United Kingdom

United Kingdom: Pension system in 2014

The public scheme has two tiers, (a flat-rate basic pension and an earnings-related additional pension), which are complemented by a large voluntary private pension sector. The public scheme is currently being reformed into a flat-rate basic pension. An income-related non-taxable benefit (pension credit) targets extra spending on the poorest pensioners.

Key indicators: United Kingdom

		United Kingdom	OECD
Average worker earnings (AW)	GBP	35 633	25 668
	USD	55 539	40 007
Public pension spending	% of GDP	5.6	7.9
Life expectancy	At birth	80.4	80.0
	At age 65	19.4	19.3
Population over age 65	% of population	18.1	16.2

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Qualifying conditions

State Pension age is currently 65 years for men and 62.5 years for women. The pension age for women is gradually rising to 65 years by November 2018. Increases of the State Pension age to 66 years by October 2020 and to 67 years between 2026 and 2028 have been legislated. The Government has also proposed that subsequent State Pension age changes are to be based on changes in life expectancy. Under the old system, an individual reaching state pension age qualifies for a full basic State Pension by: i) paying; or ii) having been treated as having paid; or iii) being credited with, National Insurance contributions, for 30 qualifying years in their potential working lives. A proportionally reduced basic state pension is paid to people with fewer than 30 qualifying years, to a minimum of one qualifying year of contribution or credits. People reaching State Pension age from 6 April 2016 will require 35 years of contributions to receive a full new State Pension amount, and the minimum qualifying period will be 10 years.

Benefit calculation

Basic

The full basic State Pension for a single person is GBP 113.10 per week in 2014/15. The announced policy intention is that the full new State Pension will be set at a level above that of the current level of Pension Credit.

Earnings-related

In addition to the basic State Pension, in the current system people can get additional earnings-related State Pension, which can range from less than GBP 1 to close to GBP 200 a week, depending on work history. The earnings-related scheme will not be part of the new State Pension, and will not be available for people reaching state pension age from April 2016.

Contracting out

Occupational and personal pension arrangements have been able to choose to “contract-out” of the additional pension element of the State Pension. The adoption of the new State Pension will lead to the abolition of the option of contracting out.

Workplace Private Pension Provision

In October 2012, the government began rolling out automatic enrolment into workplace pension schemes. Once complete in February 2018, all employers will have a legal duty to enrol all qualifying workers aged between 22 and State Pension age who earn over GBP 10 000 in 2014/15 into a qualifying workplace scheme. Minimum contributions will build to 8% of a statutory earnings band between GBP 5 772 to GBP 41 865 in 2014/15 by October 2018.

To support automatic enrolment, the government established the National Employment Savings Trust (NEST), a trust-based occupational defined contribution scheme. NEST has a public service obligation to admit any workers automatically enrolled by their employer, and is designed to provide low-cost, quality pension provision for low to moderate earners, transient workers and smaller employers that the market finds difficult to serve.

Targeted

Pension Credit, is a tax free weekly benefit for people who are living on low incomes and guarantees all pensioners an income above a certain level. Pension Credit is an income related benefit and is not based on National Insurance contributions. There are two elements to the Pension Credit, the Guarantee Credit and the Savings Credit. The Guarantee Credit ensures a minimum level of income by providing financial help for people who have reached the qualifying age (see below) and whose income is below the standard minimum guarantee amount. In 2014/15 this was GBP 148.35 for individuals and GBP 226.50 for couples (these amounts may be higher for people with severe disabilities, caring responsibilities or certain housing costs).

The savings credit is an extra amount for people aged 65 or over who have made modest provision for their retirement. It is designed to reduce the effective withdrawal rate of benefits from 100% under its predecessors to 40%. People, whose income (excluding any guarantee credit) is below their guarantee credit minimum guarantee and above the savings credit threshold, GBP 120.35 for individuals and GBP 192.00 for couples respectively in 2014/15, receive 60% of the difference between their income and the threshold up to a maximum of GBP 16.80 for individuals and GBP 20.70 for couples, respectively. For people with incomes above their guarantee credit minimum guarantee (that is they are not entitled to the guarantee credit), the maximum savings credit is reduced by 40% of their income over their guarantee level.

The qualifying age for Pension Credit is gradually increasing to 65 alongside the increase in women's State Pension age and will increase further as State Pension age raises beyond 65 for both men and women. The savings credit element of the scheme will not be available to those who reach state pension age on or after 6 April 2016 (i.e. the same cohort which qualify for the new State Pension).

Variant careers

Early retirement

It is not possible to claim a State Pension age early. Voluntary pension benefits can be claimed from the age allowed by the scheme.

Late retirement

Deferral of the state pension has always been possible in order to earn extra State Pension increments. This extra State Pension is paid on top of the normal State Pension when a person eventually claims for the first time or claims again.

Until 6 April 2005, deferral of the State Pension earned approximately 7.5% for each year (equivalent to 1% for every seven weeks). From 6 April 2005, the increment increased to about 10.4% for each year (or 1% for every five weeks).

The amount of extra money a person gets depends on how long they put off claiming their State Pension. They may choose one of the following options:

- A higher weekly state pension for life (if the State Pension is deferred for at least five weeks).
- A one-off taxable lump-sum payment (if the State Pension is continuously deferred for at least one year). The lump-sum is made up of the State Pension foregone during the deferral period plus interest which is guaranteed to be at least two percentage points above the (Bank of England) base rate. The choice has to be made when the State Pension is eventually claimed.
- For those who reach State Pension age from April 2016, it will not be possible to take a lump-sum payment. To receive a higher weekly State Pension for life, the State Pension will need to be deferred for at least nine weeks. The extra State Pension received for deferring will be awarded at a lower rate than for those who reached State Pension age prior to April 2016.

Childcare

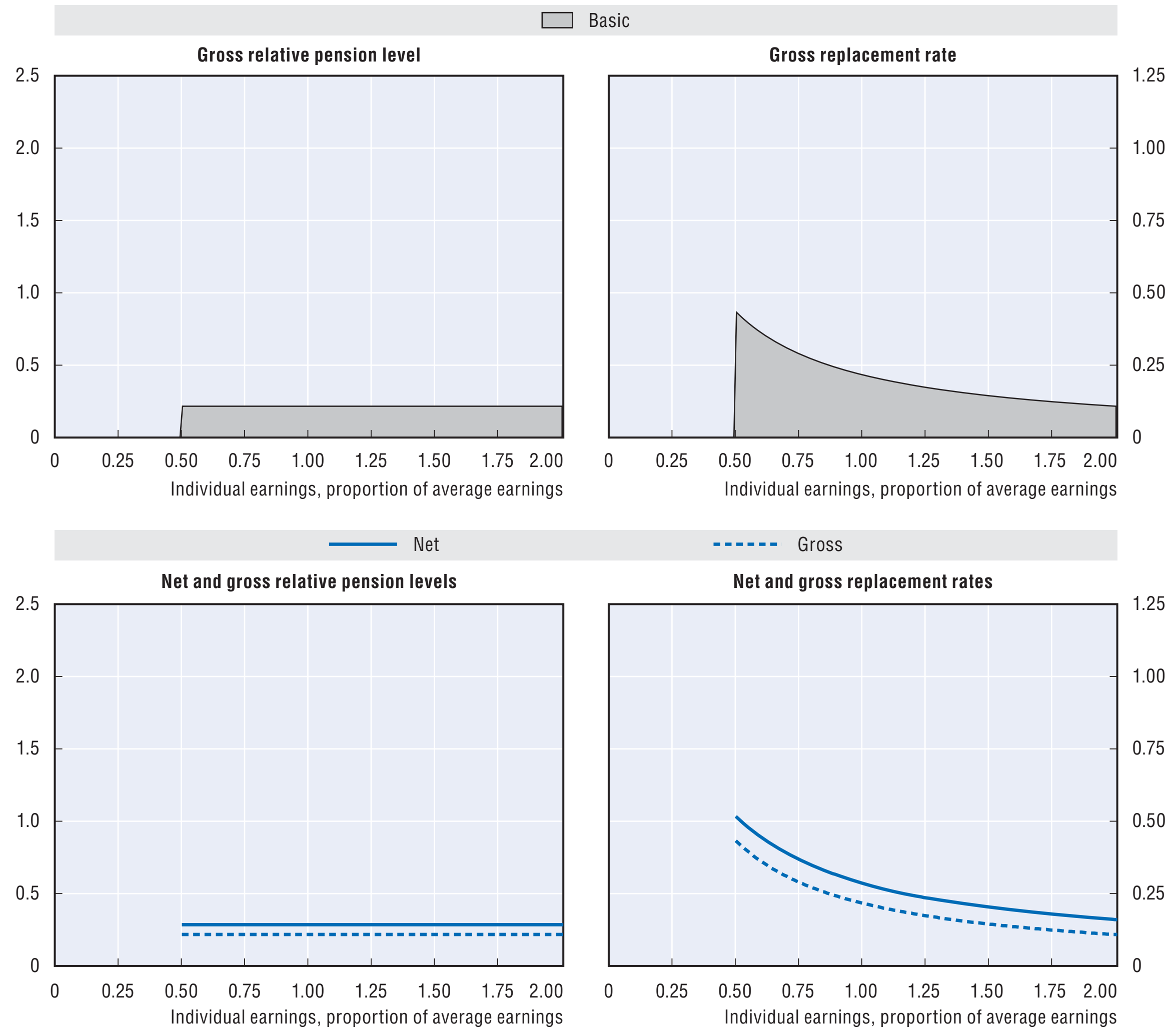
Both tiers of the public pension scheme (basic State Pension and State Second Pension) provide protection for periods of child care. This covers both people not in paid work and those working but earning below the lower earnings limit (LEL) who therefore do not contribute to the system. Prior to 6 April 2010, for the basic State Pension, protection was provided by Home Responsibilities Protection (HRP), and covered years where Child Benefit was awarded for at least one child under 16. HRP reduced the number of years required for a full basic State Pension so that, with sufficient HRP, only 20 years' work (including periods when National Insurance contributions may have been credited) was required. For the State Second Pension, years where Child Benefit was awarded for a child under age six were credited; caring parents were deemed to have earnings at the low earnings threshold.

HRP has been replaced by a system of weekly National Insurance credits for parents and carers. People attaining State Pension age after 2010 may be awarded credits if they have Child Benefit for a child under age 12. These credits may count towards their basic State Pension and State Second Pension entitlement. Any years of HRP acquired before 2010 have been converted to qualifying years of National Insurance credits.

Unemployment

Periods of unemployment on insurance or assistance benefits are credited to a person's National Insurance contributions record for the basic State Pension. There are no National Insurance credits for periods on these benefits for the State Second Pension.

Pension modelling results: United Kingdom in 2062, retirement at age 68



Baseline scenario: Legislation scenario (wage indexation of basic pension benefits)

Men	Individual earnings, multiple of average					
Women (where different)	*0.5*	*0.75*	*1*	*1.5*	*2*	*3*
Gross relative pension level	21.6	21.6	21.6	21.6	21.6	21.6
(% average gross earnings)						
Net relative pension level	28.5	28.5	28.5	28.5	28.5	28.5
(% net average earnings)						
Gross replacement rate	43.3	28.9	21.6	14.4	10.8	7.2
(% individual gross earnings)						
Net replacement rate	51.7	36.7	28.5	20.3	16.0	11.4
(% individual net earnings)						
Gross pension wealth	7.1	4.7	3.6	2.4	1.8	*1.2*
(multiple of individual gross earnings)	*7.8*	*5.2*	*3.9*	*2.6*	*1.9*	*1.3*
Net pension wealth	7.1	4.7	3.6	2.4	1.8	1.2
(multiple of individual gross earnings)	*7.8*	*5.2*	*3.9*	*2.6*	*1.9*	*1.3*

Assumptions: Real rate of return 3%, real earnings growth 1.25%, inflation 2%, and real discount rate 2%. All systems are modelled and indexed according to what is legislated. Transitional rules apply where relevant. DC conversion rate equal 85%. Labour market entry occurs at age 20 in 2014. Tax system latest available: 2013.

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