salary growth post NPA.

Trustees and sponsoring employers may wish to review their late retirement factors and ensure that they do not increase the expected cost of benefits if more employees choose to work after NPA. Whilst reviewing late retirement factors, schemes may also want to consider whether to make them unisex in the light of the recent *Test-Achats* case.

In terms of accrual after NPA, the likely options are:

- Allowing continued accrual in the DB scheme;
- Paying the contributions that would have been paid into the DB scheme on behalf of the member into a defined contribution (DC) scheme;
- Allowing the member access to a less generous DC scheme;
- Making no provision for the employee to have access to a pension scheme.

The last of these would almost certainly be age discriminatory and unlikely to be easy to justify objectively. Also, under the new employer duties regime, employees under age 75 with earnings above a certain level will be able to require their employer to give them access to a pension scheme with a minimum employer contribution.

Allowing continued accrual in the DB scheme would probably be the safest option whereas offering a DC scheme instead would be likely to require objective justification that it is a proportionate means of achieving a legitimate aim.

Another option might be to offer members the better of continued accrual in the DB scheme and late retirement increases on their accrued pension. However, deciding which option is more valuable may be complicated if the member has to pay contributions in

order to receive continued accrual (but not if they receive late retirement increases). In certain circumstances, there may also be tax considerations arising from continued accrual that would not arise if the option of late retirement increases is taken.

For some schemes, the removal of the DRA may reopen the question of flexible retirement: should members be permitted to draw some or all of their benefits while continuing to work? If so, should members in receipt of pension be able to accrue new benefits, and what form should those benefits take?

Defined contribution schemes

Where employers offer a DC scheme, allowing for the likelihood of employees working beyond NPA should be more straightforward. However, particular issues may arise with lifestyling options – members may not want all their funds to be invested in low risk, low return assets at age 65 if they are not planning to retire for some time. This highlights the importance of good communication with members so that any lifestyling arrangements can be adjusted to take account of the member's retirement plans.

Member communications

Even if there is no change required to the scheme rules or administration processes, trustees should review the wording used in retirement letters and other member communications to ensure it is clear and correctly reflects the options available to members. In particular, there is potential for confusion over retirement from the scheme and retirement from employment which may not necessarily coincide for employees who continue to work after NPA.

Risk benefits

Under regulations made in April 2011, employers who provide insurance to their employees are able to withdraw this with effect from age 65 (or the state pension age, if later). However, the exemption is couched in terms of insurance arrangements provided by an employer and it is not clear whether this would also apply where arrangements are provided by trustees through an occupational pension scheme. Trustees providing risk benefits through their pension scheme should consider taking legal advice on the extent to which they can rely on this exemption.

Where can I get further information?

For specific advice, please get in touch with Jane Beverley on 020 7839 8600 or by email to jane.beverley@puntersouthall.com. Alternatively, speak to your usual Punter Southall contact.

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