

Flexible Retirement and Pension Provision

Response to Consultation

The comments set out below form Sacker & Partners LLP's formal response ("Response") to the consultation paper "Flexible Retirement and Pension Provision" issued by the Department for Work and Pensions (DWP) in October 2007. This consultation paper asks for views of trustees, employers and pensions professionals on the impact of the Employment Equality (Age) Regulations 2006 ("Age Regulations") in the context of flexible retirement and pensions. Sackers is a firm of solicitors specialising in pensions law.

Given the complicated nature of this area, we note that there may be a number of other points to be made on flexible retirement. The fact that we have restricted ourselves to making the points below does not mean that we believe other issues are either not of concern or indeed less important than those in this Response.

1. Flexible Retirement - General Comments

- We note that the stated policy intention of the Government is to encourage flexible retirement (by which is meant an ability to draw down pension whilst continuing to work) with the aim of getting older workers to remain in the employment market.
- We have found that although a number of employers have discussed flexible retirement, in our experience very few, and only generally larger companies, have implemented a flexible retirement policy as yet.
- There are several key reasons why employers have shied away from allowing flexible retirement :
 - paternalistic employers are concerned that it is not realistic for members of occupational pension schemes to be taking pension rather than continuing to save for pensions during their working lives
 - risk-averse employers are concerned that allowing flexible retirement may open them up to discrimination claim
 - a flexible retirement policy can be expensive to implement and complicated to communicate
 - many employers are hanging back from making immediate changes to see if an industry standard emerges or are waiting for further guidance from Government or a test case as to the effect of the Age Regulations in this context.
- Finally, we note some commentators have highlighted that an area of doubt remains as to whether it is permitted to offer a pension to someone whilst they remain in service. In order to be an "occupational pension scheme" under section 255 of the Pensions Act 2004 a scheme's activities must be limited to "retirement-benefit activities". For this purpose, the definition of "retirement benefits" means "benefits paid by reference to reaching or expecting to reach retirement". On a narrow interpretation this phrase could exclude a pension paid to someone who remains in work for the same business. We do not believe this wording should be problematic for flexible retirement, but we should be grateful for confirmation in

your response or in the proposed guidance that pensions paid while people continue to work for the same business are permissible.

2. Offering Flexible Retirement

- As with all other areas of pension scheme benefit design, for there to be age discrimination, a person of one age must suffer a detriment as a result of being treated differently from a person of another age. Even where such a detriment exists, for there to be unlawful age discrimination, there must be no exemption in the Age Regulations, and no objective justification.
- As the law stands at the moment, we believe it is likely that if employers do offer flexible retirement, they need to do so from age 50¹ when the current tax laws allow people to take their pensions. Setting an alternative (higher) age could be difficult for an individual employer to objectively justify in normal circumstances.
- However, it would be helpful to understand if it is the intention under the Age Regulations for the definition of “early retirement pivot age” to at least allow schemes to set an age below which a consent requirement could be operated for flexible retirement, as it seems to us this is a possible reading of the definition.
- In addition, it may be possible to interpret regulation 12 of the Age Regulations as allowing schemes to set an age below early retirement pivot age (but above 50) when flexible retirement becomes available.
- We do not believe that it should be unlawfully discriminatory for an employer not to offer flexible retirement at all. We do not accept that someone necessarily suffers a detriment by not being able to take a pension until they retire (given the accepted meaning of a pension is a series of payments made to someone when they have stopped working).
- In addition, the European Framework Directive on Equal Treatment (Council Directive 2000/78/EC – the “Directive”) permits the UK legislation (under Article 6(2)) to allow employers to set ages at which workers become entitled to retirement benefits under pension schemes. We do not believe the definition of early retirement pivot age currently allows schemes to say no pension (or other benefit) can become payable at all before a particular age. However, we believe Article 6(2) of the Directive could be used in the UK to add a further exemption in the Age Regulations to permit schemes to set an age at which people become entitled to take certain benefits – e.g. flexible retirement.

3. Setting an age for allowing flexible retirement

- We note that the consultation paper indicates the DWP is not inclined to legislate to allow schemes to set an age for flexible retirement (allowing employees to be able to take pension while they carry on working).
- However, in addition to the point made above regarding what the Directive allows, we believe it would be possible for the Government to objectively justify legislating at the national level to give employers' the ability to determine when and if they offer flexible retirement, so avoiding the difficulties and costs for

¹ Increasing to age 55 in 2010

individual employers who may otherwise have to objectively justify setting an age for flexible retirement higher than 50.

- This is because if private pension provision is inadequate, dependency on the State will increase. Indeed, recent longevity surveys² have highlighted the fact that we are living longer even than predicted. This means that as well as working longer, pensions will need to be provided for a longer period.
- We note that the consultation paper (e.g. paragraph 16) indicates that this is a current concern of Government and a primary aim of flexible retirement is to encourage working beyond Normal Pension Age (NPA), not to enable pensions to be paid from age 50 as a supplement to earnings.
- In addition, it seems far more likely that even paternalistic employers will embrace flexible retirement options sooner if they can limit these options to a period when employees are winding down to retirement, rather than having to offer this to employees in their 50s.

4. Flexible Retirement - Options

- There is no clear consensus about what options members should be given when they request payment of a pension whilst they continue to work (referred to below as an “in-service” pension).
- When the in-service pension comes into payment there are three main options:
 - to stop accrual at the date the in-service pension comes into payment;
 - to offer continued accrual to Normal Pension Age (NRA); or
 - to offer continued accrual to the date of retirement.
- Ceasing accrual altogether - could a decision not to offer continued accrual be discriminatory? Provided members are offered a genuine option, we do not believe this is discriminatory. If members choose to take up the offer of flexible retirement they do so in the knowledge that after taking an in-service pension, continued accrual will cease. In short, they opt-out of pensionable service. The death benefits provided would be as for a pensioner.
- Ceasing accrual at NRA - if members are only offered continued accrual until NRA, it may be possible to rely on the exemption in the Regulations for a “late retirement pivot age” to cease accrual at NRA and offer a late retirement uplift. The death benefits to be offered would be those to be provided as for a pensioner.
- Ceasing accrual at actual retirement – we do not believe this could be discriminatory.
- A number of our clients have considered whether to offer continued accrual in an alternative plan, for example in a defined contribution scheme (where main scheme benefits are provided on a defined benefit basis). We do not believe this is discriminatory where the member has made the choice to take an in-service

² Published by the Office of National Statistics

pension, and could alternatively have simply continued accrual on their “old” basis.

5. Early Leavers legislation

- The Pension Schemes Act 1993 (PSA 1993) makes it a requirement for occupational pension schemes to provide a member with a Short Service Benefit (SSB) on leaving pensionable service. By contrast Long Service Benefit (LSB) is entitlement to the benefits he would have been entitled to when “he attains normal pension age”.³
- Because the PSA 1993 was conceived before the Finance Act 2004 made it permissible to take a pension whilst remaining in service, the PSA 1993 provisions are now out of step and difficult to interpret. It is unclear whether any “in-service” pension should be treated as an SSB or LSB or perhaps a third type of benefit. The analysis of what type of benefit an in-service pension should be treated as is relevant to establish what preservation rights attach to that benefit. Particular difficulties relate to the revaluation of pensions in deferment, anti-franking and the right to a transfer.
- We believe it would be helpful to amend the Early Leavers legislation to make provision for the payment of an in-service pension as part of a flexible retirement policy.

6. Communication of options

- We believe that the difficulty of communicating a flexible retirement policy effectively may be putting employer off offering such an option.
- It is well recognised that pensions are a hard to communicate to employees. But a flexible retirement policy is particularly difficult to communicate. This is because of the number of options which may be available to each member and because (although overtly appealing) it may be an inappropriate choice for some members.

7. Cost

- Because of the complicated nature of flexible retirement, employers are likely to have to take detailed advice on the implementation of any policy and changes will need to be made to scheme rules. In addition, administration and computer systems will need changing and extra communications will be needed.
- Therefore, the implementation of flexible working policy can add considerably to the cost of providing benefits at a time when pension schemes are already under pressure because of recent legislative and regulatory changes.
- Some employers have dealt with increased costs by imposing limitations on the flexible retirement options, for example, by:
 - allowing members to request only one flexible working projection in a 12 month period; and

³ PSA 1993, section 71(1)

- limiting the number of drawdown options, for example, only allowing a member to take one tranche of pension while continuing to work.

8. Miscellaneous

- Because of the confusion surrounding flexible retirement, many employers have deferred making a decision until there is more guidance on this issue and an industry standard has emerged.
- Anecdotally we note that take up of flexible retirement options is low. This may be because policies are in their infancy and those coming up to retirement have already planned their finances.
- We note that in defined contribution (DC) schemes it is easier to create different options for members on flexible retirement. However, we believe that the comments made above under section 3 regarding the appropriateness of taking pension whilst remaining in employment have even more force in relation to DC benefits. This is because in general DC pots are smaller than pensions payable from defined benefits schemes.

Please contact Faith Dickson (faith.dickson@sackers.com) or Zoe Lynch (zoe.lynch@sackers.com) of this office (switchboard number 020 7329 6699) if you have any questions on this response.

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