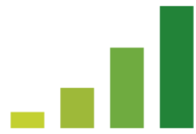

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Recent UK pensions policy

Carl Emmerson

Presentation at UCEA Annual Higher Education Pensions Conference, London, 13 June 2016

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Currently seeing major pensions reform

- State pensions
  - new flat-rate state pension with the associated abolition of contracting out for those in DB pensions
  - increases in the state pension age
- Private retirement saving
  - continued roll-out of automatic enrolment into workplace pensions
  - introduction of Lifetime Individual Savings Accounts
- Plus lots of others that I won’t cover in this talk
  - DC pensions freedoms, increases in minimum pension age, restrictions to pension contribution limits for those on very high incomes, etc.

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New single-tier state pension

- Affects those reaching the state pension age after 6 April 2016
- Replaces the basic state pension and the state second pension
- Rights accrued prior to April 2016 calculated as greater of existing system and if new system had always been in place
- Going forwards every year of contributions will accrue £4.44 per week in state pension income
  - up to a maximum of 35 years of contributions, no pension paid to those with fewer than 10 years of contributions
  - no further accrual once reached, or above, £155.65 per week
  - wide range of activities count including: employment, self-employment, unemployment, disability and caring
- Pension credit guarantee remains in place, but the savings credit is abolished for new pensioners

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New single-tier state pension

- ‘Triple lock’ indexation
  - increased each year in line with the greater of growth in earnings, growth in prices (as measured by the Consumer Price Index) or 2.5%
  - not a sensible way to index over the longer-term
- Abolition of the state second pension naturally leads to the abolition of contracting out
  - since 2012 has only existed for those in DB pensions
  - employees: pay 1.4% more National Insurance on earnings between the lower earnings limit and the upper accrual point, reducing their take home pay by up £480 per year
  - employers: pay 3.4% more National Insurance on this band of earnings, increasing employment costs by up to £1,165 per employee per year
  - £5.5bn a year tax rise, £3.3bn from public sector employers and £1.4bn from public sector employees

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Impact on state pension incomes

- 43% of those reaching the state pension age between 2016 and 2020 will get a higher state pension
  - women and the self-employed are particularly likely to gain
  - some losers: those who have accrued fewer than 10 years of contributions
- By no means all new pensioners will get £155.65 per week
  - only true of 17% of those reaching the state pension age over the next four years
  - 23% will get more as already accrued more than this amount
  - 61% will receive less, typically due to having been contracted out
- Flat rate accrual, of £4.44 per week, is a genuine simplification
- In the long-run this will mean, for most individuals, a lower state pension than under an unreformed system
  - long-run public finances strengthened by this reform

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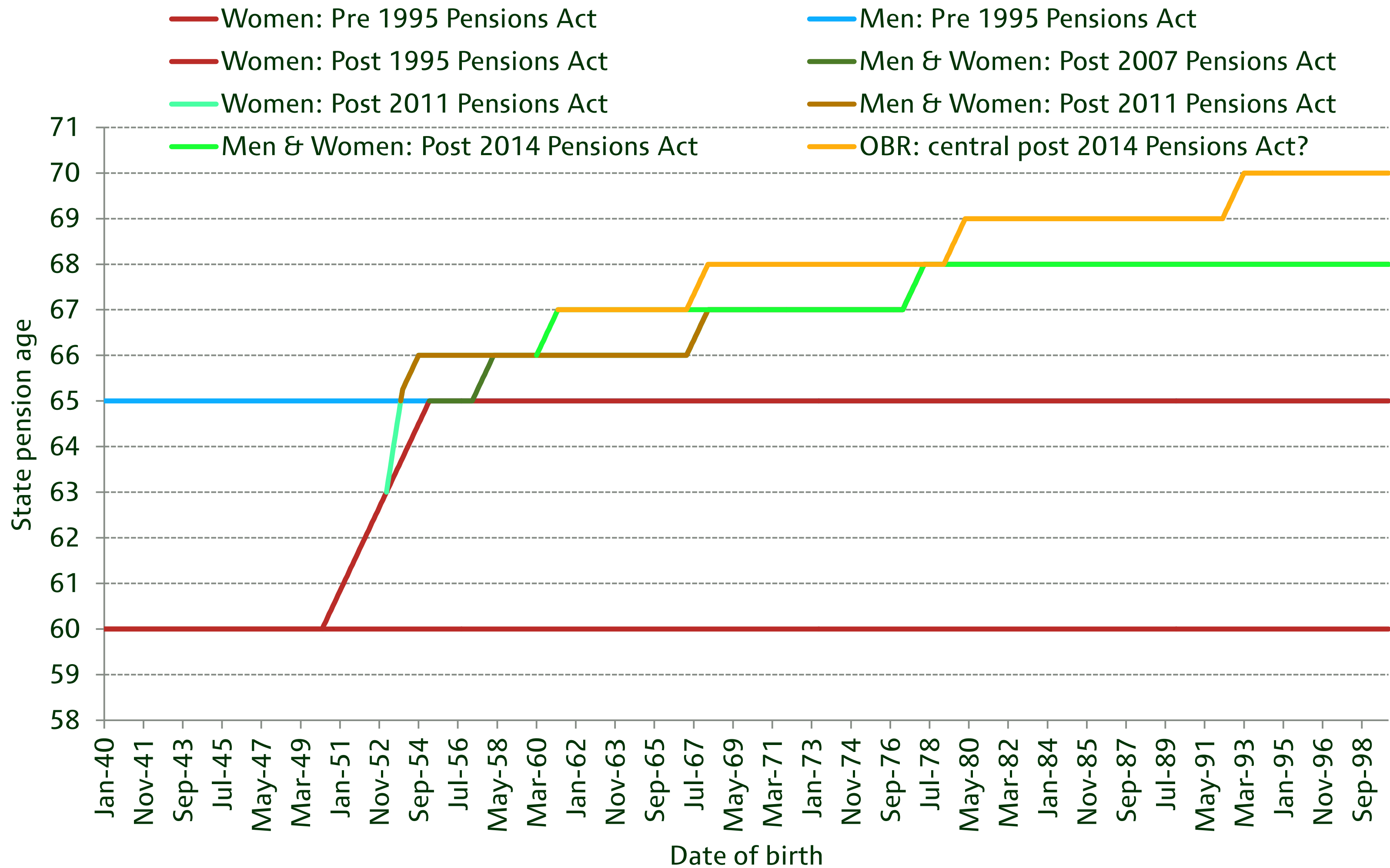
State pension age increases



Source: Department for Work and Pensions (2014); Office for Budget Responsibility (2015).

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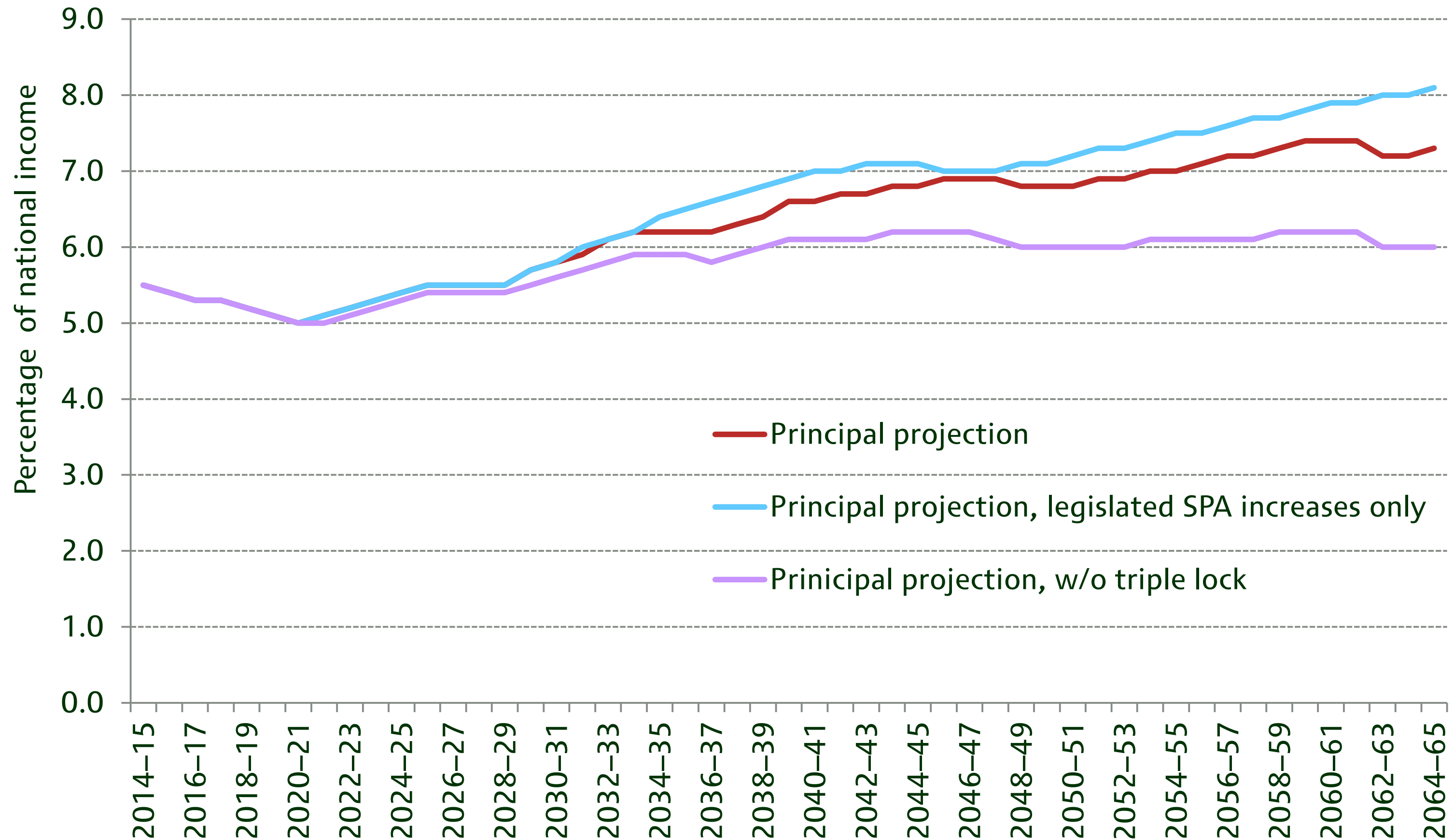
State pension spending projected to rise



Source: Office for Budget Responsibility (2015).

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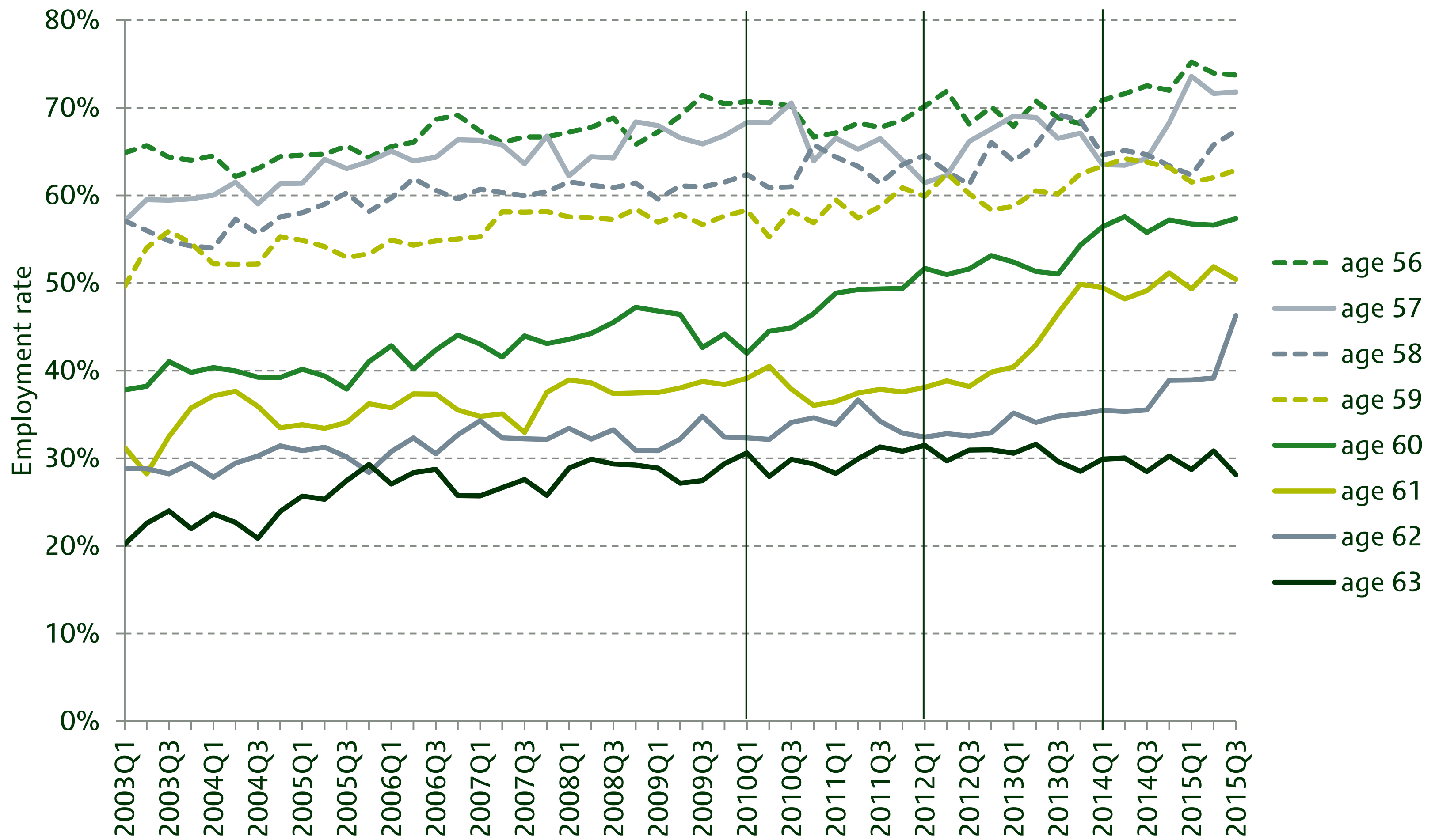
Rising female state pension age is pushing up employment rates



Source: Labour Force Survey.

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Automatic enrolment

- Automatic enrolment requires employers to enrol their eligible employees into a pension scheme unless they specifically opt-out
  - introduced for the largest employers in October 2012, increasing number of employers affected over time
- Being introduced in UK on a scale untested internationally
  - 6.2 million employees automatically enrolled by April 2016
- Aim to increase the saving of workers – due to worries about under-saving for retirement

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Automatic enrolment: policy details

- Eligibility: aged 22-SPA, earn over a threshold (£10,000 in 14–15, 15–16 and 16–17)
- Each employer is given "staging date"; larger employers given earlier staging dates
  - employers must automatically enrol eligible employees within 3 months of staging date
  - employees can opt out, but default is to be enrolled
  - employers can delay to Sept 2017 if have open DB pension scheme
- Minimum contributions:
  - until April 2018: employer contribution 1% of "band earnings"; total contribution 2% of "band earnings"
  - then rising, reaching 3% employer, 8% total from April 2019

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Staging dates for employers of different sizes

PAYE scheme size as of April 2012	Staging Date
120,000 or more	1st October 2012
…	…
6,000 to 9,999	1st April 2013
…	…
160 to 249	1st April 2014
…	…
50 to 53	1st April 2015
…	…
Some with fewer than 30	1st April 2016
…	…
All existing employers	1st April 2017
…	…
All existing & new employers	1st February 2018

Source: NOW: Pensions (http://www.nowpensions.com/auto-enrolment-staging-dates/).

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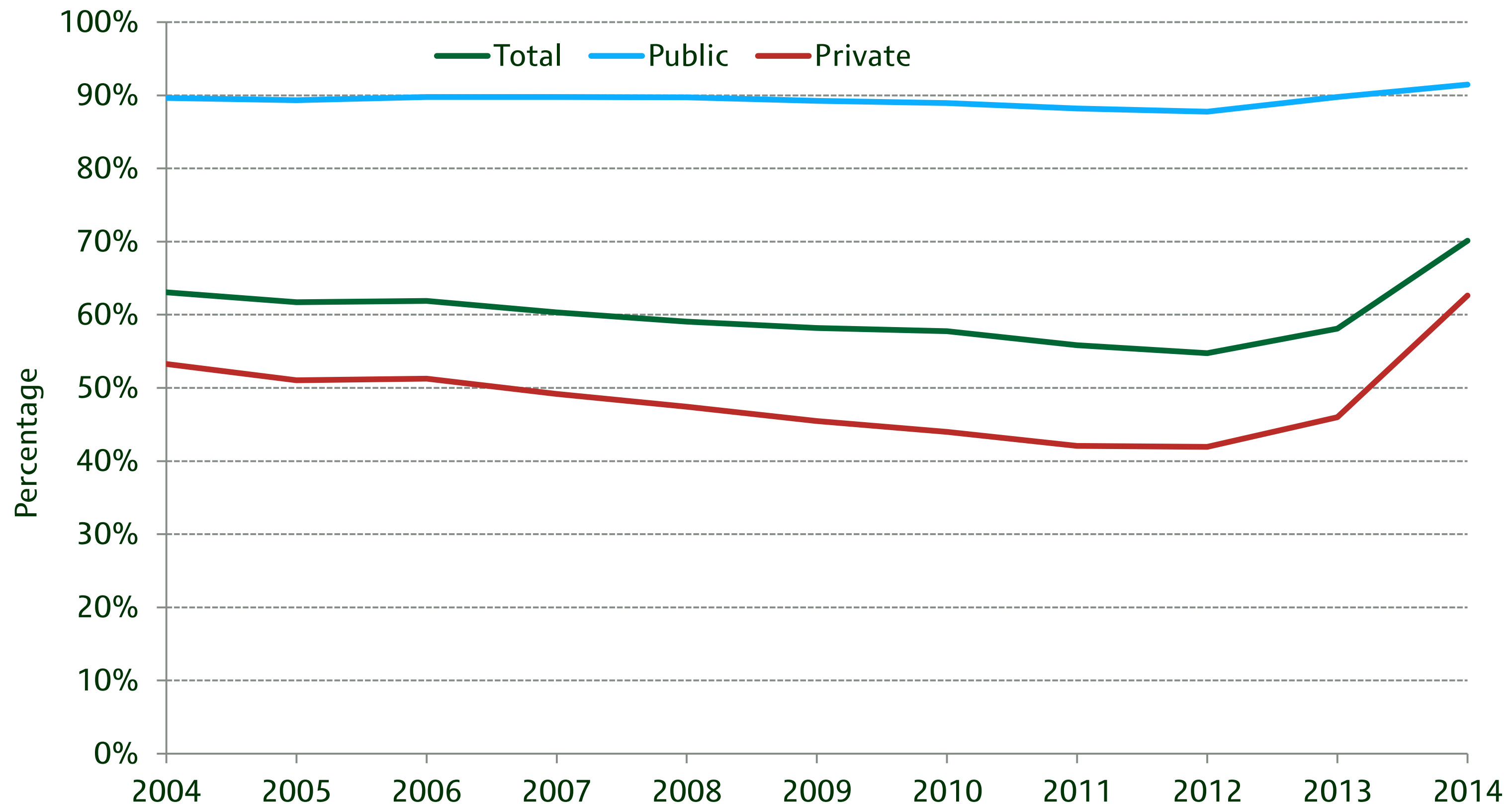
Membership of workplace pensions



Source: Department for Work and Pensions (2015).

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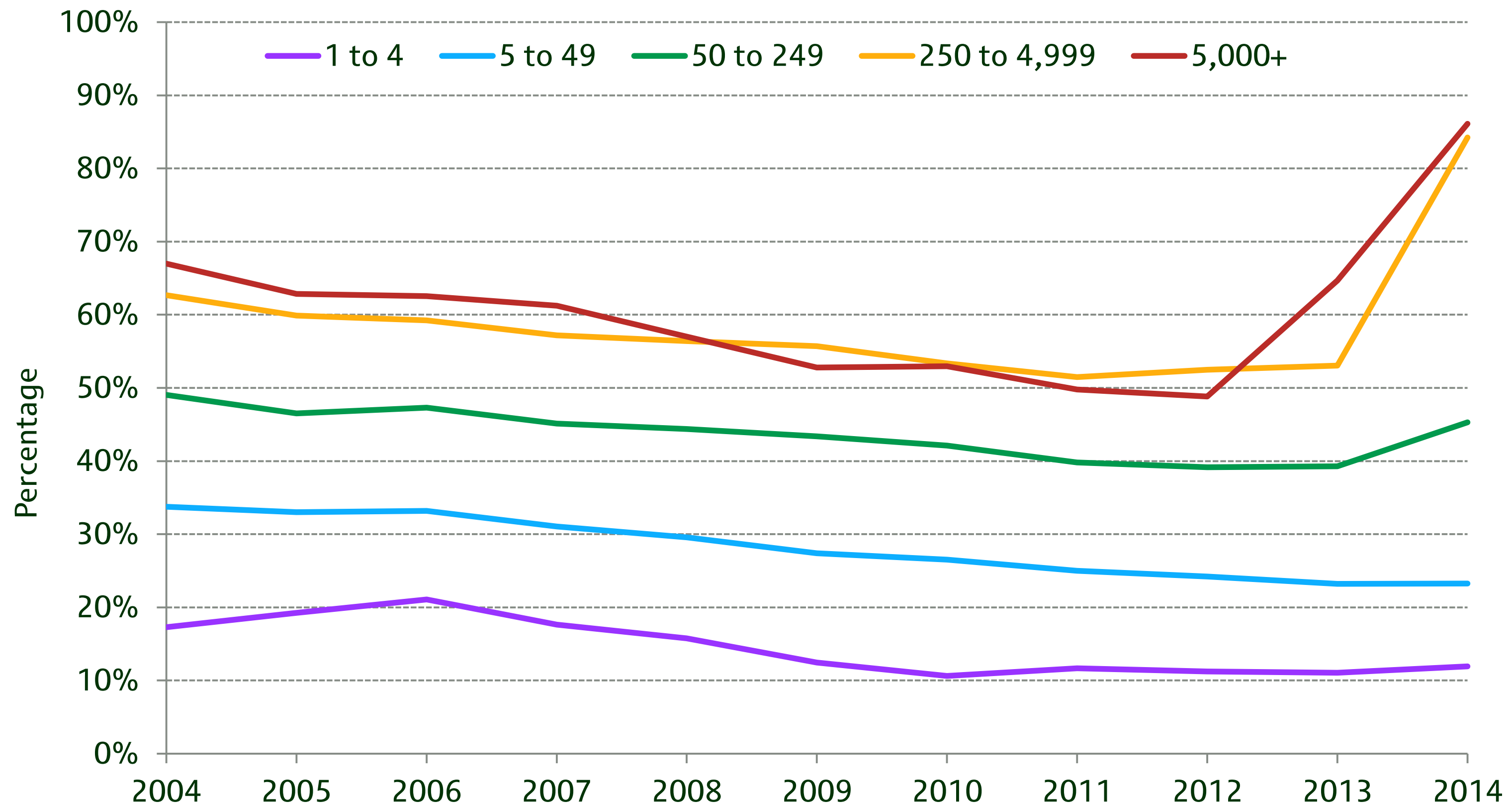
Private sector membership of workplace pensions, by employer size



Source: Department for Work and Pensions (2015).

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Lifetime Individual Savings Accounts

- Accounts can be opened by 18-40-year-olds from April 2017
- Contributions count towards ISA limit; like ISAs, no tax on returns
- While aged 18-50, government will add 25% to up to £4,000 of contributions each year
  - so over 32 years, max £32,000 top-up on £128,000 of contributions
- Can withdraw from age 60, or earlier to buy 1st home for <£450,000
  - if withdraw earlier for other purposes, 5% charge + lose the top-up
  - though will consult on possibility of withdraw-and-replace option

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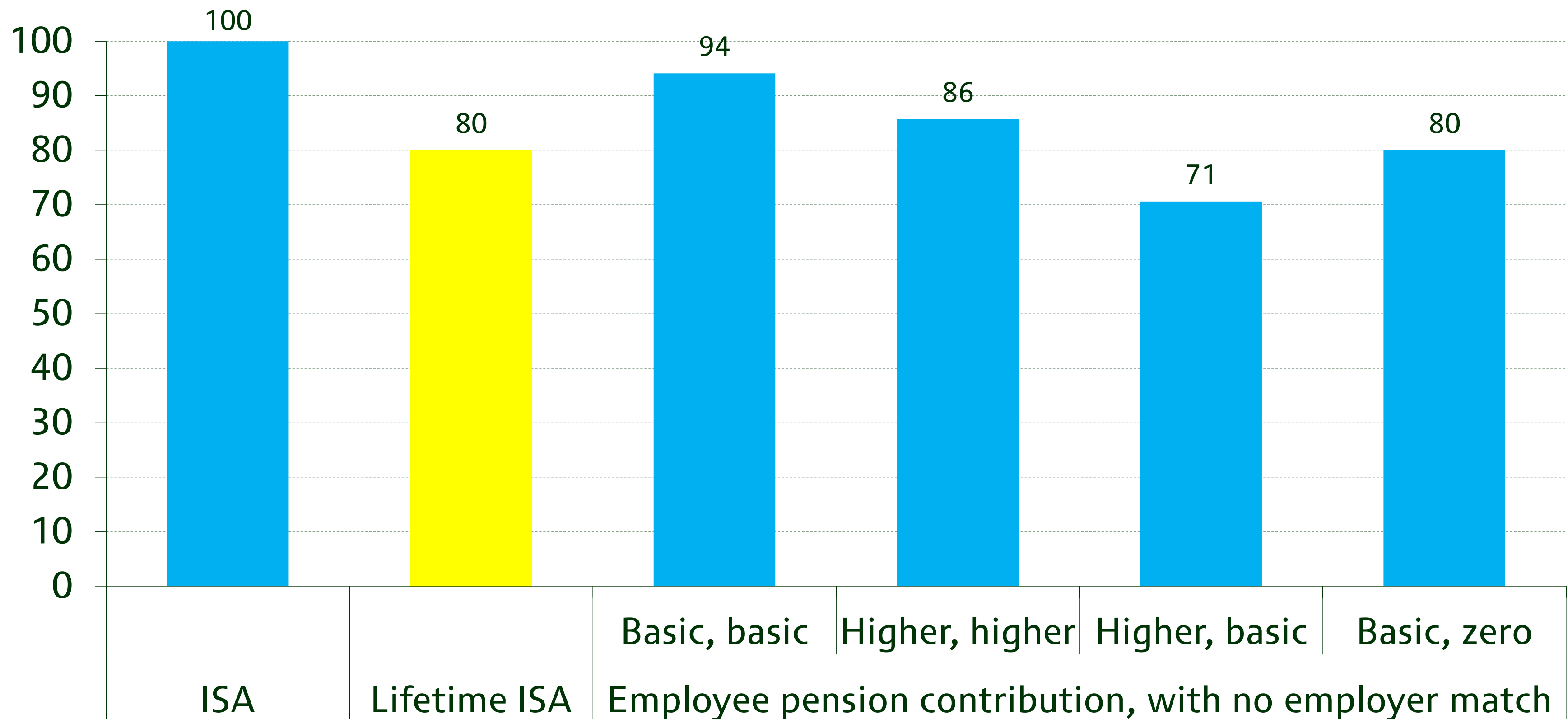
Contribution required to match 100 saved in ISA

By marginal tax rate in work and in retirement



- Employer pension contributions still more generously treated
- Can gradually shift money from lifetime ISA to pension from age 60
  - benefit from lifetime ISA top-up *and* pension tax-free lump sum

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Source: Adam (2016).

Lifetime Individual Savings Accounts

- Clear rationale for encouraging saving for retirement
  - less so when use of money from age 60 unrestricted
  - less clear rationale for encouraging saving for a home more than other pre-retirement consumption
- Expect lots of shifting existing savings to new vehicle
  - in 2013, 3.2m under-45s had more than £3,000 in ISAs
- Big winners: basic-rate taxpayers who can transfer existing savings
  - and higher-rate taxpayers saving for 1st home, and those constrained by pension contribution limits
- Little detail on what government expects
  - cost, take-up, new saving *vs.* shifting existing funds,…
  - potentially expensive

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Conclusions

- Single-tier pension delivers a welcome simplification of the state pension system
  - in the short-term many gain, in the longer-term most lose
- State pension age currently rising particularly sharply for women and will reach age 66 for both men and women by end of this decade
  - further increases in line with longevity, subject to review, planned
- But long-run state spending on pensions still projected to rise
- Early evidence suggests automatic enrolment is boosting membership of workplace pensions
  - evidence on contributions and, preferably, total saving needed
- Lifetime ISAs will be attractive to basic-rate taxpayers whose own pension contributions don't attract an employer match
  - but how much additional saving will they generate?

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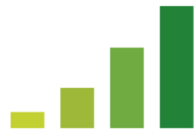

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