2015 Pension Policy Notes

UNITED KINGDOM

- **Reconsider the policy to allow full pension withdrawals**
- **Develop professional training for workers in physically demanding jobs to improve their job prospects as they get older**

The newly designed system could provide both an adequate retirement income and be financially sustainable. Overall, the relative average income of people aged 66 and over (versus that of the whole population) is currently among the lowest within OECD countries. However, the old-age poverty rate is well below the OECD average and is only slightly above the poverty rate for the total population. In order to improve adequacy, the basic and state second pensions will be replaced from 2016 by the new state pension (nSP). It will provide a more effective safety net for those who would have been unable to achieve a full state second pension (self-employed, low earners or workers with interrupted careers), but benefits will otherwise be lower, especially for high earners. A minimum of 35 years of contributions, five more than currently required, will be needed for the full rate nSP which will be set at a higher level than both the current basic pension and the means-tested Pension Credit supplement. The private component consists of an automatic enrolment scheme into voluntary occupational pension plans, including the National Employment Savings Trust (NEST). NEST is a low-cost, workplace, defined-contribution pension “master-trust” scheme that can be used by any employer. The combination of a higher basic pension and a substantial voluntary pension generate long-term replacement rates that are potentially high for low-wage earners but decline with wages as the impact of the nSP benefit fades away.

Key indicators: United Kingdom and OECD average

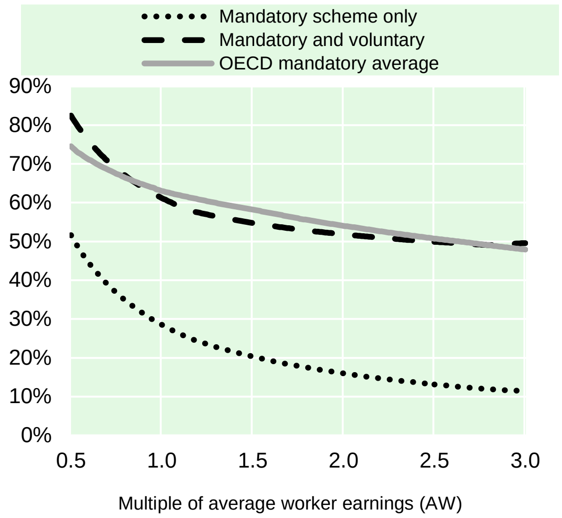
	Mid-1980s	Mid-1990s	Mid-2000s	latest available	latest OECD	long-term	long-term OECD
Pensionable age for a full-time career starting at the age of 20	65.0 (60.0)	65.0 (60.0)	65.0 (60.0)	65.0 (62.0)		68.0	
Retirement age	65.0 (60.0)	65.0 (60.0)	65.0 (60.0)	65.0 (62.0)	62.9 (61.8)	68.0	64.6 (64.4)
Net replacement rate, avg earner						28.5	63.2 (62.7)
Total mandatory contribution rate	No separate pension contribution				19.1		
Total pension spending, % of GDP	9.1	10.3	10.7	11.4	10.3		
Public pension spending, % of GDP	5.9	5.7	6.0	6.2	8.4		
Public debt, % of GDP	47	48	50	113	115		
Employment rate 55-64, %	62.3 (32.7)	56.1 (39.2)	65.6 (48.0)	67.7 (54.3)	66.1 (49.1)		
Labour-market exit age	62.8 (60.8)	62.0 (60.7)	63.3 (61.4)	64.1 (62.4)	64.6 (63.1)		
Old-age poverty rate, %	8.1	10.7	10.6	13.4	12.6		
Life expectancy at 65, years	13.6 (17.4)	15.0 (18.4)	17.4 (20.1)	18.6 (21.1)	18.4 (21.5)	23.5 (25.3)	22.9 (25.9)
Old-age dependency ratio	0.26	0.27	0.27	0.30	0.28	0.50	0.57
Fertility rate	1.8	1.7	1.9	1.9	1.7	1.9	1.8

Note: The figures for women appear in parenthesis where they differ from those for men.
Long-term: Around 2060 based on all legislated reforms up to mid-2015.

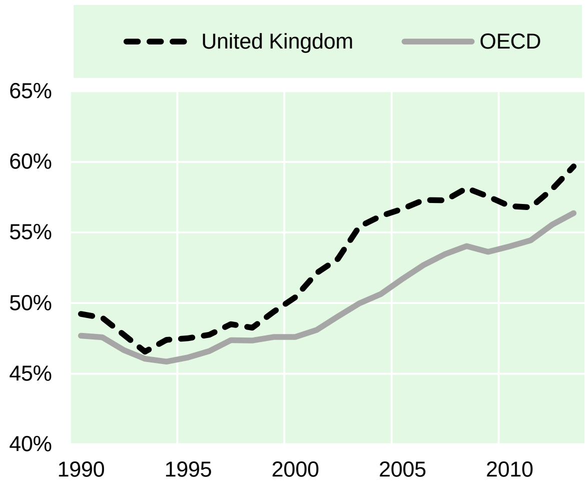
Taking pensions as a lump-sum could lead to pensioners having insufficient resources long after they have retired. NEST was introduced in 2012. The government has announced that retirees will have more choice over how to use their pension pots. Currently 25% of the pot can be withdrawn as a tax-free lump-sum from age 60. This withdrawal age was reduced to 55 in April 2015 and will then increase in line with retirement age. It will be possible to withdraw the entire pot as a lump-sum of which 25% will still be tax-free. Policy makers will need to ensure that people fully understand that by not taking an annuity they will not be guaranteed a steady income flow in later life, as once the lump-sum has been spent it will no longer provide any financial security.

With retirement ages being linked to any future increases in life expectancy, working to age 70 will become more common. The State Pension age is will be 66 for both men and women in 2020 and 67 by April 2028. The government has introduced a review process for considering future changes in the State Pension age, with the first report by May 2017. Subsequent reviews will take place within each 5-year parliamentary period. The effective age of labour market exit is currently 64 for men and 63 for women on average.

Long-term net replacement rates (%), by earnings level



Employment rate for those aged 55-64



Sources: OECD pension models; OECD Employment Outlook

Increasing pension knowledge and adapting labour markets are the key policy issues. The design of the pension system ensures a safety-net for low earners or those unable to make sufficient contributions, whilst encouraging independence and individual control over the retirement choice. However, enabling individuals to have such control over assessing their future pension adequacy comes with many risks. Without sufficient understanding of financial markets and costs, as well as the complexity of investments and annuities, individuals may be more tempted to take their pension as a lump sum. This of course may work for some but could cause serious financial pressures for many when aged in their late 80s or 90s. Moreover, the labour force participation rate of those aged 55 to 64 is currently 70% for men and 55% for women, only slightly above the OECD averages. With higher retirement ages in the future this rate should rise naturally, particularly for women due to the initial equalisation period. However to ensure that older workers are able to fully participate in the labour market policy makers will need to consider options to ensure that workers, particularly those in physically demanding occupations, are either able to remain in their current job or have sufficient training to enable them to transfer during later life.

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