Changes to the UK retirement system

Population Issues Seminar, Vancouver

14 October 2015

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Recent reforms to UK social security

- abolition of earnings-related state pension
- higher level of flat-rate pension
- reduced need for means-tested pension
- more generous indexation of flat-rate pension
- …best of prices, earnings or 2.5%
- rising State Pension Age to offset ageing population

State Pension Age (SPA)

- 65(M) / 60(F) since start of National Insurance in 1948
- equalisation at 65 for M and F between 2010 and 2020
- increase to 66 overlaid between 2016 and 2020
- legislation increases SPA to 67 between 2026 and 2028
- legislated review process for further increases

State pension age review process

- review every 5 years
- report by Government Actuary on proportion of adult life people can expect to spend on state pension
  - cohort expectation of life at SPA
  - keep at 1/3 of expectation of life from entry into labour force
- independent report on wider factors to be taken into account
  - e.g. regional, gender and occupational mortality differences

SPA expected outcome (my estimates)

- 67 between 2026 and 2028
- 68 in 2040 (year of birth 1972 cohort)
- 69 in 2052 (year of birth 1983 cohort)
- 70 in 2064 (year of birth 1994 cohort)
- 71 in 2076 (year of birth 2005 cohort)
- 72 in 2088 (year of birth 2016 cohort)

Indexation of retirement age in EU

Indexation of retirement age

- Belgium
- Cyprus
- Denmark
- Greece
- Netherlands
- Portugal
- Slovakia
- United Kingdom

Sustainability factor approach

- Finland
- Spain

NDC approach

- Sweden
- Italy
- Latvia
- Norway
- Poland

“Freedom of choice” (for DC plans)

- removal of requirement to buy an annuity
- 25% may be taken as tax-free lump sum at retirement
- balance can be used
  - to buy an annuity (as before)
  - to purchase a drawdown contract (as before up to age 75)
- or UFPLS (uncrystalised fund pension lump sum)
    - series of cash withdrawals each 25% tax free/75% taxed

Annuity market

- highly developed and efficient
- standard market (with no underwriting)
- enhanced annuity market (underwritten)
  - health status
  - lifestyle (e.g. smoker habit, alcohol consumption)
  - location
- industry now criticised by regulator for not directing people to enhanced annuities (generally with different companies)
- retrospective review by regulator of advice given

Outcomes

- expect significant decline in sale of annuities
- …but market still significant
- risk of withdrawing funds too rapidly (or too slowly)
- higher state pension should reduce claims on welfare benefits
- taxable payments will be brought forward
- some retirees will pay tax unintentionally at higher rate
- currently very limited availability of drawdown/UFPLS products
- transfers possible from DB to DC to access freedoms
- …but required to take independent financial advice

Radical shake up of decumulation

- will completely change the post-retirement landscape
- enhanced annuities will remain good value for some
- annuities may appear better value as interest rates rise
- ...and will still offer the best insurance against longevity
- more flexible draw-down products will need to be developed
- education and advice will be needed in large measure
- formal advice required before transferring from DB to DC
- …except for very small pension pots

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