

Regulatory Impact Assessment Occupational Pensions

Age Regulations

The Employment Equality (Age) (Amendment 2) Regulations 2006

October 2006

Purpose and intended effect of measure

1. This Regulatory Impact Assessment (RIA) assesses the impact of the revised pension provisions contained in the Equality Employment (Age) Regulations 2006 (otherwise known as the Age Regulations) which were introduced as a requirement of the European Employment Directive 2000/78/EC when they come into force on 1 December 2006. The original regulations were due to come into force on 1 October, but the Government decided to delay implementation in order to provide clarification and further amendments.
2. This RIA reflects changes made to the original regulations as a result of responses to consultation in October 2006 on draft amending regulations. The governments overall plans for transposition of the pension provision elements of the Directive have not changed substantially as a result of the comments received during the consultation, although some refinements and additions have been made as a result of industry concerns arising from the Government requirement that sections of schemes must be closed and cease future accrual at all times.

Objective

3. Occupational pension schemes contain a great many age-based rules necessary for their effective operation and management. In the context of age discrimination legislation the aim is to ensure that employers are not discouraged from maintaining occupational pensions for their employees. The regulations do this by allowing employers and trustees, as far as possible, to maintain existing age-based rules.

Background

4. The European Employment Directive (Council Directive 2000/78/EC) covers occupational pension schemes¹, and allows Member States to exempt certain aspects of occupational pensions from age legislation:
 - The fixing of ages for admission or entitlement to occupational pensions, including the fixing of different ages for employees or groups or categories of employees; and
 - The use of age criteria in actuarial calculations.
5. In addition, the Directive allows for provisions of occupational pensions to remain lawful if they are justified by a legitimate aim, such as a legitimate objective of employment policy.

¹ Personal pensions (i.e., pension plans other than those offered by the employer) are not covered, with the exception of any payments into such pensions by the employer. The Directive does not cover state pensions. The Age Regulations will not affect them.

Rationale for government intervention

6. Employers who wish to maintain occupational pensions are already under many competing pressures and face some difficult decisions in how they run their pension schemes in the future. Since many rules in schemes are necessarily age-based, there is the potential for age legislation to jeopardise the provision of occupational pensions if employers or trustees decide to close or level down schemes rather than face legal challenges, even unsuccessful ones.
7. If regulations did not address this in implementing legislation and provide as far as possible for rules to be exempt or objectively justified, employers might decide to close pension schemes rather than risk future legal challenges. The Government has identified many different age-based rules that are used by schemes, though there could be more that are specific to schemes.
8. It is likely the most defined benefit pension schemes would be affected if we did not implement legislation as they are likely to have one or more rules that would have to change. Latest data shows that there are around 10,000 defined benefit schemes in the UK and they cover around 8.7 million employees, of which around 5 million are in the public sector².
9. It is also possible that a proportion of defined contribution occupational schemes could be affected. These schemes cover around 1 million employees³.

Consultation

10. The Government has taken a progressively consultative approach on how to implement age discrimination legislation in Great Britain since 2001.
11. As well as formal consultations, the Government has had a strategy of continuing engagement with main stakeholders (DTI Minister chairs the Age Advisory Group). Informal views on policy options have, in addition, been sought from pension expertise in industry at every stage. This included an informal consultation between 11 and 20 October. This consultation received 179 responses of which 121 raised the issue of the definition of 'section' and 73 raised the issue of former Inland Revenue limits. In addition a number of drafting suggestions were received.
12. As a result of these consultations, the regulations include further exemptions for employer contributions to personal pension schemes. But, with so many schemes in existence, it is not possible to cover all the different arrangements in the different schemes.

² GAD Occupational Pension Schemes Survey 2005

³ GAD Occupational Pension Schemes Survey 2005

Options

13. The alternatives in implementing the amending regulations are:

- **Option 1 – To do nothing.**

14. Following further discussion with the pensions industry it is clear that the current version of the pension schedule is too limited and does not cover some common practices. These could be covered by a clarification of an exemption or inclusion of minor amendments to an existing exemption. If the schedule were to be implemented on 1st December without further amendments, employers and trustees of occupational schemes would have to objectively justify many of their rules.

15. As outlined in paragraphs 7 and 8, it is likely that many of the UK's occupational pension schemes would be affected if legislation were not implemented. Schemes would be required to change some of their rules. This would lead to one-off administrative costs.

16. As defined benefit schemes have seen their costs increase considerably during the past few years, it is anticipated that schemes would choose changes to their rules which lead to a reduction in costs. This would, in turn, have a detrimental effect on scheme members' benefits and ultimately their pension income. Employees who have based their retirement plans on the assumptions that they would receive a particular pension income, may find that this income is less than they anticipated

- **Option 2 - To provide clarification and further exemptions**

17. Employers having to objectively justify many age-based rules in occupational pension schemes could result in considerable costs (through deciding on whether each age-based rule was objectively justified) and uncertainty for employers, as the only way to test if those rules complied with the age legislation would be through the Employment Tribunal system. Claims could arise many years into the future. There is considerable danger, therefore, that employers would be tempted to withdraw pension benefits rather than go through this process. This would result in the Government not achieving its objective.

18. The Directive's provisions that allow for rules not to count as unlawful age discrimination, or to be objectively justified (and effectively exempted) will, in the context of age discrimination legislation, provide for the maximum certainty in the running of occupational pension schemes. This is because employers will be left to look through and decide if they have any other rules that need consideration. It is only those other rules that employers would have to objectively justify or change. This will keep costs down compared with an alternative of making employers go through the process for all rules (option 1). Therefore we propose this option be taken.

Costs and benefits

Costs and benefits to individuals

19. About 44 per cent of employees are covered by occupational schemes. The average employer contribution is 10 per cent of members' salaries in open DB schemes and 5 per cent in open DC schemes. Clearly any reduction in benefits could result in a substantial loss to employees⁴.
20. This option avoids the need for scheme sponsors to abolish or objectively justify specified types of scheme rules. This, in itself, will reduce administration costs.

Implementation costs to firms

21. Employers will need to go through all their age-based rules and consider whether they are allowable (either because they are exempt from the regulations or because they are objectively justified) or whether they need to consider keeping them and justifying them objectively themselves.
22. Trustees who run occupational pension schemes will need to become aware of the changes and would need to consider their obligations. In August 2003 there were about 230,000 trustees of occupational pension schemes. If each trustee takes one hour in a meeting to consider their obligations, then this would cost about £3.6 million.⁵
23. These are likely to be incurred either shortly after or shortly before the legislation is implemented. However, a significant portion of these costs would have had to have been met by schemes under the original proposals. These regulations change the nature of that examination. These regulations do not, however, impose any information costs on schemes.

Policy costs to employers

24. The overall aim is to ensure that, as far as possible, acceptable rules and practices of occupational pensions remain unchanged. Where change does occur, because employers do not think that they can objectively justify existing rules, it is unclear whether this will result in a cost or benefit to employers.
25. The average cost to employers of a tribunal claim where discrimination is the main jurisdiction is about £4,400⁶. We have assessed the total cost of tribunal claims for all aspects of age discrimination in the original summary RIA which can be found on the DTI website.

⁴ Source: Department for Work and Pensions Employers' Pension Provision Survey (2005).

⁵ The average wages of employees is about £12 per hour (Source: Annual Survey of Hours and Earnings 2004). The total cost for all trustees is therefore £12 x 1.3 (to take into account non-wage costs) x 230,000.

⁶ This is an estimate based on the results of the Survey of Employment Tribunal Applications 2003. This number represents the median cost. The mean cost is estimated to be about £4,900.

Small Firms Impact Test

26. As the primary aim of these regulations is to allow schemes to continue to operate under their existing rules as much as possible, we would expect the impact on small firms to be minimal.

Competition Assessment

27. As the primary aim of these regulations is to allow schemes to continue to operate under their existing rules as much as possible, we would not expect there to be any competition effects.

Implementation and delivery plan

28. Subject to parliament's approval the regulations will be in place by November 2006, they come into force in December 2006. Revised guidance will be available around the same time to help employers prepare.

Post-implementation review

29. The Government will monitor surveys such as the Employers' Pension Provision Survey, to look at the extent of provision of occupational pensions. However, case studies are more likely to be able to assess the impact of the legislation.

Summary and recommendation

30. In implementing the legislation the Government's aim has been to combat unfair age discrimination and to encourage the continuing provision of occupational pension schemes. To achieve this objective the Government proposes to provide that as many rules as possible are not unlawful under the Regulations. The effect will be that most age related provisions in pensions schemes will remain lawful. So this will leave employers to look through and decide if they have any other rules that need consideration. It is only those other rules that employers would have to objectively justify or change. This will keep costs down compared with an alternative of making employers go through the process for all rules.
31. There will be some costs for employers and the Exchequer arising from Employment Tribunal claims. Employees should benefit from the maintained provision of their occupational pensions.

