PENSIONS POLICY INSTITUTE

PPI

PPI Proposed Activity Case Studies for TUC Pensions Champion Training

The following are three proposed case studies for use in the Activity Pack for the role play training of Pensions Champions. These can be tailored further to suit the TUC needs and we can also provide outcomes that allow for subsequent life course events. For example a planned future change in working hours to part time or sabbatical and how this would alter the expected pension.

<u>Case 1: Woman born in July 1954. State retirement date is Nov 2018 aged 64 and 4 months.</u>

You are a woman who has been a housewife for a lot of her life. You looked after the children in the home for 16 years from 1973 to 1989, earning Home Responsibility Protection from 1978 when it was introduced. For the next five years, 1989 to 1994, you were at home as a housewife and did not earn state pension credits. Your husband has a full history of National Insurance Contributions.

In 1994, aged 40, financial constraints in the household required you to get a job. You worked 1 day a week part time for 10 years at a 20% proportion of the middle level earnings for a woman your age, on average £3,000 per year. At age 50 you became full time in the job and decided to become a member of the company's defined benefit pension scheme with an accrual rate of 1/60ths . Your current salary is £20,463.

Prescription
Note all figures are in 2009 earnings terms.

You retire at age 64 and 4 Months in 2018.
If your work pattern continues you will have 28 qualifying years for the state pension. To receive a full basic state pension at your SPA in 2018 you require 30 qualifying years. The projected full BSP in 2009 earnings terms is £89.25.
You receive 28/30 of the full 2018 BSP = £4,331 annually (£83.30 per week)
Your S2P = £1,440 annually (£41.35 per week)
Employer pension = £4,561 annually (£87.72 per week)
Taking the maximum permissible tax free lump sum of £19,500 [assuming 12:1 commutation factor]
Revised pension allowing for lump sum = £2,936 annually (£56.47 per week)

Case 2: A man born in August 1945. State retirement age is 65 in August 2010

You are a man who has been earning most of your life at middle level earnings for your age. You were self employed from age 21 to 40, during this time you took out a Retirement Annuity Contract (RAC) when they were introduced in 1971 into which you paid 10% of earnings. You did not qualify for SERPS while you were self employed.

In 1985 at age 40 you took a job with an employer who had a Defined Contribution pension scheme where the employer pays contributions of 5% and you pay 3%. You joined this scheme and ceased making contributions to your RAC. You have remained in this job for the past 24 years. You are unmarried and rent the flat that you live in at £70 a week. Your current salary is £21,322.

You are concerned as to how much pension you will have when you come to retire next year.

Prescription
Note all figures are in 2009 earnings terms.

You retire at age 65 in 2010. You have 44 qualifying years for the BSP. The requirement to qualify for a full BSP in 2010 when you retire is 30 years. You receive a full BSP.
Weekly BSP = £4856.8 annually (£93.40 per week)
SERPS = £2,411 annually (£46.36 per week)
S2P = £1,125 annually (£21.64 per week)

RAC fund = £27,175 built up over 14 years
If a 25% lump sum is taken
    Lump sum = £6,794
    Pension = £1,368 annually (£26.30 per week)
If whole fund is annuitised
    Pension = £1,824 annually (£35.07 per week)

Employer pension pot = £62,466 built up over 25 years
If a 25% lump sum is taken
    Lump sum = £15,616
    Pension = £3,144 annually (£60.47 per week)
If whole fund is annuitised
    Pension = £4,192 annually (£80.62 per week)

<u>Case 3: A woman earning at the lower end of the earnings scale. Born in 1972 state pension age is 67</u>

You are a 37 year old woman. You worked for 4 years from age 18 to 22 in a low paid job (at the tenth percentile of the age related female earnings scale) earning below £5,000 a year. You got married at age 22 to a doctor and spent the next 10 years at home not looking for work and did not qualify for credits.

At age 32 you and your husband separated, the divorce was finalised shortly thereafter. You received the house in lieu of any rights to your husband's pension. At age 32 you started in the labour market again and got a job at low pay (again, tenth percentile of female age related scale).

You had to give up this job after two years in order to care for your very ill mother. You cared for your mother for 2 years earning home responsibility protection for both years. You then re-entered the job market and got another similarly low paid job.

You have no pension entitlement in this job at the moment but you intend to stay opted in when you are enrolled into a personal account in 2012. Your current salary is £12,232.

Prescription
Note all figures are in 2009 earnings terms.

You retire in 2039 aged 67 with 38 qualifying years for the BSP. The requirement to qualify for a full BSP in 2039 when you retire is 30 years. You receive a full BSP.
Weekly BSP = £4,641 annually (£89.25 per week)
SERPS = £102 annually (£1.96 per week)
S2P = £8,737 annually (£168.01 per week)

Personal Account
Fund value in 2037 = £14,540
If a 25% lump sum is taken
    Lump sum = £3,635
    Pension = £516 annually (£9.92 per week)
If whole fund is annuitised
    Pension = £688 annually (£13.23 per week)

Methods to increase pensions in retirement

Increase pension contributions – This will be most beneficial for younger people where there is time for the higher contributions to accumulate investment return in order to make a significant difference at retirement.

Consider buying back years missing qualifying years in the BSP – If you do not have enough qualifying years to receive a full pension you can buy back missing years. However, from April 2010 the required number of years falls to 30, which should make it easier to qualify for a full basic state pension.

Think about how much tax free cash to take at retirement – When you receive your pension it is income and is taxed as such, taking the tax free lump sum avoids tax on part of your pension savings.

Shop around at retirement – You are not tied to any particular provider when you come to purchasing an annuity with your pension pot at retirement. This can be quite a competitive market so it is worth looking around for a good rate. Some providers will give better rates for people who have impaired lives for example smokers.

Claim all the State benefits you are entitled to – There are a number of means tested benefits that pensioners are entitled to but have low take up rates. Pension Credit provides a minimum level of income via Guarantee Credit and some extra benefit to reward people over 65 who have some made some provision toward retirement via Savings Credit. Other state benefits include Council Tax Benefit and Housing Benefit to help with housing costs and Attendance Allowance to help with the costs associated with disability

Take financial advice – see a qualified financial adviser who can talk through all your financial options with you and make suggestions tailored to your needs.

GLOSSARY

Accrual Rate
See defined benefit pension scheme

Annuitising
Annuitising is converting the pension pot built up in a defined benefit pension scheme into a regular pension income. This is done by buying an annuity. There are various types of annuity to chose from such as an index linked annuity (see below) or a level annuity (see below) or one that has a spouse's benefit attached payable on the death of the pensioner. The pension pot will often be split in two, with one part used for a tax free lump sum and the other part used to buy an annuity. But this need not be the case; the whole fund may be annuitised.

Annuity
In these cases, 'annuity' refers to an immediate life annuity, unless otherwise stated. An immediate life annuity is an insurance product that pays an income from the date of purchase until the date of death. An annuity insures an individual against the financial risk that he or she lives longer than expected and so requires an income for longer than expected.

Auto-enrolment
A pension scheme enrolment technique which means that employees automatically become members of the pension scheme, either when they start a new job or at a certain predetermined point in time. Employees have the right to opt out of saving in the scheme if they choose. If the Pensions Bill 2007/8 is enacted, employers will be required to automatically enroll most employees into saving in a private pension.

Basic State Pension (BSP)
The first-tier of state pension benefits in the UK. Individuals can receive up to £90.70 a week (in 2008/9), provided they have a sufficient number of 'qualifying years'. A qualifying year is a year in which the individual earns at least a minimum amount or in which the individual receives a credit, for example, through caring or receipt of certain state benefits. After April 2010, individuals will need at least 30 qualifying years to receive the full amount of BSP. Individuals who have fewer than 30 qualifying years will be entitled to less than the full amount.

Commutation factor
See Tax free lump sum

Defined benefit (DB) pension scheme
A defined benefit pension scheme is a pension scheme where the benefit is pre-determined by a set of rules. A common DB scheme is the final salary scheme where the pension is a proportion of the member's salary at the end of their working life. In such cases the proportion is given by the number of years service in the scheme divided by the accrual rate. For example, a man who worked for 40 years as a member of a scheme with an accrual rate of 1/60ths would receive a pension of 40/60 = 2/3 of his final salary.

Defined contribution pension scheme
A defined contribution scheme is a scheme where a set amount is paid in at regular intervals. These contributions are invested. The resulting combination of contributions and the investment returns build up an individual pension pot. At retirement the pot is used to purchase an annuity. The pension is at whatever level the annuitised pot can afford.

Earnings terms
The 'value' of money changes over time. For example, £200 today is likely to be worth more than £200 in 10 years time in terms of what can be bought and how it compares to the amounts of money that other people have. In order to properly compare amounts of money today with amounts of money in future, an adjustment has been made to future amounts of money to account for how much earnings is likely to grow between now and when the income becomes payable.

Home Responsibilities Protection (HRP)
A scheme that was introduced in 1978 as a way of protecting the BSP entitlement of people who were not paying National Insurance contributions but who were contributing to society in another way, for example, by caring.

Index-linked annuity
An index-linked annuity pays out an amount year which increases in line with price inflation. They are intended to offer protection against inflation, so that purchasing power stays the same from year to year. This protection comes at a price, making them more expensive than level annuities.

Level annuity
A level annuity pays out the same amount each year without being increased to protect against inflation. This means that the real purchasing power of a level annuity decreases from year to year.

National Insurance contributions
These are contributions that must be paid by most workers. Payment of Class 1 National Insurance contributions gives entitlement to a range of state benefits, including state pension.

Occupational pension
A pension scheme organised by an employer on behalf of its employees. Only employees of the organising employer(s) can usually join the scheme, and active membership usually ends when the employee no longer works for the employer.

Pension Credit
A state means-tested benefit available to older people. Pension Credit has two components: Guarantee Credit, which aims to provide a minimum level of income, and Savings Credit, which aims to reward saving.

Percentile of earnings
Percentiles are a way of considering how data is distributed. A percentile of earnings is the value of earnings at the point where a certain percent of all people earn less than that amount. For example if we have 1,000 people and arrange them in order of earnings from lowest to highest, then to get the 10th percentile level we say, 10% of 1,000 is 100, so just count 100 people from the lowest earner, and walk up to that 100th person and ask how much they earn. Similarly the 50th percentile is whatever the 500th person earns and the 90th percentile is whatever the 900th person earns. We used the 10th, 50th and 90th percentiles of earnings to represent low, middle and high earners respectively.

Personal accounts
Personal accounts is the name of a new, low-cost, national pension savings scheme that the Government proposes to introduce from 2012.

Personal pensions
Unlike occupational pensions, which are organised via an employer, personal pensions are individual accounts organised directly between an individual and a pension provider.

Retirement Annuity Contract (RAC)
A Retirement Annuity Contract was the forerunner to a Personal Pension. It is a defined contribution pension arrangement with an insurance company or friendly society for people who were self employed, so did not have access to an employer’s pension scheme. They were available from to take out from 1971 to 1988. After 1988 people who had already taken out a

retirement annuity contract could keep on contributing to it but no new contracts could be issued.

State Earnings Related Pension Scheme (SERPS) and State Second Pension (S2P)
Along with its predecessor SERPS, S2P makes up the second-tier of state pension provision in the UK. It is earnings-related, so the amount received by an individual depends on how much they earned or were credited as earning during their working life.

State pension age
This is the first age at which men and women can claim their state pension. It is currently 65 for men and 60 for women. State pension age will increase for women to 65 between 2010 and 2020. The Pensions Act 2007 legislated for further increases in state pension age for both men and women, to 66 between 2024 and 2026, to 67 between 2034 and 2036 and to 68 between 2044 and 2046.

Tax free lump sum
When taking a pension, the tax rules allow you to take some of the value of the pension as tax free cash. The amount allowed is generally up to a quarter of the value of the pension pot, or a theoretical equivalent of a pension pot for a defined benefit pension scheme. When a tax free lump sum is taken out of the pension of a defined benefit scheme the pension is reduced. The amount of pension given up (or "commuted") is calculated as the amount of the lump sum divided by a commutation factor. The commutation factor represents the amount of lump sum purchased for each £1 of pension given up. commutation factor varies by scheme and within schemes it may vary by the age of the person retiring.