



Joint Colloquium of the IACA, PBSS and IAAHS Sections of the International Actuarial Association

Westin Copley Place Hotel, Boston, U.S.A. – 4-7 May 2008

Social Security and Pension Reform United Kingdom Case Study

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THE FUNDAMENTAL CONCEPT

The Beveridge proposal

- > universal coverage
- > comprehensive social security
- > flat-rate safety net basic pension (not earnings-related)
- > actuarially determined contributions
- > responsibility of individual and employer, not state
- > funded occupational pension schemes to make up

THE FUNDAMENTAL CONCEPT

Basic Pension (BP)

- > flat-rate pension
- > entitlement based on contribution record
- > retirement age of 65 (men) and 60 (women)
- > credits for sick and unemployed
- > credits for those with home responsibilities
- > low level of benefits (now some 15% of average earnings)
- > additional pension for dependent wife

THE FUNDAMENTAL CONCEPT

State earnings-related pension scheme (SERPS)

- > SERPS introduced from 1978
- > revalued average of best 20 years' earnings
- > possibility of contracting out for occupational schemes
 - > must provide reasonable level of benefits
 - > must provide guaranteed minimum pensions
 - > in return, contributions to SERPS reduced by 'rebate'
- > seen as a partnership between state and private pensions

THE FUNDAMENTAL CONCEPT

Structure of retirement income

- > compulsory flat-rate first tier (basic pension)
- > compulsory earnings-related second tier (SERPS)
 - > contracting out through DB occupational pension schemes
 - > and later through occupational DC schemes
 - > and also personal and stakeholder pensions
- > voluntary occupational or personal pension schemes
 - > with reasonably favourable tax treatment
- > personal savings
- > means-tested income support for those on low incomes

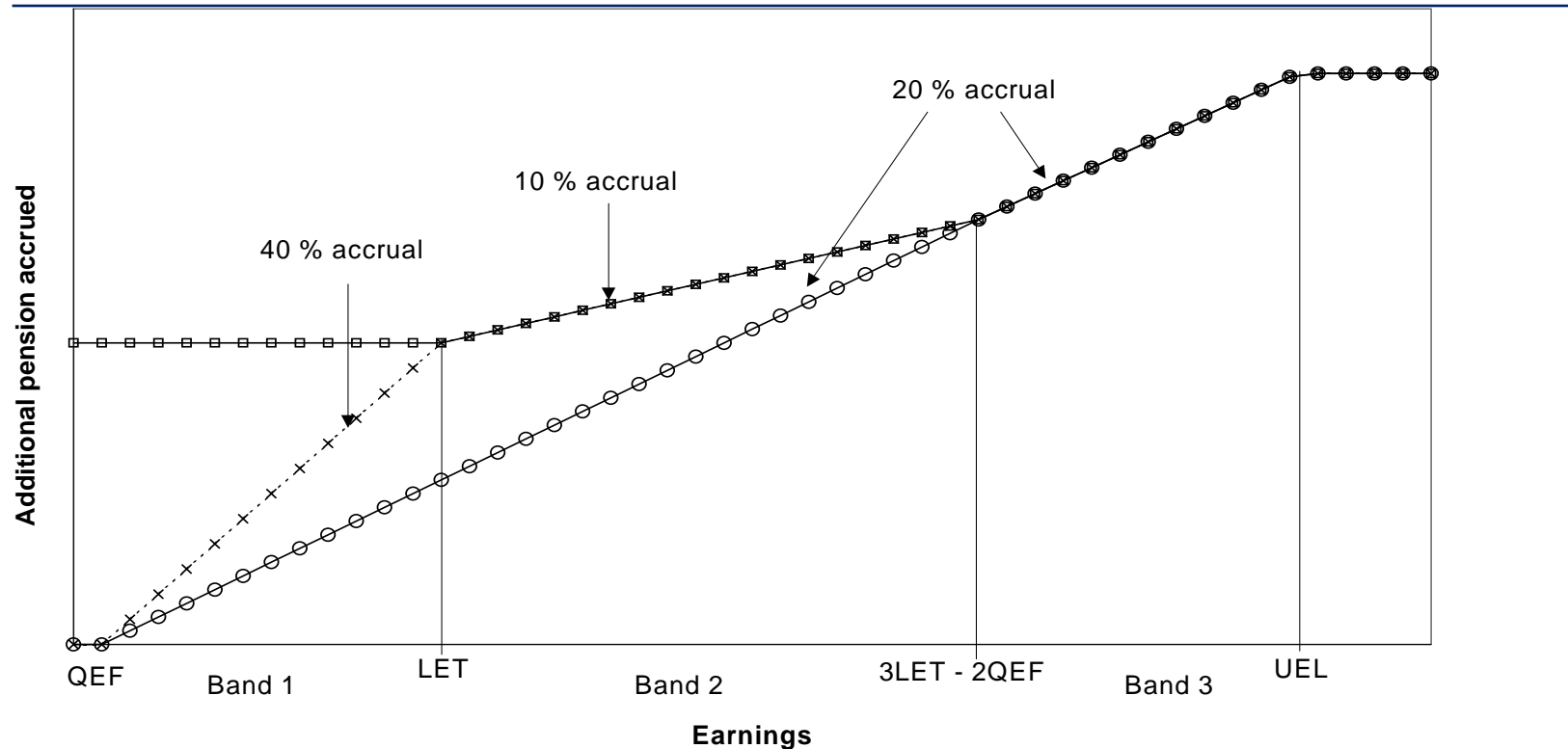
PENSION REFORM IN THE UK

Continuous pension reform since 1975

- > State earnings-related pension scheme (SERPS) (1975)
- > contracting out for DB occupational schemes (1975)
- > basic pension linked to RPI (1980)
- > appropriate personal pensions for contracting out (1987)
- > cut back of SERPS – career average revalued (1988)
- > equalisation of pension age at 65 (by 2020) (1995)
- > State Second Pension replaced SERPS (2002)
- > Minimum Income Guarantee (2002)
- > pension credit with an earnings link (2003)
- > trend to more dependence on means-testing
- > longevity risk offset by revaluation and rising pension age

STATE SECOND PENSION

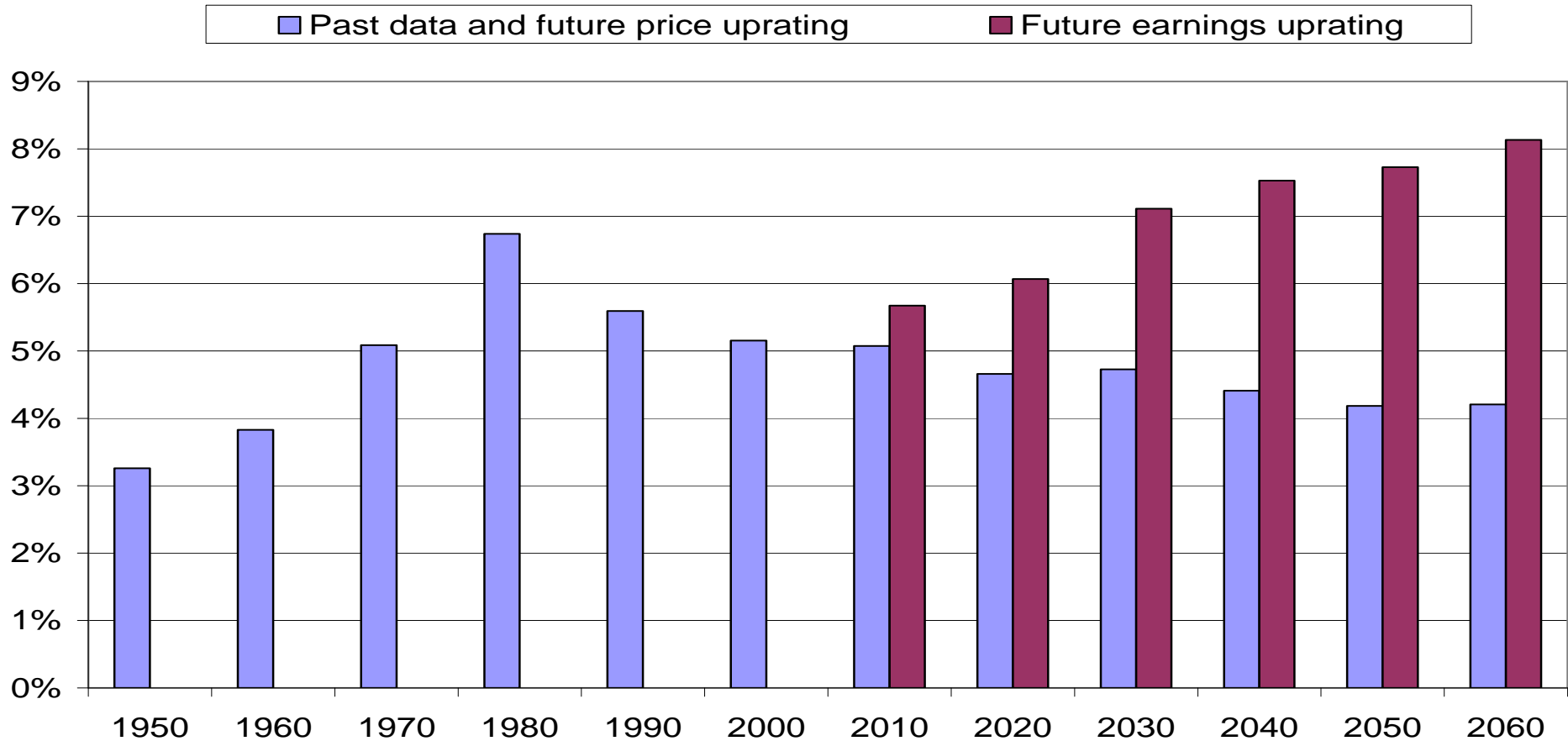
Accrual Pattern under S2P



- State Second Pension, including effect of deemed earnings at low earnings threshold for low earners
- Benefits given up by members of contracted-out occupational schemes (as for pre-2002 additional pension benefits)
- x--- Benefits given up by members of APPs (State Second Pension ignoring deeming of earnings to low earnings threshold)

STABLE FINANCIAL POSITION

Expenditure from National Insurance Fund as % of GDP

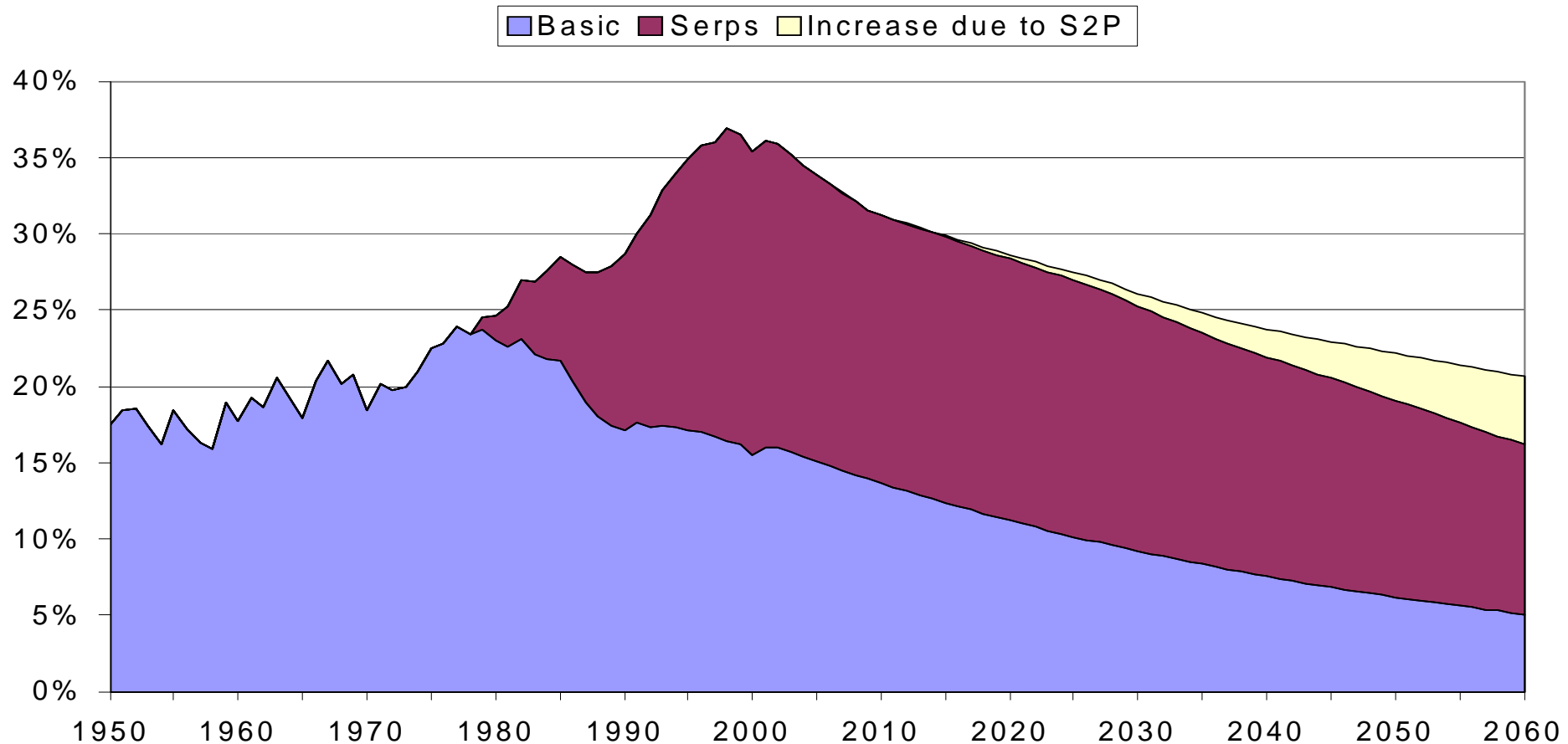


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DECLINING EFFECTIVE LEVEL OF BENEFITS

Pensions by year of award as % of earnings (at average earnings levels)



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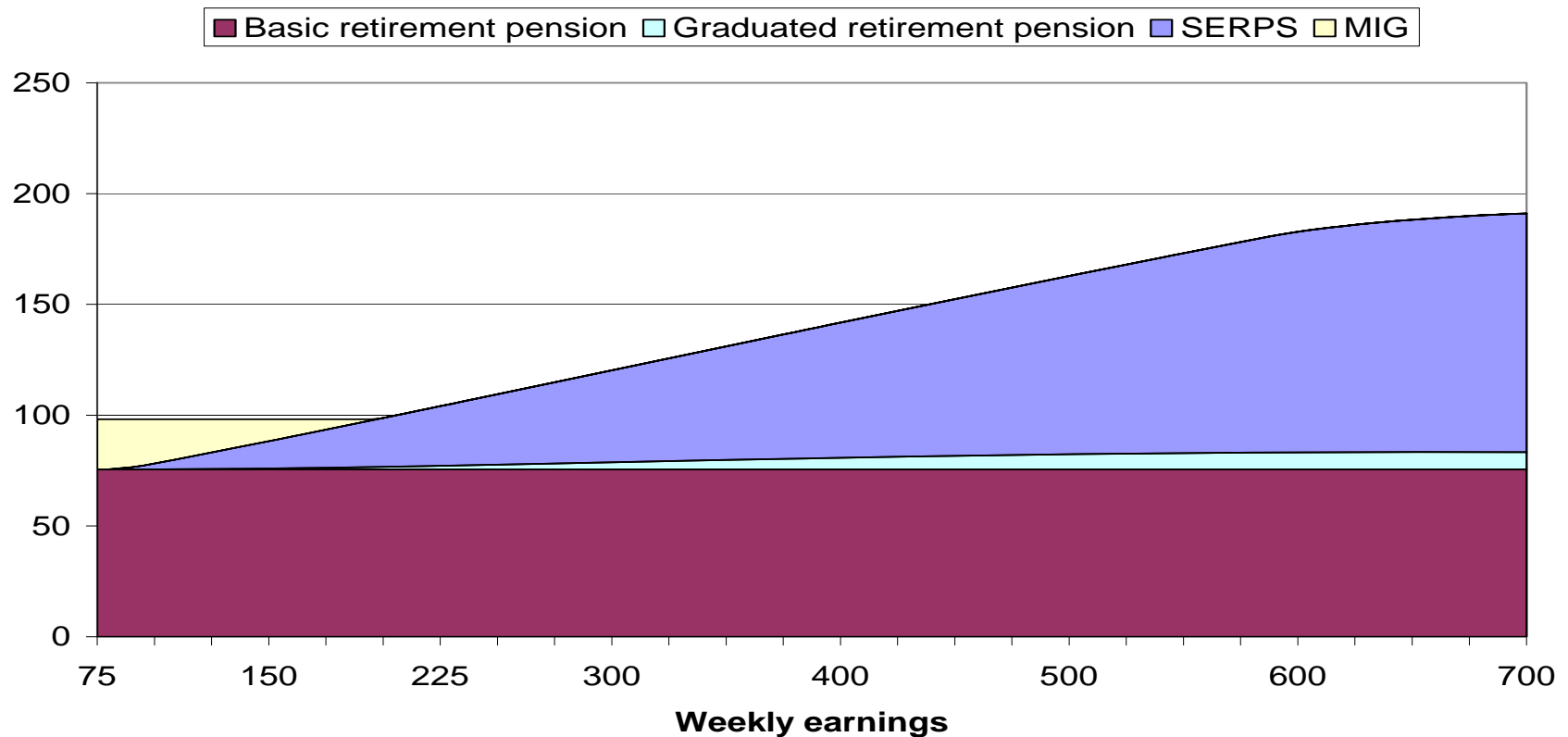
MEANS-TESTED BENEFITS

Pension Credit

- > originally known as Minimum Income Guarantee
- > Pension Credit from October 2003
- > to be uprated in line with earnings
- > Savings Credit allows 60p in £1 to be kept above full BP...
- > ...subject to maximum level of Pension Credit

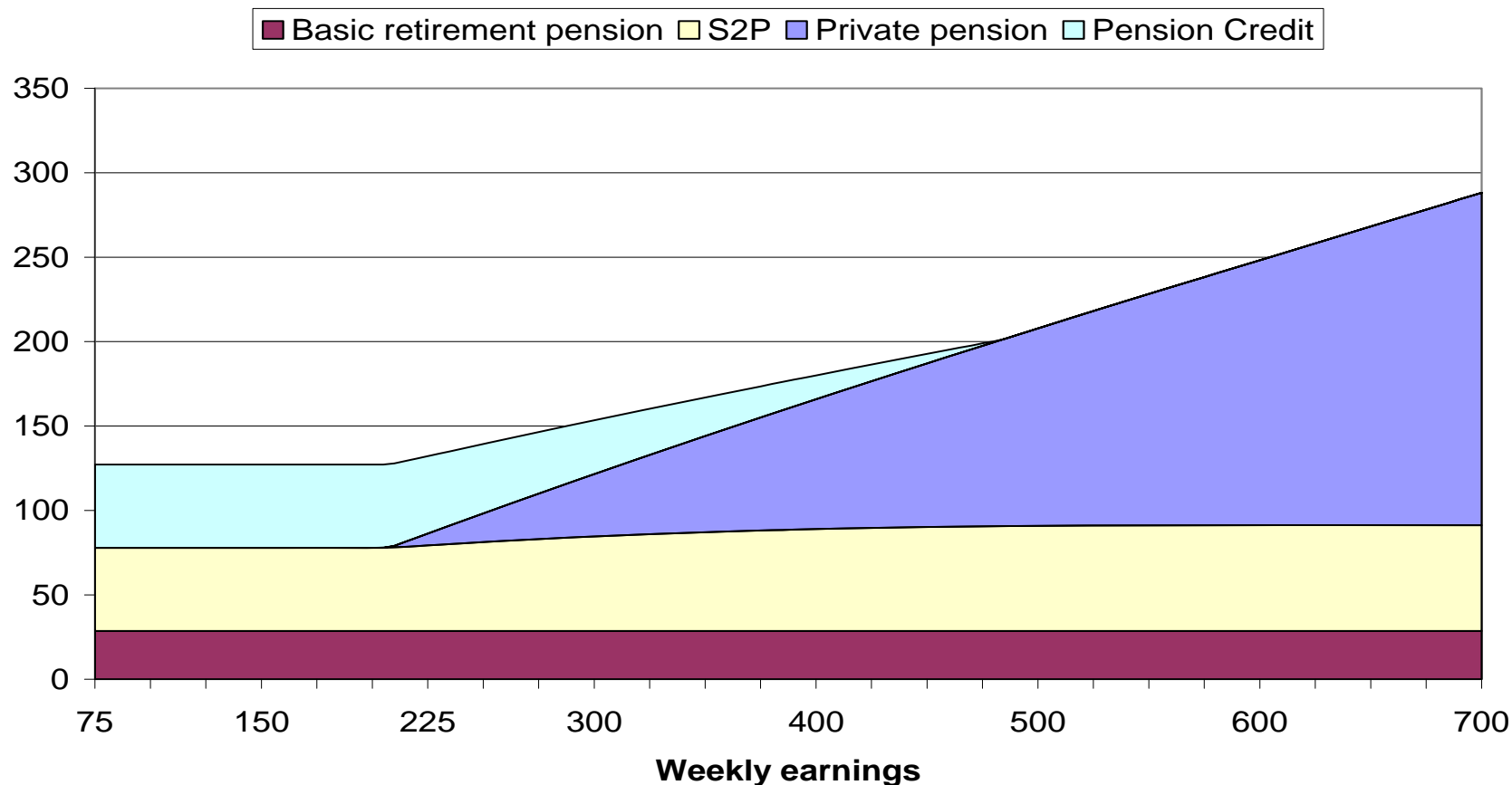
MEANS-TESTED BENEFITS

Weekly pension at award in 2002/03



MEANS-TESTED BENEFITS

Weekly pension at award in 2051/52



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OVERALL ASSESSMENT

Challenge set for The Pensions Commission

- > stable low cost of social security (at about 6% of GDP)
- > no ageing population financing problem
- > relatively high level of funded pension provision
- > significant consumer choice.....BUT
- > basic pension entitlement is too low
- > leaving many qualifying for means-tested benefits
- > and expectations of a growing proportion
- > extremely complex combination of benefits
- > occupational pension schemes running into difficulties

THE PENSIONS COMMISSION

Issues to be addressed – social security

- > declining value of BP (and S2P) relative to earnings
- > high cost of increasing BP for everyone
- > shift to dependence on means-tested benefits
- > residual problem of coverage for older women
- > high level of complexity
- > tendency to contract back in to S2P

THE PENSIONS COMMISSION

Issues to be addressed – funded pensions

- > declining significance of defined benefit plans
- > solvency and security issues for private sector schemes
- > externally funded on going concern basis
- > many schemes closing to new entrants...
- > ...and some to further accrual of benefit
- > most schemes have shortfall on closure basis
- > defined contributions generally low
- > individuals shouldering more of the risk
- > insufficient private savings

THE PENSIONS COMMISSION

Factors leading to problems with DB schemes

- > taxation of surplus legislation in 1986
- > conversion of discretionary increases into guarantees
- > tax on dividends from 1997
- > accounting standards forcing market value disclosure
- > prevalence of short-term attitudes among employers
- > increasing willingness to close schemes...
- > ...forcing attention to closure or even buy-out position
- > falling interest rates
- > rapidly improving mortality
- > weak investment performance at the end of the 1990s

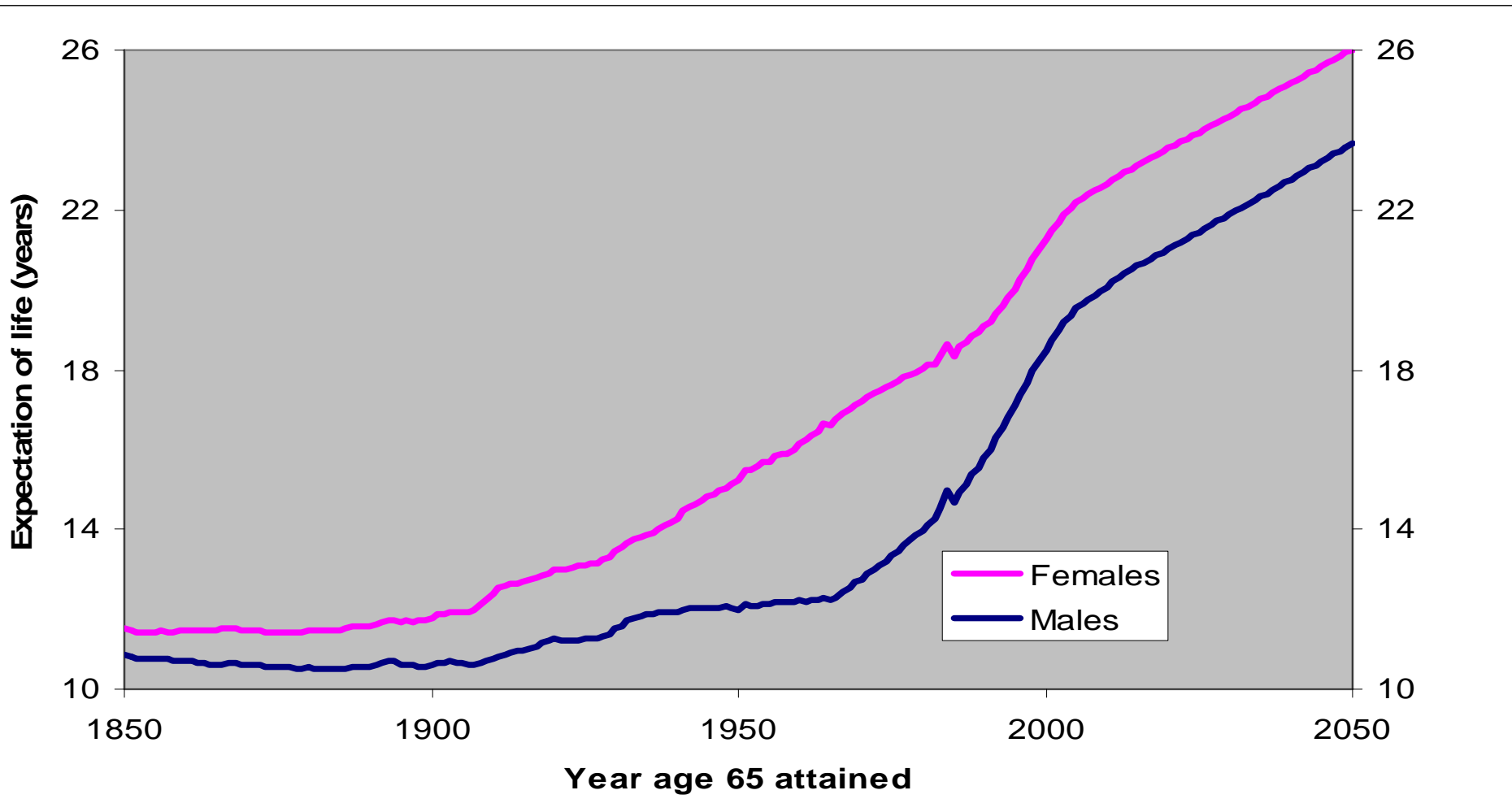
THE PENSIONS COMMISSION

The four options facing the UK

- > pensioners will become poorer relative to others
- > taxes devoted to pensions must rise
- > savings for retirement must rise
- > average retirement ages must rise

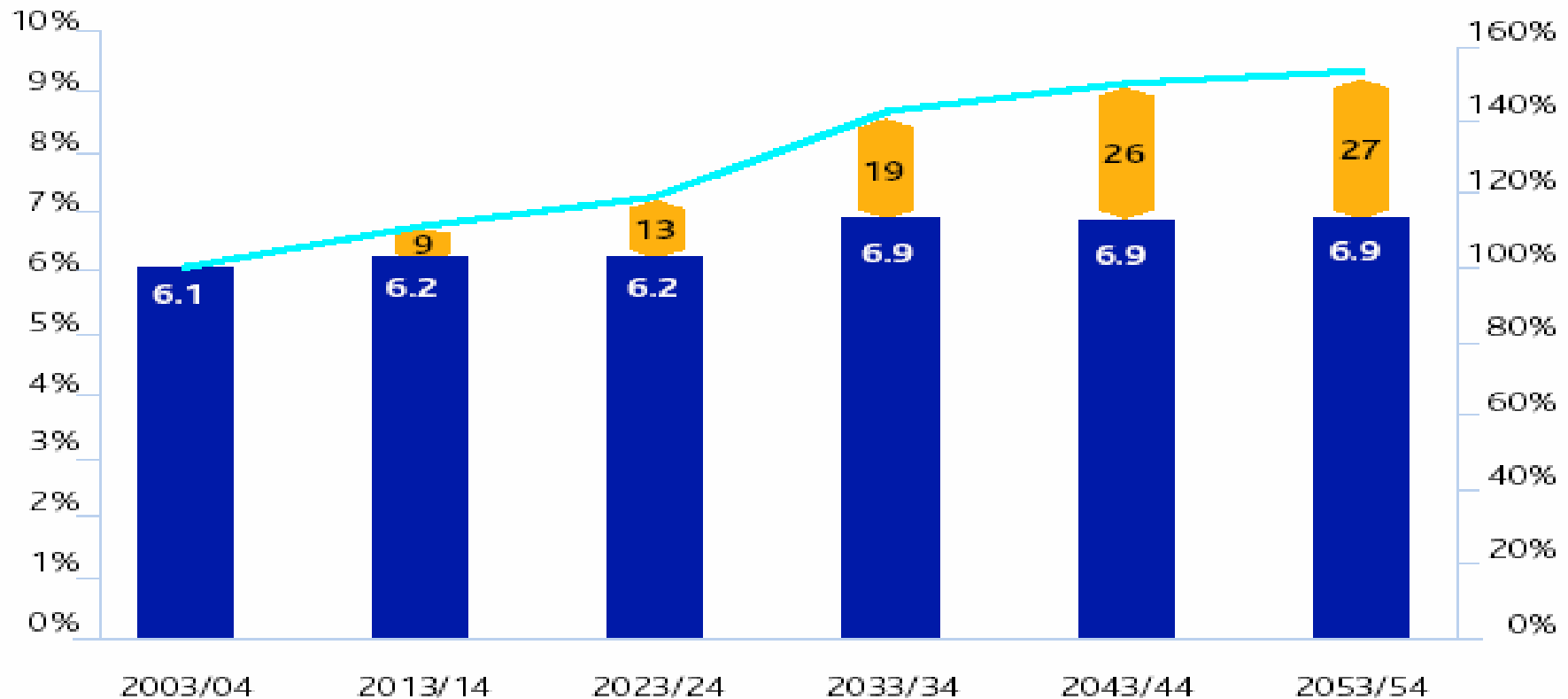
INCREASING LONGEVITY

Expectation of life at age 65 on cohort basis, E&W



THE PENSIONS COMMISSION

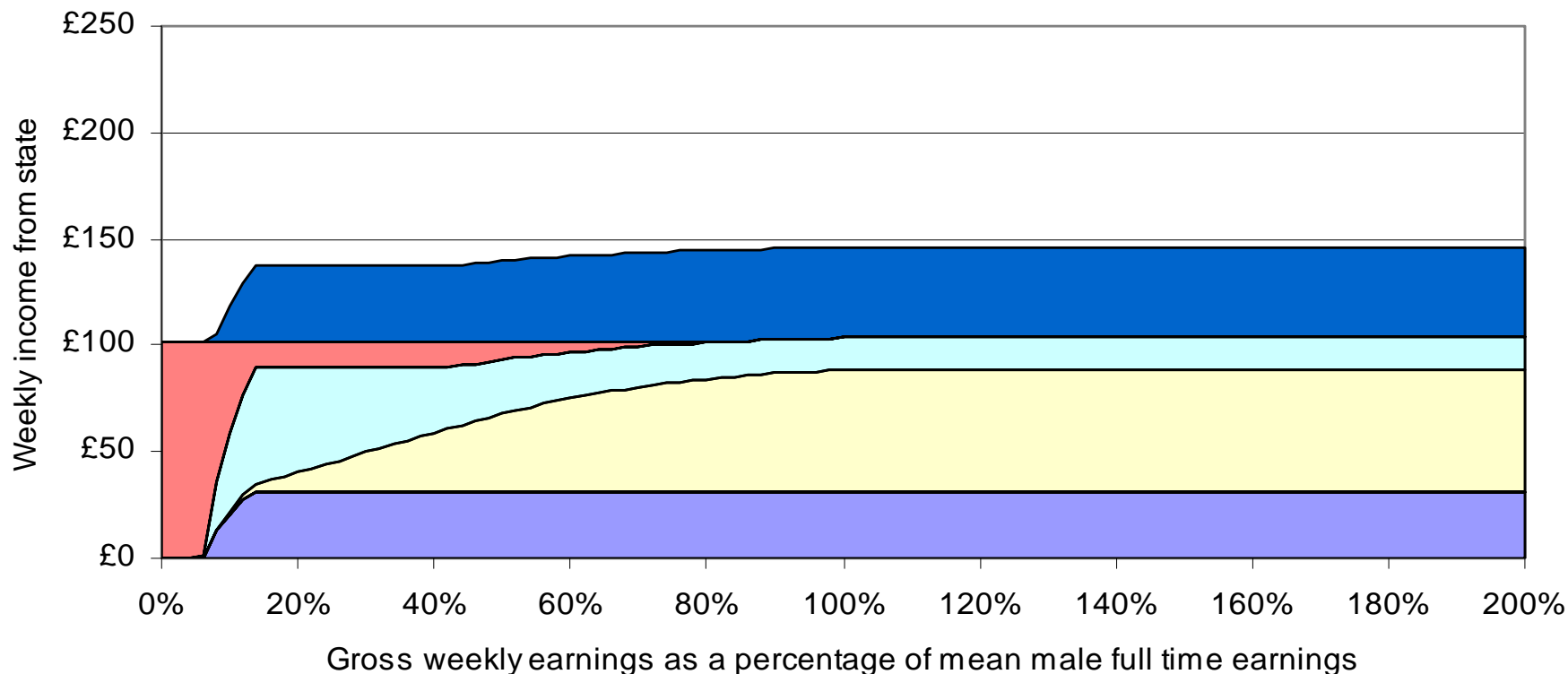
Projected state spending per pensioner in 2003/04 prices



- State spending as a percentage of GDP (Left Hand Scale)
- Number of pensioners indexed 2003/04 = 100% (Right Hand Scale)
- Gap is the percentage decline in the proportion of GDP going to the average pensioner

THE PENSIONS COMMISSION

Weekly income from the state in 2050



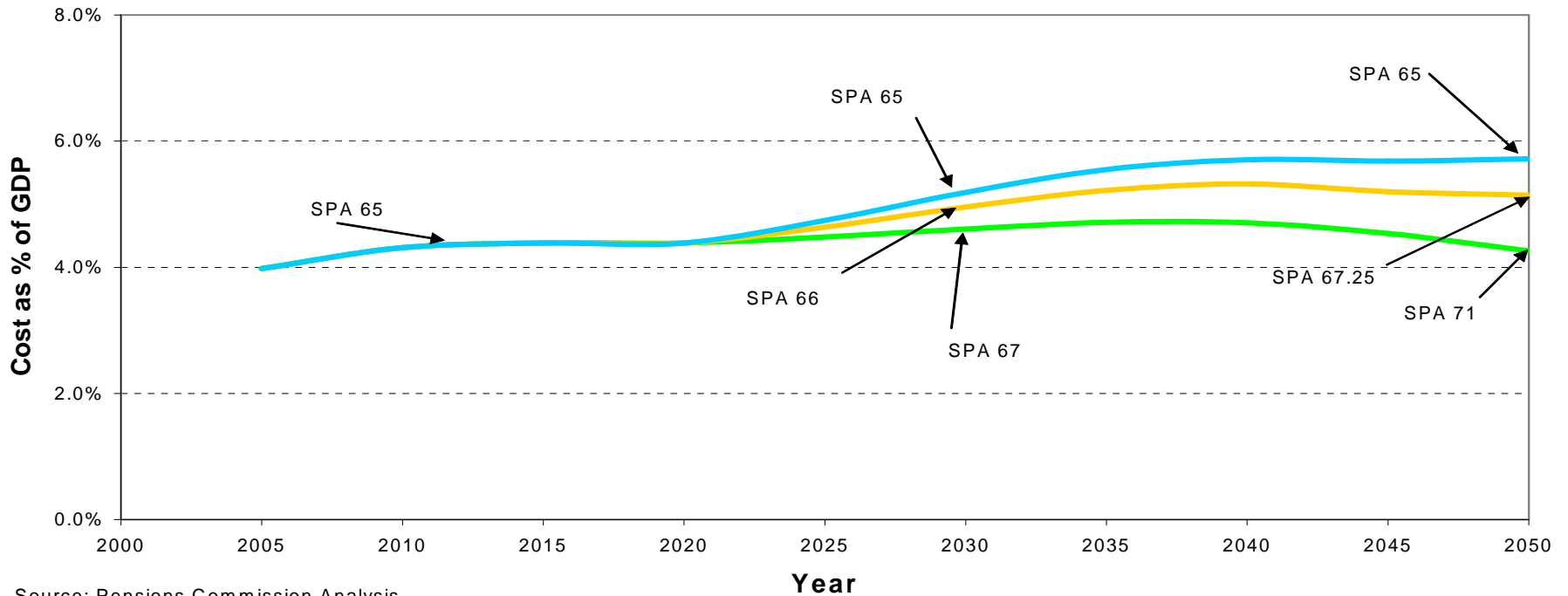
■ BSP ■ SERPS ■ Extra S2P ■ GC ■ SC

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THE PENSIONS COMMISSION

Earnings uprating of BP and raising retirement age

Cost of BSP at 19% of median earnings linked to earnings:
Various changes to SPA



Source: Pensions Commission Analysis

— Raise 1 year in 5 from 2020 — In line with life expectancy 2005-2050 — No change

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THE PENSIONS COMMISSION

The Commission's recommendations

- > state resources should be used to keep folk out of poverty
- > means-testing should be avoided as much as possible
- > S2P should become flat-rate and be combined with BP
- > the basic pension should be increased with earnings
- > state pension age should be raised to 67 or even 68 or 69
- > consideration should be given to making BP universal
- > contracting-out should be phased out
- > earnings-related provision should be funded
- > earnings-related provision should be encouraged through a National Pensions Savings Scheme with auto-enrolment

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THE GOVERNMENT'S PROPOSALS

White Paper proposals (May 2006)

- > restore earnings link for basic pension
- > raise pension age to 68 by 2046
- > S2P to become flat-rate top-up to BP
- > abolish DC contracting-out
- > individual accounts with auto-enrolment

THE GOVERNMENT'S PROPOSALS

Basic Pension

- > earnings upratings from 2012 (or so)
- > increasing pension age
 - > 65 for men and women from 2020
 - > raise from 65 to 66 between 2024 and 2026
 - > raise from 66 to 67 between 2034 and 2036
 - > raise from 67 to 68 between 2044 and 2046
- > only 30 years' contributions required for full pension
- > home responsibilities credits on a weekly basis

THE GOVERNMENT'S PROPOSALS

State Second Pension

- > freeze (or slow down revaluation of) earnings bands
- > transition to second flat-rate pension over 20 years
- > abolish contracting-out on a DC basis fairly soon
- > expect a lot of DB schemes to contract back in

THE GOVERNMENT'S PROPOSALS

Individual savings

- > auto-enrolment into individual savings accounts
- > provision for opting out
- > contributions on earnings from £5,000 to £30,000 a year:
 - > 4% from employees
 - > 3% from employers
 - > 1% from tax relief
- > contributions collected with National Insurance
- > investment mechanisms still to be decided...
- > ... but expected to involve wholesale investment of funds
- > rather than retail pension products

THE GOVERNMENT'S PROPOSALS

Occupational pension schemes

- > new stronger pensions regulator
- > the Pensions Protection Fund
- > the Financial Assistance Scheme
- > emphasis on improving funding levels
- > ... but already too late for many company schemes
- > new attempts at simplification of regulations
- > ...and lessening burdens on schemes
- > defined benefit schemes unlikely to be resuscitated
- > problems of perceived privilege of public sector workers

THE END

Questions and discussion



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