United Kingdom

United Kingdom: Pension system in 2012

The public scheme has two tiers (a flat-rate basic pension and an earnings-related additional pension), which are complemented by a large voluntary private pension sector. Most employee contributors "contract out" of the state second tier into private pensions of different sorts. An income-related benefit (pension credit) targets extra spending on the poorest pensioners.

Key indicators

		United Kingdom	OECD
Average worker earnings (AW)	GBP	35 900	26 300
	USD	58 300	42 700
Public pension spending	% of GDP	6.2	7.8
Life expectancy	At birth	80.4	79.9
	At age 65	19.3	19.1
Population over age 65	% of working-age population	28.9	25.5

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Qualifying conditions

State pension age is currently 65 for men and 60 for women born on or before 5 April 1950. From 6 April 2010, women's State Pension age began to increase from 60 to 65. The UK government have announced proposals that State Pension age for men and women will increase from 65 to 66 between 2018 and 2020. The qualifying age for Pension Credit will also increase in line with State Pension age.

Under current law, two further increases are due to take place to 67 between 2034 and 2036 and 68 between 2044 and 2046. However, the UK government is considering how the State Pension age should be changed in the future. This may mean the timetable for increases to 67 and 68 will be revised. Further changes to the State Pension age are likely to affect the age at which someone can get Pension Credit.

As a result of the Pension Act 2007, a person reaching state pension age from 6 April 2010 qualifies for a full basic state pension by: *i)* paying; *ii)* having been treated as having paid; or *iii)* being credited with, National Insurance contributions, for 30 qualifying years in their potential working lives. A proportionally reduced basic state pension is paid to people with fewer than 30 qualifying years, to a minimum of one qualifying year of contribution or credits.

For people reaching state pension age before 6 April 2010, a full basic state pension is paid those with qualifying years of National Insurance contributions and credits for around nine-tenths of their potential working lives (39 years for women with a state pension age of 60; 44 years for men and women with a state pension age of 65). A proportionally reduced state pension is paid to people who do not meet the full condition, but only to a minimum of 25% (i.e. 10 years for women with a state pension age of 60; 11 years for men and women with a state pension age of 65).

Benefit calculation

Basic

The full basic state pension for a single person is GBP 107.45 per week in 2012, estimated to be almost 16% of average earnings.

Earnings-related

For earnings between the lower earnings limit (GBP 5 564 per year in 2012/13) and the low earnings threshold (GBP 14 700), the replacement rate is 40% of the difference. This also applies to people covered by credits. This is equivalent to treating people earning below the low earnings threshold as if they had earned at this level. Over the next range, the replacement rate is 10%, ending at the ceiling of GBP 40 040.

The benefit value is calculated on average lifetime salary, with earlier years' pay uprated in line with average economy-wide earnings. The benefit is then price-indexed after retirement.

Contracting out

Occupational and personal pension arrangements have been able to choose to "contract-out" of the additional pension element of the state pension. In return for rebates of National Insurance, contracted out schemes had to provide a minimum level of pension. From April 2012, as part of a drive to simplify the pensions system, the government abolished contracting out for defined-contribution arrangements. The adoption of the single tier pension would lead to its abolition for defined-benefit schemes as well.

Workplace Private Pension Provision

In October 2012, the government began rolling out automatic enrolment into workplace pension schemes. Once complete (February 2018), all employers will have a legal duty to enrol all qualifying workers aged between 22 and state pension age who earn over GBP 8 105 (2012/13 rates) into a qualifying workplace scheme. Minimum contributions will build to 8% of a statutory earnings band (GBP 5 564 to GBP 42 475 – 2012/13 rates) by October 2018.

To support automatic enrolment, the government established the National Employment Savings Trust (NEST), a trust-based occupational defined-contribution scheme. NEST has a public service obligation to admit any workers automatically enrolled by their employer, and id designed to provide low-cost, quality pension provision for low to moderate earners, transient workers and smaller employers that the market finds difficult to serve.

Targeted

Pension Credit, is a tax free weekly benefit for people who are living on low incomes and guarantees all pensioners an income above a certain level. Pension Credit is an income-related benefit and is not based on National Insurance contributions. There are two elements to the Pension Credit, the guarantee credit and the savings credit. The guarantee credit ensures a minimum level of income by providing financial help for people who have reached the qualifying age (see below) and whose income is below the standard minimum guarantee amount. In 2011/12 this was GBP 137.35 for individuals and GBP 209.70 for couples (these amounts may be higher for people with severe disabilities, caring responsibilities or certain housing costs).

The savings credit is an extra amount for people aged 65 or over who have made modest provision for their retirement. It is designed to reduce the effective withdrawal rate of benefits from 100% under its predecessors to 40%. People, whose income (excluding any guarantee credit) is below their guarantee credit minimum guarantee and above the savings credit threshold, GBP 103.13 for individuals and GBP 164.55 for couples respectively in 2011/12, receive 60% of the difference between their income and the threshold up to a maximum of GBP 20.52 for individuals and GBP 27.09 for couples, respectively. For people with incomes above their guarantee credit minimum guarantee (that is they are not entitled to the guarantee credit), the maximum savings credit is reduced by 40% of their income over their guarantee level.

The qualifying age for Pension Credit is gradually increasing to 65 alongside the increase in women's State Pension age.

Voluntary private pension

The government is introducing automatic enrolment into a qualifying workplace pension scheme, starting with the largest employers first. Qualifying defined-contribution schemes will require a minimum overall contribution rate of 8%.

Variant careers

Early retirement

A state pension will not be paid before state pension age.

Late retirement

Deferral of the state pension has always been possible in order to earn extra state pension increments. This extra State Pension is paid on top of the normal State Pension when a person eventually claims for the first time or claims again.

Until 6 April 2005, deferral of the state pension earned approximately 7.5% for every each year (equivalent to 1% for every seven weeks). From 6 April 2005, the increment increased to about 10.4% for each year (or 1% for every five weeks).

The amount of extra money a person gets depends on how long they put off claiming their state pension. They may choose one of the following options:

- A higher weekly state pension for life (if the state pension is deferred for at least 5 weeks).
- A one-off taxable lump-sum payment (if the state pension is continuously deferred for at least one year). The lump-sum is made up of the state pension foregone during the deferral period plus interest which is guaranteed to be at least two percentage points above the (Bank of England base rate). The choice has to be made when the State Pension is eventually claimed.

Childcare

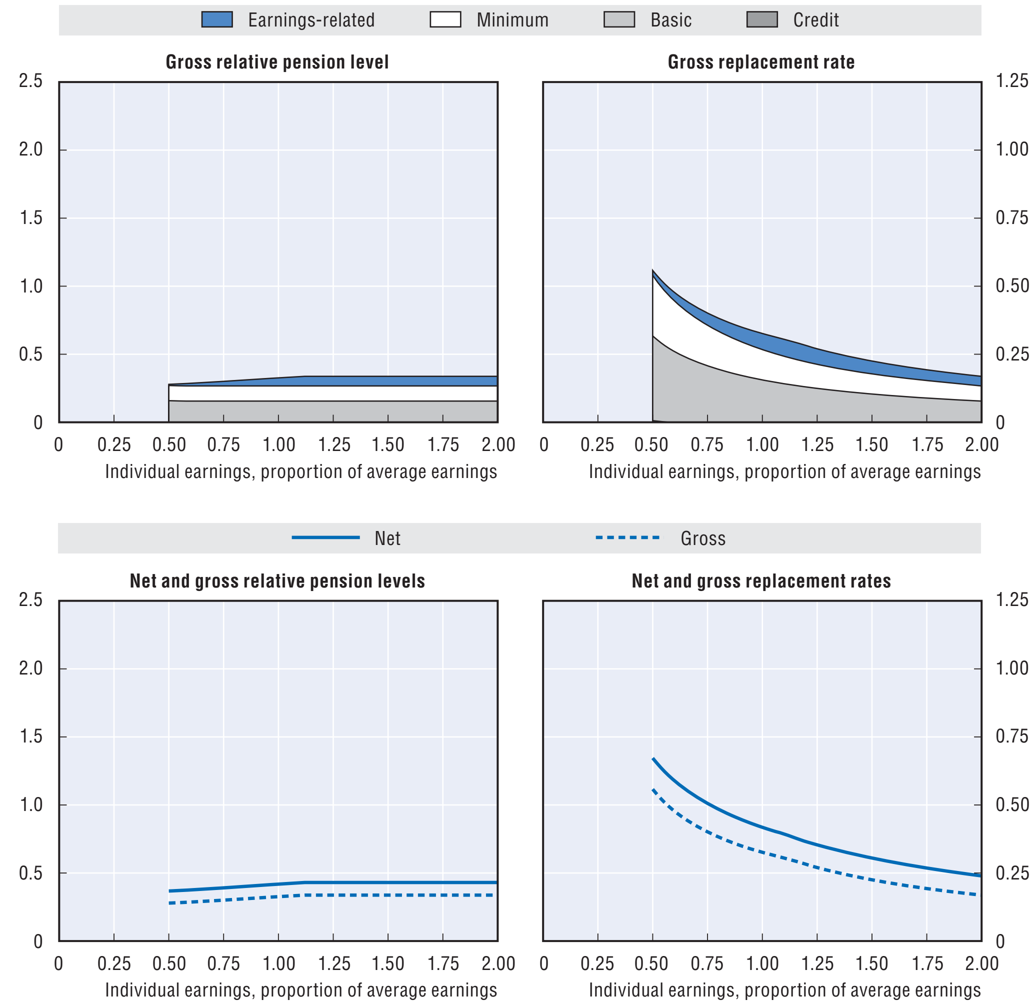
Both tiers of the public pension scheme (basic state pension and state second pension) provide protection for periods of child care. This covers both people not in paid work and those working but earning below the lower earnings limit who therefore do not contribute to the system. Prior to 6 April 2010, for the basic state pension, protection was provided by Home Responsibilities Protection (HRP), and covered years where Child Benefit was awarded for at least one child under 16. HRP reduced the number of years required for a full basic state pension so that, with sufficient HRP, only 20 years' work (including periods when National Insurance contributions may have been credited) was required. For the state second pension, years where Child Benefit was awarded for a child under age six were credited; caring parents were deemed to have earnings at the low earnings threshold.

HRP has been replaced by a system of weekly National Insurance credits for parents and carers. People attaining state pension age after 2010 may be awarded credits if they have Child Benefit for a child under age 12. These credits may count towards their basic State Pension and state second pension entitlement. Any years of HRP acquired before 2010 have been converted to qualifying years of National Insurance credits.

Unemployment

Periods of unemployment on insurance or assistance benefits are credited to a person's National Insurance contributions record for the basic state pension. There are no National Insurance credits for periods on these benefits for the state second pension.

Pension modelling results: United Kingdom



Men *Women (where different)*	Median earner	Individual earnings, multiple of average				
		0.5	0.75	1	1.5	2
Gross relative pension level	30.7	27.9	30.1	32.6	33.8	33.8
(% average gross earnings)						
Net relative pension level	39.8	36.8	39.1	41.8	43.0	43.0
(% net average earnings)						
Gross replacement rate	37.9	55.8	40.1	32.6	22.5	16.9
(% individual gross earnings)						
Net replacement rate	48.0	67.2	50.6	41.8	30.5	23.9
(% individual net earnings)						
Gross pension wealth	5.9	8.7	6.3	5.1	3.5	2.6
(multiple of individual gross earnings)	*6.5*	*9.5*	*6.9*	*5.6*	*3.8*	*2.9*
Net pension wealth	5.7	8.6	6.1	4.9	3.4	2.5
(multiple of individual gross earnings)	*6.3*	*9.4*	*6.7*	*5.4*	*3.7*	*2.8*

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