IOPS COUNTRY PROFILE: THE UNITED KINGDOM

DEMOGRAPHICS AND MACROECONOMICS

Gross GDP 2017 Q2	**USD616,090.77m**
GDP per capita 2016 (USD)	**39,952**
Population 2016	**63.7m**
Employment rate (March to May 2017)	**74.9%**
Population over 65 (%)	**18**
Labour force (April to June 2017)	**32.07million**
Dependency ratio (2016) [2]	**55.70**

Source: ONS.gov.uk and The World Bank [(2)]

THE UNITED KINGDOM: COUNTRY PENSION DESIGN

STRUCTURE OF THE PENSION SYSTEM

Public pensions

- **Tier 1**
- Unfunded – pay as you go system that is paid through National Insurance contributions
- Redistributes money throughout the population to provide all individuals with a minimum standard of living
- Includes the basic State Pension and the new State Pension
- **Tier 2** is also provided by the state and aims to provide pension income that is more closely related to employees' earnings levels. Tier 2 is less redistributive (from higher-income to lower-income) than Tier 1. Tier 1 and Tier 2 operate on an unfunded 'pay-as-you-go' contributory basis, through the National Insurance (NI) system.

Private pensions: occupational (voluntary)

- **Tier 3** includes pensions arising from automatic enrolment, a policy requiring employers to enrol eligible employees into a qualifying workplace pension scheme. The primary aim of private pensions is to redistribute income across an individual's lifetime, and not to redistribute income from higher-income to lower-income people.

Private pensions: personal (voluntary)

- **Tier 3** includes voluntary pension arrangements that are not directly funded by the state. Private pension contributions, from the employer and/or the individual, fund designated pensions for the individual.

Source: The Pensions Primer: A Guide to the UK Pensions System. Updated as at June 2017, Pensions Policy Institute

THE UNITED KINGDOM: THE PENSION SYSTEM’S KEY CHARACTERISTICS

THE BASIC STATE PENSION

The basic State Pension changed on 6 April 2016. It is designed to be simpler than the older state pension system. The new flat-rate State Pension is a regular payment from the government most people can claim when they reach State Pension age. It’s not means-tested, but the amount payable depends on the number of qualifying years of National Insurance contributions or credits a person has built up. The State Pension age is the earliest age a person can start receiving their State Pension.

State Pension age for women has been rising since 2010: by November 2018, women’s State Pension age will have increased to age 65, the same as men’s. From November 2018 onwards, State Pension age for both men and women will continue rising and it will be age 66 by October 2020. State Pension age will then be increased again from April 2026 onwards and will be at age 67 by 2028. Under the Pensions Act 2007 the State Pension Age will increase from 67 to 68 between 2044 and 2046. The Pensions Act 2007 also introduced the ability to replace price inflation with earnings inflation as the link for increases to the basic State Pension.

The Government also changed the way in which the increase in State Pension age is phased so that rather than reaching State Pension age on a specific date, people born between 6 April 1960 and 5 March 1961 will reach their State Pension age at 66 years and the specified number of months. The Pensions Act 2014 provides for a regular review of the State Pension age, at least once every five years.

People who reached State Pension age before 6 April 2016 and are already in receipt of the State Pension are not affected by the changes. For these people, the full basic State Pension is £122.30 per week and they must have 30 qualifying years of National Insurance contributions to get the full amount. They may also qualify for an Additional State Pension depending on their contributions. This is sometimes known as State Second Pension although this has been replaced by the new State Pension for those reaching state pensionable age after 5 April 2016. The ability of Defined Benefit (DB) schemes to contract-out of the State Second Pension ended on 6 April 2016, following the introduction of the single tier state pension. For employers with DB schemes which remain open to future accrual, this will increase National Insurance (NI) costs for employers and members.

The age at which someone can claim the new State Pension is based on gender and date of birth. Men born on or after 6 April 1951 and women born on or after 6 April 1953 are eligible to claim the new State Pension. The age at which someone can claim the new State Pension may be different to the age when they get their workplace or personal pension. The ‘Default retirement age’ (a forced retirement age of 65) no longer exists which means people can continue working after they reach State Pension age.

A person will build up their entitlement to the State Pension by making National Insurance (NI) contributions during their working life. National insurance is paid by some people over the age of 16 in order to qualify for certain benefits including the State Pension. There are different types of National Insurance – known as ‘classes’ – and the type of NI paid depends on employment status, the salary earned, and whether someone has gaps in their National Insurance record. For the tax year 2017/2018 the full new state pension is £159.55 per week. However, some people might be entitled to more than this if they have built up entitlement to ‘additional state pension’ under the old pre-April 2016 system, or less than this if they were ‘contracted out’ of the additional state pension. To be eligible for the full new State Pension a person will need 35 years National Insurance (NI) record and at least 10 ‘qualifying years’ on their national insurance record to qualify.

People who reach state pension age on or after 6 April 2016 do not have to claim their State Pension when they reach State Pension age. If they wish they can defer their claim and receive extra pension when they do eventually claim. If they have already claimed their pension they can cancel it so that they can receive an increased pension later on, but they can only do this once.

People who reached state pension age before 6 April 2016 and who are now in receipt of the State Pension can decide to stop getting it for a time in order to build up extra pension for the future. This is known as deferring the State Pension which can only be done once. People wishing to defer their State Pension have two options:

- get the extra pension paid as an increase to their weekly rate of State Pension - for every 5 weeks deferred, their pension will be increased by 1% which works out at 10.4% for every full year
- get a taxable, lump sum payment by putting off getting the State Pension for at least a year

One of the first acts of the Coalition Government in 2011 was to introduce the triple lock to guarantee a minimum increase in the State Pension each year. Under the triple lock, the basic State Pension or the new State Pension is increased each April by the higher of the growth in average earnings, the Consumer Price Index (CPI), or 2.5%. The triple lock only applies to the State Pension.

In addition to the new State Pension there are several means-tested benefits that pensioners may be eligible for, depending on their circumstances. Pension Credit is a benefit paid to people who have reached the qualifying age and have a low income. Pension Credit is not the same as the State Pension, which is based on National Insurance contributions paid during a person’s working life.

Pension Credit can be paid on top of retirement and other pensions. It has two parts – the Guarantee Credit and the Savings Credit. – and can be paid singly or together if a person qualifies. To claim Guarantee Credit a person needs to have reached the Pension Credit qualifying age. In 2017/18, Guarantee Credit tops up a person’s weekly income to a guaranteed level of £159.35 if single or £243.25 if married or in a civil partnership. Savings credit is an extra amount for those people who have made some provisions for their retirement, such as contributing to a personal pension or building up a modest amount of savings. The additional income provided by Savings Credit is up to £13.20 a week for a single person, and £14.90 for married couples and civil partners. People must be over 65 or over to be eligible for Savings Credit. People reaching State Pension age on or after 6 April 2016 may not be eligible for Savings Credit.

SCHEMES FOR PUBLIC SERVICE EMPLOYEES

In March 2011 the Independent Public Service Pensions Commission recommended that the government should introduce primary legislation to provide greater transparency, simplicity and certainty around Public Service Pensions. The Public Service Pensions Bill was introduced to Parliament in September 2012. The House of Commons and House of Lords reached agreement on the wording of the Bill on 24 April 2013, with Royal Assent granted the following day.

The Public Service Pensions Act (2013) introduced the framework for the creation of schemes for persons in public service (as set out in s1(2) of The Act) and also the governance and administration of such schemes. It also provides for extended regulatory oversight by the The Pensions Regulator. The Act is intended to provide a common framework for 'responsible authorities' to create these schemes. In general, the responsible authority is the relevant Secretary of State or appropriate Scottish or Welsh Ministers. With some exemptions for schemes relating to certain Scottish or Welsh public servants, the Act requires that HM Treasury consent to scheme regulations before they are made.

The Public Service Pensions Act 2013 relates to schemes established under the Act, which includes civil servants, the judiciary, local government workers, teachers, health services workers, fire and rescue workers, members of police forces and members of the armed forces. It also relates to new public body pension schemes and other statutory pension schemes which are connected to the newly established schemes. It does not apply to schemes in the wider public sector, nor to any scheme which is excluded from being a public service pension scheme within the meaning of the Pensions Act 2004.

Each public service scheme has scheme regulations which set out details of the membership and benefits to be provided under the scheme. They also identify scheme managers, and provide for pension boards and scheme advisory boards to be established. The regulations form the scheme rules. A number of different types of people are involved with governing and administering public service schemes and scheme managers must comply with a number of legal requirements, including provide benefits information to members, publishing information on pension boards, keeping certain records, ensuring that pension boards members don't have conflicts of interest, establishing and operating adequate internal controls, and reporting late payment of contributions

All people involved in governing and administering public service schemes should have the appropriate skills and expertise. However, there's a specific legal obligation on pension board members to have knowledge and understanding of their scheme rules, their scheme's documented administration policies and pensions law.

WORKPLACE PENSION SCHEMES

Defined benefit schemes

The landscape of private pensions in the UK is varied and changing in terms of its overall size. Private pensions are generally provided through the workplace though private pensions can be arranged by anyone directly with the insurance provider. Schemes provided by employers (or a group of employers) to provide retirement and other benefits to, or in respect of, their employees are known as workplace pensions, or occupational schemes.

Workplace pension schemes in the UK are usually defined by the type of benefit they provide. There are three main types:

- defined benefit schemes (sometimes known as 'final salary' schemes);
- defined contribution schemes (sometimes known as 'money purchase' schemes); and
- hybrid schemes (mixture of final salary and defined contribution benefits).

Benefits payable under a traditional defined benefit scheme are calculated by reference to a fixed formula, which is usually based on the value of a member's salary and the length of their pensionable service. Members generally pay a fixed rate of contributions with the employer funding the balance of costs (and therefore bearing all the risks). Under the Pensions Scheme Act 2015 a pension scheme is a 'defined benefits' scheme if:

(a) the scheme provides for all members to be paid retirement income beginning at normal pension age and continuing for life,

(b) there is a full pensions promise in relation to the retirement income and any other retirement benefits that may be provided to members,

(c) the normal pension age in relation to the retirement income and any other retirement benefits that may be provided to members is fixed, and

(d) such other requirements as may be specified in regulations are met.

A career average revalued earnings (CARE) scheme is a type of defined benefit scheme that calculates retirement benefits using earnings throughout an employees career. The accrued retirement benefits for each year are revalued from the year of accrual to retirement age using an appropriate index. A cash balance scheme is a type of defined benefit pension under which members build up lump sum benefits on either a final salary or career average basis.

The Pension Protection Fund (PPF) was set up by the Government in 2005 to pay compensation to members of eligible defined benefit schemes where there is a qualifying insolvency event in relation to the sponsoring employer and where there are insufficient assets to the levels of compensation payable by the PPF.

Defined contribution schemes

Defined contribution pension schemes invest the contributions made by the individual and their employer in a range of different investments. The individual may have a choice about how the contributions are invested. The benefits payable at retirement depend on:

- contributions paid into the scheme
- the length of time the contributions were invested
- how the investments performed over the period before retirement

Under the Pension Schemes Act 2015, a defined contribution scheme is one where 'there is no pensions promise in relation to any of the retirement benefits that may be provided to the members.'

Hybrid schemes

There are many varieties of hybrid schemes, but they can broadly be classed as either mixed benefit or dual-section:

- a mixed benefit scheme offers one set of benefits which has elements of both defined benefit (DB) and DC schemes, such as a DC scheme with an underpin on a DB basis
- a dual-section scheme has two sections, one offering DC benefits and the other offering DB benefits

Group personal pensions

Group personal pensions (GPPs) are pensions arranged by an employer for the benefit of its employees. Even though GPPs are arranged by the employer, the contract is held between the employee and the pension provider. Group personal pensions may have lower charges than individual personal pensions, because the provider may offer the employer a discount for the volume of policies. The employer may also choose to contribute to its employees pensions, but there is no obligation that they do so, unless the GPP is being used for automatic enrolment purposes.

From October 2001 until October 2012, every employer with five or more staff was required by law to provide a stakeholder pension scheme. Stakeholder pensions are very similar to personal pensions but they must meet specific criteria set by the government as to transfers and fees. This requirement to provide a stakeholder pension scheme was removed by the introduction of automatic enrolment on 1 October 2012 which requires employers to enrol staff into a pension scheme that meets specific automatic enrolment rules.

PERSONAL PENSION SCHEMES

Personal pensions are a type of Defined Contrbution pension scheme. They are provided by insurance companies (or other financial institutions) to help individuals save for their retirement. They are set up as contracts between the provider and the individual and there are no limits on the number of pension schemes an individual can have (although there are limits on the total amounts across all schemes that can be contributed).

A self-invested personal pension (SIPP) is a type of personal pension arrangement which allows the member to choose how their scheme is invested. They offer much wider investment powers than are generally available for other personal pensions, including group personal pensions and are therefore classed as ‘investment regulated pension schemes’. A scheme is an investment regulated pension scheme if at least one of the members (or someone connected to them) is able to influence how their own pension pot is invested. An occupational pension scheme with less than 50 members is also an investment regulated pension scheme if at least one of the members (or someone connected to them) is able to influence what the pension scheme invests in.

THE PENSIONS LANDSCAPE

We are in a period of rapid change in the UK pension market, in terms of the overall market size, types of scheme and the coverage of provision. The membership profile of schemes has undergone huge expansion since the start of AE in 2012. Active occupational scheme membership is now at its highest ever level. The vast majority of the 7.3m new members have joined DC workplace pension schemes. DC memberships have consequently overtaken that of DB. Within the private sector there are now more memberships in DC schemes than in DB schemes. However, coverage is only around 40% of the working population as worker groups such as the self-employed and multiple job-holders are generally not, as yet, participants in AE.

Although the majority of new members have joined multi-employer DC schemes – master trusts and group personal pensions – there remains a long 'tail' of around 32,000 micro occupational DC schemes (with 2-11 members each), covering about 91,000 members in total. Few workers have been newly enrolled into DB schemes in the private sector, which is now largely a closed book of business in run off (only 15% of DB schemes are now open), but the same pattern of a tail of small schemes has emerged – a third of all DB schemes have fewer than 100 memberships, and 80% have fewer than 1,000 members – although in total these schemes hold £130bn in assets.

The table below represents the private pension landscape in the UK, showing at a high level the different forms of employer-sponsored provision available within the private sector, and giving an overview of the size of each type of provision.

	DB	**Hybrid: mixed benefit**	**Hybrid: dual-section**	**DC (trust)**	**DC (workplace contract)**
Schemes	5,170	180	910	33,650	2,620
Open schemes	820	20	440	26,240	2,400
Total memberships	7,142,000	621,000	5,370,000	8,489,000	N/A
Total active members	1,170,000	55,000	1,203,000	5,151,000	4,880,000

Sources: The Pensions Regulator's data based on scheme returns 31 December 2016, Annual survey of hours and earnings (ASHE) 2015 (published March 2016). Please note: the ASHE 2015 reports 4.4 million active members of DC trust-based schemes and 244,000 active members in schemes where the type was unknown.

Changes in the law which took effect from 6 April 2015 gave many members of occupational pension schemes increased flexibility over how to take their DC benefits. On reaching the minimum pension age (normally 55) members of DC schemes have the option to:

- leave their pension 'pot' untouched
- enter drawdown, thereby taking some of their pension money whilst leaving the remainder invested
- withdraw cash in one or a number of lump sums
- purchase an annuity to provide an income for the rest of their life
- mix their options
- or take their entire pension pot in one go

When taking income from a pension, the first 25% is usually tax-free with the remainder subject to income tax. The tax-free amount should not use up an individual's personal tax allowance, which for 2017/18 is £11,500. The amount of income tax payable depends on an individual's total income for the year and their tax rate.

AUTOMATIC ENROLMENT

To support the millions of people in the UK not saving enough for retirement, legislation was introduced in the Pensions Acts 2007, 2008, and updated as part of the Pensions Acts 2011 and 2014, and the packages of associated regulations, with the aim of increasing private pension saving in the UK. They form part of a wider set of pension reforms designed to ensure that the UK has a pension system that enables individuals to save towards achieving the lifestyle they aspire to in retirement, while minimising the burden on employers and the industry.

The reforms require employers to automatically enrol eligible workers into a qualifying workplace pension scheme and make a minimum contribution. The automatic enrolment duties are being staged in between October 2012 and February 2018 by employer size, starting with the largest employers. Workers will be eligible provided they: are aged at least 22 and under State Pension age; earn over £10,000 per year in 2016/17 terms (these thresholds are reviewed annually); normally work in the UK and do not currently participate in a qualifying workplace pension scheme. Current legislation specifies total minimum contributions are 2 per cent of a band of workers' earnings, of which at least 1 per cent must come from the employer. This will rise to 5 per cent from April 2018, of which at least 2 per cent must come from the employer. It will then rise to 8 per cent from April 2019, of which at least 3 per cent must come from the employer.

In 2016 the government announced a review of automatic enrolment to consider the success of the policy to date, and explore ways in which it can be further developed. Through automatic enrolment almost 7 million people have been enrolled into a pension scheme by nearly 500,000 employers. This is expected to lead to around 10 million people newly saving or saving more by 2018, generating around £17 billion a year more in workplace pension saving by 2019/20. The government is keen that as many people as possible can benefit from their own long-term saving, topped up with employer and government contributions, to give them greater financial security in retirement. The review will gather evidence on groups such as people with multiple jobs who do not qualify for automatic enrolment in any single job. It will also consider how the growing numbers of self-employed people can be helped to save for their retirement.

REFERENCE INFORMATION

KEY LEGISLATION

- The Pensions Act 2004 sets out The Pensions Regulator's (TPR)statutory objectives in exercising its functions.

- The Finance Act, which laid down relevant rules concerning the role of HMRC (the UK's tax revenue collector) in enforcing tax-related aspects.

- The Pensions Act 2007 made a number of major changes to the State Pension system mainly affecting those reaching State Pension age on or after 6 April 2010. Many of the measures in the Act have largely been superseded by subsequent legislation, such as the Pensions Act 2011 on the timetable for increasing State Pension age and the Pensions Act 2014 on state pension generally.
- The Pensions Act 2008 imposed the requirement for every employer in the UK to put certain staff into a pension scheme and contribute towards it.

- The Pensions Act 2011 amended the timetable for the increase of the state pension age to 66 and included some minor amendments to existing automatic enrolment legislation.

- Public Service Pensions Act 2013 introduced the framework for the governance and administration of public service pension schemes and provides for an extended regulatory oversight by The Pensions Regulator.

- The Pensions Act 2014 contains provisions to roll-out the single tier State Pension and bring forward the increase of the State Pension Age to 67.

- The Pensions Schemes Act 2015 introduced new flexibilities for people saving into defined contribution pension schemes.

The Pension Schemes Act 2017 places duties on those involved with running master trust pension schemes. This includes a duty to report certain events to The Pensions Regulator. The Pension Schemes Act 2017 also introduces measures for authorising and supervising master trusts and new powers for The Pensions Regulator. Authorisation will start after regulations have been developed.

KEY AUTHORITIES

Department for Work and Pensions (DWP)

The Department for Work and Pensions (DWP) is responsible for welfare, pensions and child maintenance policy. As the UK's biggest public service department it administers the State Pension and a range of working age, disability and ill health benefits to over 22 million claimants and customers. https://www.gov.uk/government/organisations/department-for-work-pensions/about

The Pensions Regulator

The Pensions Regulator (TPR) regulates UK work-based pension schemes.

www.thepensionsregulator.gov.uk.

The Financial Conduct Authority

The Financial Conduct Authority is the conduct regulator for 56,000 financial services firms and financial markets in the UK and the prudential regulator for over 18,000 of those firms. https://www.fca.org.uk/

The Prudential Regulatory Authority

The Prudential Regulation Authority (PRA) was created as a part of the Bank of England by the Financial Services Act (2012) and is responsible for the prudential regulation and supervision of around 1,500 banks, building societies, credit unions, insurers and major investment firms. The PRA's objectives are set out in the Financial Services and Markets Act 2000 (FSMA).
http://www.bankofengland.co.uk/pra/pages/default.aspx#

Her Majesty's Revenue and Customs (HMRC)

HMRC is the UK's tax, payments and customs authority.https://www.gov.uk/government/organisations/hm-revenue-customs/about

SELECTED KEY STATISTICAL REFERENCE

OECD, Global Pension Statistics project, www.oecd.org/daf/pensions/gps.