



The Government's State Pension reform plans

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The Pensions Policy Institute



- An educational charity providing non-political, independent comment and analysis of public policy on pensions and the provision of retirement income in the UK.
- Recent areas of research include:
 - Public sector pension reforms
 - The changing landscape of private pensions
- Future reports:
 - Tax relief
 - Retirement income adequacy under auto-enrolment
 - Evaluation of the Government's state pension reforms



- **The reforms**
- Impact on different groups of individuals
- The future need for means-tested benefits and the potential impact on private pension saving
- Implications of ending contracting-out
- The impact on government expenditure

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The reforms: key features (1)



- A new single-tier state pension system is being introduced, replacing the existing BSP and S2P
- Applies to people reaching SPA from April 2016 onwards
- Fully individualised – no inherited rights or pension based on partner contributions

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The reforms: key features (2)



- 35 Qualifying years needed for a full pension (compared with 30 for BSP)
- The full rate will be set above the Guarantee Credit level (currently £142.70)
- Up rated “at least by the average growth in earnings”
- Minimum qualifying period between 7 and 10 years (currently no requirement for BSP)

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The reforms: transition



- In April 2016, “foundation amount” is calculated as the greater of:
 - Individual entitlement under current system
 - Entitlement had single-tier been in place
- If “foundation amount” greater than full single-tier level, the excess is protected
- Single-tier accrual after 2016 is added until full level is reached – no accrual beyond this

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Impact on individuals: gainers



- People who do badly in the current system will get more from the single-tier
 - Older women
 - Self-employed

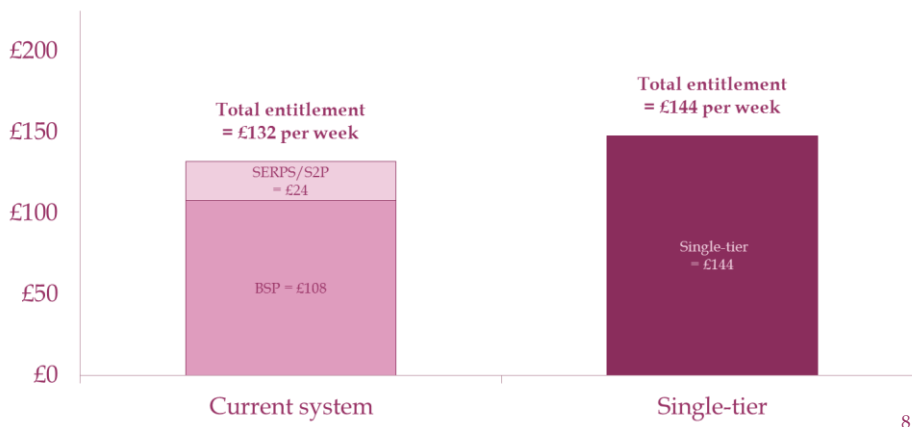
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Individuals spending time out of the work force not qualifying for S2P credits may receive more from the single-tier pension



Comparison of the state pension entitlements of two low earning individuals, each spending around half of their working life out of work, one reaching SPA in 2017 and one in 2037 (£ per week, 2012 earnings terms)

Entitlement (£ per week)



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Impact on individuals: losers



- People who do well under the current system will get less from the single-tier
 - Older high earners
 - Younger consistent earners (or qualifiers)
 - Unless they have been contracted-out...

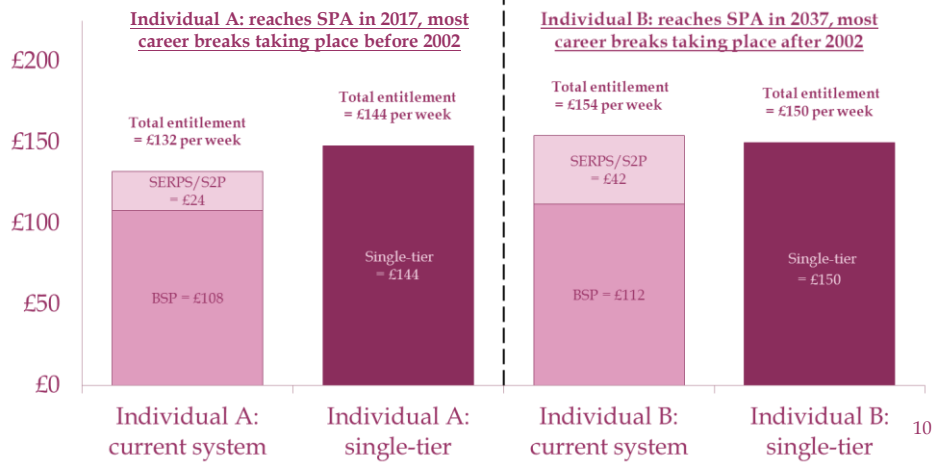
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Individuals spending time out of the work force, but that would have qualified for S2P credits after 2002 may receive less from the single-tier pension

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Comparison of the state pension entitlements of two low earning individuals, each spending around half of their working life out of work, one reaching SPA in 2017 and one in 2037 (£ per week, 2012 earnings terms)

Entitlement (£ per week)

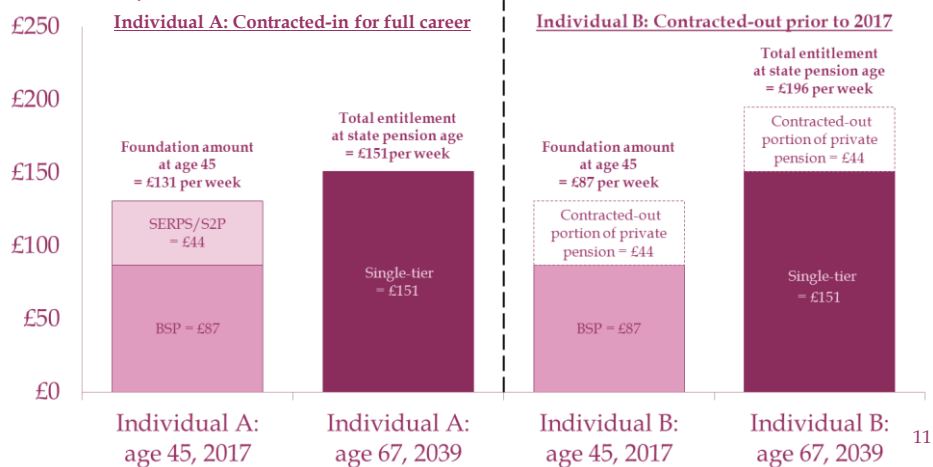


Individuals that have contracted-out in the past may be able to build up more entitlement than those that have not

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Comparison of the state pension entitlements of two median earning individuals aged 45 in 2017 and at state pension age in 2039 (£ per week, 2012 earnings terms)

Entitlement (£ per week)

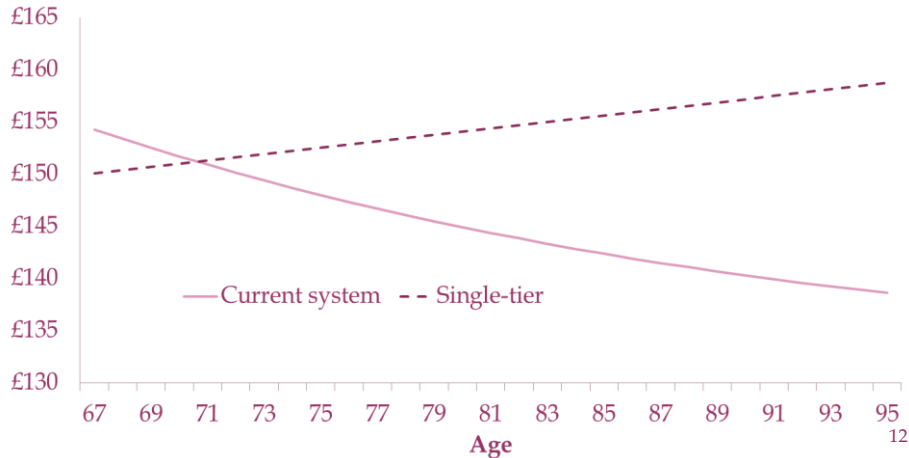


The 'triple-lock' indexation of the single-tier pension may improve outcomes for individuals that live to higher ages



Comparison of state pension entitlement in each year of retirement under the current system and the single-tier for an individual reaching SPA in 2037 (£ per week, 2012 earnings terms)

Entitlement (£ per week)



Impact on individuals: short-term and long-term effects



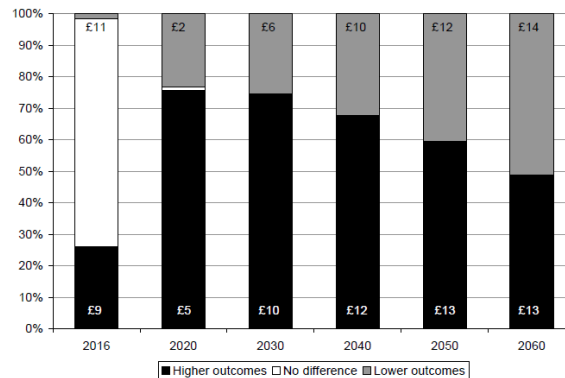
- Short-term:
 - Protection of current system entitlement
 - Boost in entitlement for people that have done badly out of the current system
- Long-term:
 - S2P (introduced in 2002) would have improved outcomes for many groups in the long-term
 - But, “triple-lock” indexation of single-tier is favourable compared to current system

Impact on individuals: short term and long term effects

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Chart taken from *The single-tier pension: a simple foundation for saving – Impact Assessment* (DWP, May 2013)

Chart 3.1: Proportion of pensioners with changed notional state pension outcomes under single tier; median weekly amounts (2013/14 earnings terms)



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Future need for means-tested benefits



DWP estimates the following:

- Single tier will reduce eligibility for Guarantee credit and council tax support but will have little impact on Housing Benefit
- By 2040, eligibility for means-tested benefits will fall by around 4 percentage points

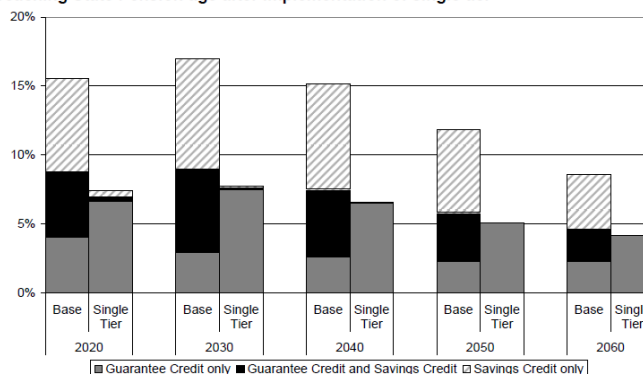
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Future need for means-tested benefits



Chart taken from *The single-tier pension: a simple foundation for saving – Impact Assessment* (DWP, May 2013)

Chart 4.1: Eligibility for Pension Credit from 2020 to 2060 amongst the population reaching State Pension age after implementation of single tier



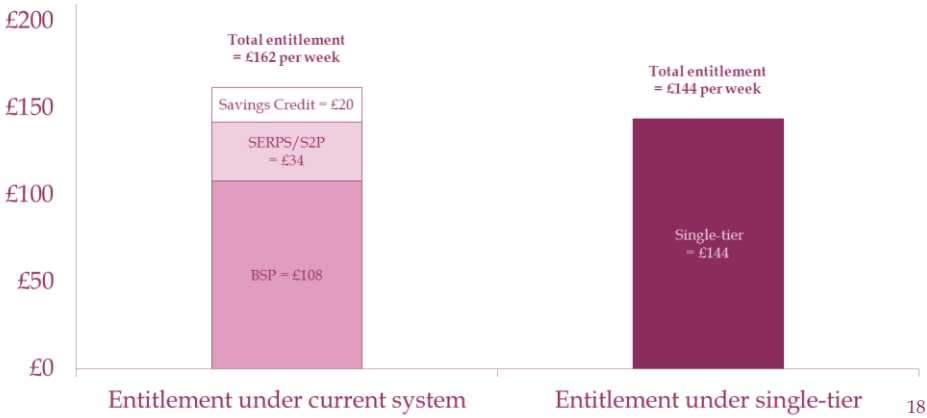
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The abolition of Savings Credit may lead to some individuals receiving less under the single-tier than the current system



Comparison of the state pension entitlements of a low earning individual with no private pension saving at state pension age in 2017 under the current system and the single-tier pension (£ per week, 2012 earnings terms)

Entitlement (£ per week)



Future need for means-tested benefits



Entitlement to housing and council tax support (amongst the population reaching State Pension age after implementation of single tier)

		2020	2030	2040	2050	2060
Housing Benefit	Base	12%	16%	15%	12%	10%
	Single tier	12%	15%	14%	12%	10%
Council Tax Support	Base	35%	37%	32%	28%	23%
	Single tier	34%	34%	30%	26%	23%

Source: DWP (2013) Single-Tier Impact Assessment

Potential impact on private pension saving



- Aim is to let people know what they will receive when they reach State Pension age and over, enabling them to judge what private provision is necessary.
- Complements introduction of auto-enrolment.

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Implications of the ending of contracting out of the State Second Pension



- The introduction of the single-tier will lead to the end of S2P and, consequently, contracting from S2P.
- The ending of contracting-out of from DB schemes will have impact on both scheme members and scheme sponsors.

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The end of contracting out – impact on scheme members



- DB scheme members will have to pay higher National Insurance contributions but, in return, they will build up a higher state pension.
- There may be changes to the contributions that members pay to or the benefit they receive from the DB scheme (depending on the reaction of the scheme sponsor).

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The end of contracting out – impact on scheme sponsors



- DB scheme sponsors will have to pay higher National Insurance contributions.
- DB scheme sponsors will need to decide whether to adjust the benefits and/or contributions.
- DWP has indicated that they will introduce powers so that sponsors can change scheme rules accordingly without trustee consent.

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Impact on future levels of Government expenditure

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- DWP estimates that, from the late 2040s, the rise in pensions expenditure is smaller under the single tier than under the current system
- Expenditure on pensions and pensioner benefits is estimated to decrease from 8.5% GDP to 8.1% GDP by 2060
- DWP estimates exclude savings from abolition of the contracting out rebate; projected to be £5.5bn (0.3% GDP) in 2016/17

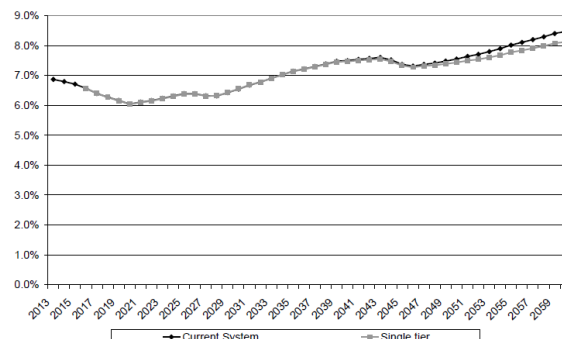
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Impact on future levels of Government expenditure

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Chart taken from *The single-tier pension: a simple foundation for saving – Impact Assessment* (DWP, May 2013)

Chart 6.1: Overall expenditure on pensions and pensioner benefits under current system and single tier (£144 start level, triple lock), as a proportion of GDP



Note: The baseline includes BSP, AP, Pension Credit, Universal Credit (where paid to households where someone is over State Pension age), HB/CTB, AA/DLA, other benefits (Winter Fuel Payments, free TV licences, Christmas bonus, Age Addition, Category D pensions). Includes the announced increase to SPA 67 between 2026 and 2028, and the SPA equalisation to 65 (for women), and rises to 66 and 68 as set out in legislation. NICs revenues are excluded.

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