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## Highlights

Our second "Changing Workforce" advisory examines how mandatory retirement fits into the overall workforce picture, and how employers faced with elimination of mandatory retirement can adapt to the change.

## Hewitt

The Hewitt Research Advisory is a regular Hewitt newsletter designed to provide a detailed overview of specific legislative and regulatory developments in Canada relating to human resources.

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## The Changing Workforce and Mandatory Retirement

Canada's aging workforce and the demographic bulge of the Baby Boomers (those age 40-60, roughly) mean that labour shortages in the coming years are a certainty for most employers (see *The Changing Workforce: Challenge and Opportunity*, a Hewitt Research Advisory published June 22, 2006).

In fact, a recent survey conducted by Hewitt Associates in Canada – *Attracting and Retaining the New Workforce, 2006* - found that three-quarters of the 232 employers who responded were *already* having problems attracting or retaining workers. Nearly half - 44 per cent - said they are having trouble with *both* recruitment and retention. Right now, the problem is worst in Alberta and Québec, and least serious in Ontario; but since Veterans (employees over age 60) and Baby Boomers make up more than half of the Canadian workforce, the labour shortage is expected to pinch much harder in all jurisdictions before getting better.

### Retirement Rationale

Given this larger context of demographic changes and labour shortages, it is clear that Canada's employers need to change the cultural mindset of early retirement, if they can. But what about mandatory retirement, the practice of forcing people out at age 65 (or earlier, in some cases) whether they want to quit working or not? How does that practice fit into the workforce shifts that are on the horizon?

The main justifications for mandatory retirement have been seen as: opening up job opportunities for younger workers; declining physical abilities and job performance of older workers; and employers' need to quantify and limit costs for pension and benefits plans.

But these objectives are no longer as valid as they used to be. The first reason will become irrelevant as the labour shortage

grows and there aren't enough younger workers to go around. The second is suspect for many jobs, because a knowledge-based economy is less physically demanding and because life expectancies, and corresponding good health, have increased dramatically since the time when mandatory retirement was first adopted. The last reason is only somewhat valid, given the trend away from Defined Benefit (DB) pension plans and toward Defined Contribution (DC) plans, plus the fact that DB plans can in fact be cost effective, because the obligation to pay benefits is deferred for the number of years that an employee continues to work.

### **Mandatory Retirement's Future**

The macro-economic reality is that most employers will soon need to encourage employees to keep working as long as they are able to contribute. Some employers are in that position already. That reality may well spell the end for mandatory retirement.

Perhaps coincidentally, both Ontario and Newfoundland & Labrador have decided to join the majority of other provinces and all three territories that have abolished widespread mandatory retirement. Only British Columbia, Saskatchewan, and the federal jurisdiction will still allow mandatory retirement at age 65 without restrictions. New Brunswick will allow it under the terms of a bona fide retirement or pension plan, and so will Nova Scotia, as long as the plan applies to all employees. Ontario will continue to allow mandatory retirement at age 65 until December 12, 2006, and Newfoundland & Labrador will allow it until May 26, 2007.

Where mandatory retirement is not allowed, exceptions can be made when there are bona fide and reasonable occupational requirements that make employment beyond a certain age untenable. Usually, these exceptions apply only to strenuous, safety-related jobs such as firefighters, police officers and airline pilots.

### **How Much Difference Will It Make?**

Interestingly, survey data shows that many workers don't want to fully retire at age 65. A Human Resources Development Canada study in 2002 showed that more than 20 per cent of workers age 45 and older planned to retire after age 65 or to never retire.

Statistics Canada's 2002 General Social Survey showed that nearly 12 per cent of recent retirees would have stayed at work if not for being forced to retire – about the same percentage of employees who currently continue working past age 65. A further 31 per cent of recent retirees would have stayed in the workforce if they could have worked shorter hours, fewer days, part-time or seasonally, or made other changes in their working conditions. Some would have done their regular work, while others might have liked to do something different, in order to keep busy, feel a sense of accomplishment and supplement their retirement savings.

In Hewitt's *Trends in Canadian Retirement Programs, 2004* survey, recent retirees were asked why they retired when they did. By far, the answer given most often was "I no longer enjoyed my work." The other two of the top three responses were early retirement incentives provided by employers, along with the ability to retire early with an unreduced pension.

Over a third of the retiree respondents to the survey stated that, in hindsight, they would have retired later. More would have considered delaying retirement if their employer had offered inducements such as phased retirement.

In the United States, mandatory retirement was abolished in 1986. Now, twice as many Americans aged 65 to 69 remain in the workforce as do Canadians, although other factors such as the availability of health care benefits may play a part in that difference.

All this is good news for employers who will need those experienced employees to help them through the transition to a smaller and less expert workforce. The retiree responses suggest that employers would have considerable leverage if they wanted to encourage older employees to delay retirement. At the same time, it's good news for employers transitioning away from mandatory retirement, because the numbers show that two-thirds of employees want to retire by age 65, or need to do so for health reasons. The remaining third may be a potential source of expert labour, but the numbers are unlikely to be so large as to disrupt the workplace or make it impossible for employers to adapt.

### **Adjusting To the Change: Benefits**

For employers not currently experiencing labour shortages, and who are used to mandatory retirement but who now will need to discard that policy, adjustments will be in order. Since many of those employers are in Ontario, where mandatory retirement will soon be forbidden, the discussion below focuses on Ontario.

Three key areas of concern for employers making the transition from mandatory retirement are: benefits costs, including the availability of statutory benefits; performance management; and severance costs.

Ontario's *Employment Standards Act, 2000* allows distinctions within benefit programs based on age, gender and marital status, in certain situations. This can be extremely helpful to employers in controlling benefits costs, as it can allow them to tailor coverage and benefit levels to an employee's age. However, a drastic change in coverage before and after age 65 might be treated as a breach of employment contract amounting to dismissal in some cases; caution and lots of advance notice will likely be needed. For this and other reasons, flexible benefits plans may be a better option, as they allow employees to choose the benefits and coverage levels most suitable for them, often at a more controlled cost to the employer.

Employers who already provide benefits continuation for retirees will face minimal cost impact by providing benefits coverage for employees beyond age 65, since they are already doing so under their retiree plan. Otherwise, the cost impact of continuing benefits coverage past age 65 depends on the type of benefit being considered.

**Extended Health & Drug Insurance:** Adding coverage for employees beyond age 65 will increase costs, and the cost impact will continue to increase the more an employee's age increases beyond age 65. Although the Ontario Drug Benefit Program (ODB) provides drug coverage for those age 65 and over, which currently reduces employers' costs for older workers, the Ontario government has announced its intention to become the second payer for "working seniors with private insurance

plans.” If that intention becomes fact, it would mean that those who work beyond age 65 will not be entitled to ODB coverage as long as they have private drug coverage through their employment.

**Dental:** Perhaps surprisingly, the peak age for dental claims is between 40 and 55. Thus, continuing dental insurance coverage past age 65 is not as expensive as some other types of insurance. Covering employees beyond age 65 will increase costs, but not as dramatically as extending most other insurance benefits.

**Group Life Insurance:** Employers who extend group life insurance benefits to those beyond age 65 will face significant cost increases if the same benefit levels are continued. For this reason, many plans which continue benefits beyond age 65 do so subject to reductions in benefits.

**Pension contributions:** In all provinces, pension contributions to Registered Pension Plans or pension accruals must continue beyond 65. The only exception is if the plan has a maximum service rule, in which case if the maximum limit is attained after age 65, accruals could stop. Note that in Québec, the law requires that the benefit earned at age 65 be increased actuarially, but there is no requirement to add accruals after age 65. Manitoba has proposed a new rule that the greater of the two (actuarial increase or additional accruals) be provided for postponed retirement. Also note that under the *Income Tax Act*, accruals must cease by the end of the year the member attains age 69, and the pension must also commence at that point, even if the member is still employed.

**Long Term Disability (LTD) & Workers’ Compensation:** Almost all Canadian LTD plans terminate coverage at age 65. This coincides with the availability of Canada Pension Plan (CPP) benefits and benefits under most pension plans. The cost of continuing LTD coverage past age 65 is significant, although many plans in the United States continue coverage to age 70, particularly if a disability is incurred after age 60. LTD coverage may be especially desirable from the employer’s point of view, since both Ontario and Newfoundland & Labrador have provided for workers’ compensation coverage to cease at age 65, even if an employee keeps working. That raises a host of questions for employers if an over-65 employee is injured at work. In particular, legislation prevents workers covered by workers’ compensation from suing their employers for workplace injuries. Will that limitation still apply to workers over 65 if they no longer receive workers’ compensation coverage? Will employers be subject to lawsuits for the costs of their medical treatment and lost wages? Continuing LTD coverage may help offset at least some of an employer’s potential liability for workplace injuries to its 65-plus workers.

### **Adjusting to the Change: Performance Management**

It’s only fair that employees who choose to keep working past age 65 be expected to maintain their productivity. Mandatory retirement has sometimes been used to let employers off the hook when dealing with aging employees whose performance is declining. It was often much simpler to let things go with the knowledge that the employee was nearing age 65, rather than deal with the performance issues directly. That will no longer be a sensible approach, since it will no longer be certain that an employee will leave at age 65.

Instead, employers will need to continue their normal performance management practices throughout an employee’s career. In addition, employers need to make sure that older employees are given equal

opportunity to ongoing training and development opportunities. Some older employees may need to be encouraged to keep up with their professional development.

At the same time, employees may need some accommodations as they age, depending on the nature of the job and the employee's physical and mental condition. Having to deal with aging employees with no fixed end to their employment may force some employers to invest more time and effort into their performance management systems and execution. Fortunately, this is an investment which should pay benefits throughout an employer's entire workforce.

### **Adjusting to the Change: Severance**

Normally when employment ends at the employer's behest, the employer must pay termination and/or severance pay under both the judge-made common law and statute law, unless there is just cause for the termination or another exception to the rule. In the past, employees subject to mandatory retirement policies who were required to leave at the specified retirement age were not entitled to termination or severance pay. That will change when mandatory retirement is eliminated.

Employers who wish to have older employees leave will no longer have a cost-free way to accomplish that, unless the employee chooses to retire. Note that offering an employee a chance to retire rather than be fired will likely be treated as a constructive dismissal – in other words, equivalent to any other dismissal, and just as costly.

Therefore, employers should plan to pay statutory termination notice and severance pay, at the very least, if they wish to terminate an older employee. The fact that an employee can then choose to retire under the terms of a private pension plan or CPP has not limited employers' liability to date.

Keep in mind that employees are also entitled to wrongful dismissal damages under the common law (the judge-made law), which may be considerably more than the statutory amounts. For older employees, these damages may be at the higher end of the scale, especially for long-service employees. However, older employees who have not performed adequately can still be dismissed for just cause without notice or pay in lieu, as long as the employer has applied reasonable standards and given the employee any warnings and chances to improve that may be necessary in the circumstances.

### **About Hewitt Associates**

With more than 60 years of experience, Hewitt Associates (NYSE: HEW) is the world's foremost provider of human resources outsourcing and consulting services. The firm consults with more than 2,300 companies and administers human resources, health care, payroll and retirement programs on behalf of more than 300 companies to millions of employees and retirees worldwide. Located in 35 countries, including Canadian offices in Toronto, Montreal, Vancouver, Calgary and Regina, Hewitt employs approximately 22,000 associates. For more information, please visit [www.hewitt.com](http://www.hewitt.com).