Government Actuary's Department

Changing State Pension age in response to demographic developments: a UK perspective

Paper to Population Issues Working Group for Retirement Age Seminar to be held at IAA meetings in Vancouver, October 2015

Date: 14 October 2015

Author: Martin Lunnon

Acknowledgements

I wish to thank Adrian Gallop, Stephen Humphrey and Corrado Coppa for their assistance in producing this paper. All errors remain my own.

Contents

1 UK pension age history

1.1 From the 1940s the State Pension age in the United Kingdom was 65 for men and 60 for women. The same age applies to both the flat-rate basic State Pension and the earnings-related additional pension introduced in the 1970s. There has been the possibility for people reaching state pension to defer receipt of their pension and to receive a higher rate (pension plus increments) at a later age.

1.2 Table 1 below shows cohort life expectancy at birth and at ages 65 or 60 for men and women in the England and Wales for different years:

Table 1 –cohort life expectancies for men and women at birth and at State Pension age in various years England and Wales

	Men		**Women**	
	Cohort life expectancy at			
	Birth	**65**	**Birth**	**60**
1948	77.3*	12.1*	82.3*	19.2*
1995	88.0	17.3*	91.6	25.9*
2015	91.2	21.8	94.5	29.2

* Substantially based on actual mortality experience since the relevant date for the cohort

1.3 The Pensions Act 1995[2] increased the State Pension Age for women from 60 to 65. This change was to be phased in over the period from 2010 to 2020. Hence 15 years' notice was given of the change. After the passage of this piece of legislation the State Pension age for all men and women born after 1955 was 65. The second report of the Pensions Commission, an independent review body which sat in the mid-2000s, ("A new pension settlement for the twenty-first century" published in 2005[3]) recommended adjusting pension ages as a tool for managing longevity risk in pension systems.

[2] http://www.legislation.gov.uk/ukpga/1995/26/pdfs/ukpga_19950026_en.pdf
[3] http://webarchive.nationalarchives.gov.uk/+/http:/www.dwp.gov.uk/publications/dwp/2005/pensionscommreport/main-report.pdf

1.4 The Pensions Act 2007[4] introduced measures gradually to increase the State Pension age for both sexes from 65 to 66 in the mid-2020s, from 66 to 67 in the mid-2030s and from 67 to 68 in the mid-2040s. Projected life expectancies are shown in Table 2 below:

Table 2 – cohort life expectancies for men and women at State Pension age in various years England and Wales (from 2012-based principal population projections)

	Men				**Women**			
	Cohort life expectancy at							
	65	**66**	**67**	**68**	**65**	**66**	**67**	**68**
2007	20.4	19.5	18.6	17.7	23.3	22.3	21.4	20.5
2025	22.9	22.0	21.2	20.3	25.5	24.6	23.7	22.7
2035	24.1	23.1	22.2	21.3	26.6	25.7	24.7	23.8
2045	25.2	24.2	23.3	22.4	27.7	26.7	25.8	24.8

1.5 The Pensions Act 2011[5] made changes to this regime. The increase in State Pension age for women to 65 was brought forward to November 2018. The increase in State Pension age for both sexes from 65 to 66 was brought forward from the mid-2020s to happen between March 2019 and September 2020. The dates of the increases in State Pension age to 67 and 68 were left unchanged. Note that this implied just 7 years' notice of change in State Pension age for some people.

[4] http://www.legislation.gov.uk/ukpga/2007/22/contents
[5] http://www.legislation.gov.uk/ukpga/2011/19/contents

2 The Pensions Act 2014

2.1 The Pensions Act 2014[6] made major changes to State Pensions, altering the structure away from the flat-rate basic State Pension and the earnings-related additional pension to a new (higher) flat-rate single tier pension called the new State Pension from 2016. There were also transitional provisions for those who had accrued rights under the previous system higher than the rate of the new State Pension at the time of its introduction.

2.2 The act also (section 26) brought forward the increase in State Pension age from 66 to 67 to the period 2026-2028. It had previously fallen in the mid 2030s.

2.3 The major change of the act was, however, to introduce "period review[s] of rules about pensionable age" (section 27). The text of the section is reproduced overleaf.

2.4 This legislation is not an "automatic balance mechanism" (a provision in a social security arrangement that ensures it remains financially sustainable in the face of demographic or economic changes). In fact, there is nothing automatic about changes to State Pension age ("pensionable age") under the act. The legislation is about reviews of State Pension age, and if the conclusion of such a review is that a change is thought desirable, the government of the day will have to propose new legislation, to be passed by both houses of Parliament, to achieve that.

[6] http://www.legislation.gov.uk/ukpga/2014/19/contents

Pensions Act 2014

27 Periodic review of rules about pensionable age

(1) The Secretary of State must from time to time—

(a) review whether the rules about pensionable age are appropriate, having regard to life expectancy and other factors that the Secretary of State considers relevant, and

(b) prepare and publish a report on the outcome of the review.

(2) The first report must be published before 7 May 2017.

(3) Each subsequent report must be published before the end of the period of 6 years beginning with the day on which the previous report was published.

(4) For the purposes of each review, the Secretary of State must require the Government Actuary or Deputy Government Actuary to prepare a report for the Secretary of State on—

(a) whether the rules about pensionable age mean that, on average, a person who reaches pensionable age within a specified period can be expected to spend a specified proportion of his or her adult life in retirement, and

(b) if not, ways in which the rules might be changed with a view to achieving that result.

(5) The Secretary of State must, for the purposes of a review, appoint a person or persons to prepare a report for the Secretary of State on other specified factors relevant to the review.

(6) The Secretary of State must lay before Parliament any report prepared under this section.

(7) For the purposes of subsection (4)—

(a) a person's adult life is the part of the person's life after he or she reaches the specified age;

(b) the proportion of a person's adult life spent in retirement is the proportion of his or her adult life spent after reaching pensionable age.

(8) In this section—

"pensionable age" has the meaning given by the rules in paragraph 1 of Schedule 4 to the Pensions Act 1995 (and "the rules about pensionable age" means those rules);

"specified" means specified by the Secretary of State.

3 A review under the Pensions Act 2014 – the role of the Government Actuary and others

3.1 Although clause 3 of section 27 of the Pensions Act 2014 sets out that each review "must be published" within 6 years of the previous review, the understanding is that reviews will be carried out every 5 years (with some allowance for slippage in the timetable of any review). It is likely that the first review will commence after the publication by the Office for National Statistics of new population projections for the UK (based on experience up to 2014), expected at the end of October 2015.

3.2 A review under section 27 of Pensions Act 2014 must include three reports, one by the Secretary of State (of the Department for Work and Pensions), one by the Government Actuary who must, as a minimum, address some specific questions set out in legislation, and one by persons appointed by the Secretary of State to consider other specified factors relevant to the review. All three reports must be laid before Parliament.

3.3 The first review under the act has not yet taken place, so much of this commentary is speculative. However some information was given by the Department for Work and Pensions in a background note published in November 2013[7]. Among other things this background note states that the (implementation of the results of) any review "will seek to give individuals affected by changes to their State Pension age at least ten years' notice".

3.4 The Department for Work and Pensions will manage the review process, commission the Government Actuary and appointing the person(s) to write the other review and commissioning that review. The Secretary of State must also, by law, specify certain parameters of the calculation that the Government Actuary must perform to produce the report.

3.5 In order for the Government Actuary to write the report the following parameters will need to be set by the Secretary of State (and agreed). The November 2013 background note suggested possible values for these parameters:

a) Proportion of adult life spent in retirement (1/3rd)

b) Age at which adult life starts (20)

c) Measure of life expectancy to use (uni-sex cohort life expectancy)

d) Mortality basis (UK principal population projection as produced by the Office for National Statistics).

These may or may not be used for the first review to be conducted before 2017.

[7] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/263660/spa-background-note-051213_tpf_final.pdf

3.6 Based on the assumptions listed above and the 2010-based population projections which were used at the time of the 2013 background note, the State Pension age would rise to 68 in the mid-2030s and to 69 in the late 2040s.

3.7 The report from the Government Actuary could potentially be quite short, along the lines of:

"…people who reach the current SPA of X in the period 20YY to 20ZZ can be expected to spend between A% and B% of their adult lives in retirement. [These proportions are as close to the specified proportion, C%, as can be achieved with an integer SPA **or** These proportions could be made closer to the specified proportion if SPA were altered to age W in year V **or** something else…]"

The conclusions of the report could be purely factual, limited to describing how State Pension age would need to change to meet the parameters set by the Secretary of State.

3.8 Although the legislation talks about the Government Actuary's review covering people who reach State Pension age in a certain "specified period" (presumably reach State Pension age under the current legislation), there would be an expectation that the review would cover a longer period – and could highlight consequential changes that might be needed for any period before or after the "specified period".

3.9 Even within the constraints of the assumptions which are likely to be specified under legislation or otherwise set out by DWP, there may be scope for consideration in the Government Actuary's report of the following issues:

a. results presented on a range of assumptions about life expectancy, for example,
   - using the Office for National Statistics' high and low life expectancy variants which have different rates of improvement for mortality rates, or
   - using assumptions about mortality rates thought to be suitable for different groups of the population such as social classes
   - differential mortality by sex

b. additional sources of uncertainty that may exist around the Office for National Statistics' projections[8], for instance as a result of uncertainty about future medical developments

c. illustrative results for different parts of the United Kingdom (England, Wales, Scotland, Northern Ireland and possibly England & Wales and Great Britain)

d. the sensitivity of the results to the
   - definition of when adult life starts
   - proportion of adult life to be spent in retirement
   - weighting of male and female mortality rates or other methodology used to give uni-sex rates

e. implications of the results for the projected old-age dependency ratio – that is, the number of people projected to be above the State Pension age divided by the number of working age (however defined)

f. comment on the proportions of people who may not survive to SPa, and whether there are particular issues for certain regions or social groups

g. international comparisons.

[8] This was explicitly called for in the Actuarial Profession's sessional paper "Considerations on State Pension age in the UK" (March 2015) referred to in section 4 below – see paragraph 141 to 144 of that paper

3.10 Wider consideration of the issues around the State Pension age could cover:

- labour market issues, especially participation rates, around the existing SPa, how these vary between different regions of the UK or parts of the labour force, and any trends in these matters
- interaction between the SPa and issues around the design and regulation of occupational and private pensions and other saving
- whether changes in SPa may lead to changes in behaviour in the above areas
- age-related sickness and disability, and healthy and disability-free life expectancies, how these vary between different regions or parts of the labour force, and any trends in these matters
- the extent to which the notice period of 10 years which the government has stipulated as a minimum for changes to SPa may be considered adequate if there are to be rapid changes, say of more than 1 year every decade
- variable SPas – either a different SPa for different groups, perhaps defined geographically or by labour market participation, or a "window" or range for SPa with actuarial reductions for taking State Pension earlier or enhancements for taking it later (although noting that deferring taking State Pension until after SPa is already possible).

These issues may well be covered in the report from other person(s) commissioned by the Secretary of State.

4 Other matters and resources

4.1 Point e in the list in paragraph 3.9 is important. There are several ways in which demographic change can cause stress in the finances of a social security arrangement. One is increasing longevity. Raising the pension age will help mitigate these stresses but will not eliminate them entirely. For instance, if those already over pension age and retired with a pension start to live longer than expected, so there are more pensioners currently and in the short term future, raising the future pension age for those currently still working will not immediately increase income to the arrangement to meet the higher outgo from pensions to the increased number of pensioners.

4.2 However if demographic stress in a social security arrangement is caused by changing levels of fertility (or net migration) working their way through in the long term, changing pension age on its own will have little effect. For instance, imagine a social security arrangement with fixed longevity (and no change in pension age) but with a "baby boom" cohort which was bigger than the cohorts before and after it. When he "baby boom" cohort was of working age it would lead, other things being equal, to a temporary increase in numbers of workers and increase in contribution income, and to a lower dependency ratio and improved finances for the arrangement. Conversely when the "baby boom" cohort reached pension age it would lead, other things being equal, to a temporary increase in numbers of pensions and pension expenditure, and a higher dependency ratio and worsening finances for the arrangement. This effect could not be addressed well by altering the pension age.

4.3 Paragraph 1.1 mentioned the possibility for people to defer their State Pension after State Pension age and to receive increments (percentage increases to the rate of pension) for doing so. The rate of increments to apply to those reaching State Pension age on or after 6 April 2016 was set following a report by the Government Actuary on the actuarially fair rate of increments[9].

4.4 Further commentary on the issue, including testing of the formula suggested by the government, can be found in a paper produced by a working party of the UK actuarial profession in March 2015. The paper is available at http://www.actuaries.org.uk/research-and-resources/documents/sessional-paper-considerations-state-pensions-age-uk with video recording of the meeting at http://openchannel.multichanneltv.com/the-actuarial-profession/changes-state-pension-ages/.

[9] https://www.gov.uk/government/publications/report-by-the-government-actuary-on-the-actuarially-fair-rate-of-increments-for-those-choosing-to-defer-their-state-pension-after-2016