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One For All

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The lengthy and complex exemptions in upcoming age discrimination legislation concerning private sector pension schemes leave employers with plenty to consider.

The belief that pensions are excluded from new age discrimination legislation is a fallacy. From 1 October, 2006 — 'Age Day' — the Employment Equality (Age) Regulations 2006 will prohibit discrimination against employees and pension scheme members on the grounds of their age.

The implications for pension schemes are a far cry from the Government's initial assurances that pensions would be "entirely excluded from the scope of age discrimination legislation". Although there are certain specific exceptions for (mainly) occupational pension schemes, there is no blanket exemption. Reviewing scheme rules and practices to assess areas of possible exposure is crucial.

With effect from Age Day, it will be unlawful for employers to discriminate on the grounds of age in relation to pensions (and, indeed, across other aspects of the workplace). It will also be unlawful for trustees (or managers) of an occupational pension scheme to discriminate on the grounds of age against members or prospective members of their scheme.

Direct and indirect discrimination will both be outlawed. Direct discrimination arises where A is treated less favourably than B, simply on the grounds of age. An example might be paying higher contributions to a defined contribution scheme for those over the age of 40 than for those below. Indirect discrimination arises where a provision or practice applies equally to people of all ages, but its effect is that A is treated less favourably when compared to B on the grounds of age. An example might be having a waiting period for scheme admission: this is not age-driven, but may adversely affect younger (mobile) workers when compared to older workers.

The very nature of pension provision is age-related, the basic concept being to provide an employee with income after retirement. But without a carve-out from the general principles of the Regulations, private sector pensions in the UK could not continue in their current form.

The Regulations therefore contain a list of more than 25 exceptions. Key exemptions include:

- setting minimum ages for admission to a scheme or entitlement to benefits;
- allowing employers to pay age-related contributions to a defined contribution or defined benefit scheme (with certain provisos);
- paying benefits early (provided they are actuarially reduced and are not enhanced);
- using age criteria in actuarial calculations;
- the closure of a scheme to new entrants; and
- age-related provisions/practices designed to comply with tax legislation affecting pension schemes.

While many pension schemes have similar features, most will have elements that are scheme-specific, aimed at suiting the needs of the particular business and its employees. Although the list of exceptions is quite long, there is a host of potential issues.

One such area concerns age-related consent requirements. For example, a member can draw benefits at the age of subject to employer consent, but without consent at 65. The Government has intentionally not included an express exception for this type of provision. Unless it can be objectively justified, it will be unlawful for this to continue from Age Day.

Benefit design features that do not fit squarely within one of the exceptions could also be problematic. Providing enhanced pension benefits on redundancy before normal retirement date is common, but the Regulations do not permit the continuation of such a provision for new scheme members joining on or after Age Day.

Benefit provision or contributions stopping at normal retirement date are another potential difficulty. There is no 'maximum age' exception in the Regulations, so ceasing benefit accrual (in defined benefit schemes), stopping the payment of contributions (to defined contribution schemes) and/or failing to provide continued life assurance cover after normal retirement date will all be problematic.

It may be difficult to objectively justify continuing such a (common) practice after Age Day, particularly as cost alone will not satisfy the objective justification test. Many employers may well think twice before continuing to employ staff after the age of 65 (the default retirement date set by the Government), a reaction that would fly in the face of what the Regulations are intended to protect against.

Even if a pensions provision or practice does not fall squarely within one of the exceptions in the Regulations, it may be possible to continue providing it after Age Day without falling foul of the Regulations. To do this, the 'objective justification' test has to be satisfied. The onus is on the employer/trustees (as appropriate) to demonstrate that this test is satisfied.

The Regulations define objective justification as "a proportionate means of achieving a legitimate aim". For an aim to be considered 'legitimate' it must correspond with a real need on the part of the employer/trustees. Economic factors such as business needs and considerations of efficiency may also be legitimate aims, although cost alone is not likely to satisfy the test.

However, guidance from the Department of Trade and Industry in April 2006 states that a discriminatory practice will not be 'proportionate' in the context of objective justification "if an alternative exists that is less discriminatory".

This suggests that the justification threshold is fairly high — on this interpretation, reasonableness does not really feature. That is not consistent with the approach to objective justification tests taken by the European Court in other (comparable) areas.

There is some good news. The new legislation only affects pensionable service on and after 1 October, 2006. So all of those pensions provisions and practices that will from Age Day become unlawful can continue even after that date insofar as they relate to pensionable service before that date.

Quite separately, there are new legal requirements to consult with employees (or affected members) about changes to pension scheme benefits. However, it is likely that Age Day changes can be made without such consultation on the basis that the change is being made to comply with the Regulations. Even so, there is certainly scope for arguing that to maintain good employee relations, consultation with employees should be factored into any action plan.

Although it may be possible to change problem provisions or practices after Age Day, there are risks in doing so that need to be considered. Those risks need to be weighed against the risks of making what are likely in many cases to be fundamental changes to a pension scheme's benefit design in the short space of time between now and Age Day.

The new requirements are to be ignored at your peril. Any pensions provision or practice that does not fall within one of the listed exceptions or cannot be objectively justified will be unlawful from Age Day. There is no great escape for pensions.