Work and Pensions Committee

Oral evidence: Early drawing of state pension

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Watch the meeting

Members present: Frank Field (Chair), Heidi Allen, John Glen, Craig Mackinlay, Steve McCabe,

Questions 1 - 50

Examination of Witnesses

Witnesses: **Chris Curry**, Director, Pensions Policy Institute, and **Alan Higham**, PensionsChamp, gave evidence.

Q1 Chair: Welcome. Chris, might you introduce yourself for the sake of the record and then I will ask Alan to do the same, and then Heidi will begin our questions.

Chris Curry: Good morning. My name is Chris Curry. I am Director of the Pensions Policy Institute. We are an independent research organisation with the remit to provide evidence around pensions and retirement income in the UK.

Alan Higham: Good morning. My name is Alan Higham. I am an independent retirement expert and I give free pensions help to members of the public through the website pensionschamp.com.

Q2 Heidi Allen: We are a bit thin on the ground this morning—sorry about that—and you are too. I was expecting lots of WASPI ladies in the back row. Alan, you are the man that they all go to, apparently. You are the ladies champion and you were the first to suggest to us, I think, that on this whole WASPI issue there might be an opportunity for women to take it earlier at a lower rate. Just talk us through your thoughts on that and cover the pros and cons and why that might be a good idea.

Alan Higham: I was mindful that behind all these dusty and technical arguments there are people who are suffering. They have lost the expectation of the pension, many with very little notice, as the Committee well knows so I won't go over that ground. While doing nothing is simple and cheap, it does not solve the problem and I think a solution to this problem does need to be found. You could take the view that the Government are on perhaps legally strong enough grounds to withstand any challenge and they may win such an argument but it still would not solve the problem of the manifest unfairness that has occurred for everyone to see.

What I thought was that the problem stems back to 1995 when the pension age moved, when the legislation was passed, and if you were now to grant women the right to access their pension from age 60 you would give them a dignity of an income in their own name as a right within the sort of timeframe they were always expecting. Of course, if you were to reduce the 2016 level of pension for the early access that would bring it lower than today's amount and that will no doubt disappoint a number of women concerned. But if we go back to 1995 and look at what people's reasonable expectations were under the rules as they stood then, a number of changes that the Government have made have occurred since then that have had a positive impact on women. They can earn a pension over fewer years, their home responsibilities protections have been given credit and generally the amount of pension for lower earners, the rate at which you earn a state pension, was increased in the 2000s. There are a number of changes that have improved their lot but that is of no comfort whatsoever if you have to wait five or six years to access any of it at all.

By reducing it you bring it to a level that is perhaps not far off what they might have reasonably expected before. It may disappoint them now but I do feel it is a reasonable compromise that is worth considering. Over the long term it need not cost the taxpayer any great sum of money excepting, of course, there is probably an unwelcome short-term hit to the Government's borrowing figures as women start to access their pension earlier than the Government forecast would have allowed for.

Q3 Heidi Allen: Aside from the emotional and moral argument, which I personally don't disagree with, are there any other options that are kicking around? What is your view on why this would be the better option?

Alan Higham: I don't think it is a panacea, it is fair to say. When I came up with this argument I thought it addressed some of the concerns that the Government have. We are faced with the Government have shown no willingness whatsoever to move from their position of no change at all and have cited on all the other options some of the considerable costs involved. Here, while the costs are short term in cash flow, over the long term there are no extra costs involved. I think there is also a very strong argument for looking at those women who are in the greatest need. Even if we put aside the communication problems from the 1995 Act, one of the problems of those changes was there was always going to be a group of women who just could not afford to support themselves in their early 60s, the working patterns, prejudice in the workforce being what it is, and so we always did have the problem. Even if we had communicated excellently, I think we would have still been left with a group of women in hardship with no practical means of support and we would have to look at giving them the dignity of a reasonable income at this point in life. You could probably make the same case for men as well as they approach 65, but particularly for women given their circumstances.

The other argument that I think is worth considering is some means-tested benefit paid to women between 60 and the current pension credit age.

Q4 Heidi Allen: Chris, do you have any views on this?

Chris Curry: It is not an area that we have looked at in detail, although we did provide some initial figures as part of the written evidence that we did. I have to agree with Alan's logic in a lot of this and it is very important to think about what the issues are that we are trying to address. I very wholeheartedly agree with Alan's analysis, taking things right back to 1995, although this group in particular are very focused, very understandably, on changes that have happened recently. Looking back to 1995, the system has evolved an awful lot, much to the benefit of women and especially in this cohort as well because of, as Alan said, some of the specific changes to credits and home responsibilities protection and qualifying years.

I think that this is one of the trade-offs that often happens in any government policy but in particular in pension policy. There comes a cut-off point at one point or another and it is unfortunate that it has happened here. I think where it becomes difficult is I am not sure that any of the options other than just giving these women the pension they thought they were entitled to at the time they thought they were entitled to it would actually, from their point of view, be satisfactory. There are always going to be issues, which they see as being a fairness argument, that are not going to be addressed by any of these different things. The problem also is that I am not sure that it would be no cost if you introduced the ability to take a pension early, partly because there may well be selection effects where you have individuals who have lower expectancy being more likely to take the pension. There is some international evidence that that can occur. But also if you introduced it even on a short-term basis for a particular group or cohort, that does open up the idea that maybe this could be something that could be expanded and done on a wider basis. If you start to think about doing it for the whole of the pensioner population then suddenly it is a much bigger issue and there are much more short-term and potential long-term costs involved.

Q5 Heidi Allen: It is a Pandora's box, isn't it?

Chris Curry: Possibly.

Q6 John Glen: But isn't that the direction of travel anyway? I get that the selection effect imperils the cost neutral basis of it because those who benefit might live longer and nobody is particularly good at judging their life expectancy. But at a time when the Cridland review is looking at a reliable mechanism to essentially ratchet up in line with life expectancy and the pension freedoms are about flexibility in when we take it, wouldn't it be right for this proposal to move forward in the context of those flexibilities that are inherently part of the way that we are now looking at our pensions?

Chris Curry: It is certainly the direction of travel in private pensions.

John Glen: Yes, I recognise the distinction but is it right we should have the distinction?

Chris Curry: It is an important distinction, I think. There has not been any kind of firm movement towards having any flexibility in the pension age. It has been something that has been discussed over a number of years and I remember probably 10, 15 years ago the idea of a flexible decade of retirement was one that was discussed frequently and it was part of, I think, the UKIP manifesto.

Q7 John Glen: Sorry to interrupt you. You can elect to take the state pension later though, can't you?

Chris Curry: You can elect to take it later.

Q8 John Glen: So there is flexibility one way but not the other?

Chris Curry: That is right, yes. Part of the reason for that I think is because of the potential short-term expenditure impacts but also because if you reduce the level of pension that people take initially, that lasts with them right the way through their retirement. If you have a relatively low state pension to start with, having an even lower one right the way through can have important impacts later in life as well as at the point of retirement.

Q9 Craig Mackinlay: Just to Alan, if I may: you started to discuss what types of WASPI women might want to go up this route if it were available. I had a particular type that came in that seemed to fit perfectly with what I think ought to be a scheme to be considered. It was a younger woman whose husband had died somewhat prematurely but at the pension age and she was stuck just over 60, waiting until 65 when her pension would then accrue at the level of her late husband's. To her it seemed she was really stuck in a tough place. She was relying on benefits. She had half a corporate pension from her husband's previous employment, but she was very much one of those who was stuck in a very tough place. Have you thought what types might be the right ones? If we did not want to expand it across the whole cohort and you thought there were certain types that really needed help now, have you thought which ones they might be?

Alan Higham: The point I would make to help answer that question is that it is important to understand just how long pension age 60 for women existed. It has reigned longer than the Queen. It has been woven into the fabric of our society. I imagine if you went into the average small business and asked the owner there what age do women retire, they would probably think of 60 and I am sure that influences their recruitment decisions when faced with a 50-something woman applying for a job. Also because occupational pensions mirrored the state pension for many years and kept the women's pension age at 60 and that did not change until 1990 at the outset, and probably until 1995, huge numbers of women do have the right to take some occupational pension from age 60. We do have an issue where you have a bridging gap between age 60 and the new state pension age for women where there could be that sort of income shortfall that you allude to, Craig, and I am sure that affects a wide range of women. The possibility of having earlier access at a reduced rate could smooth the financing out.

At the moment, women are faced with running down their savings at quite an alarming rate. One of the problems of running down your savings, of course, is it makes it more likely you will have to go into debt, potentially very expensive debt, in later life that stays with you, and that can cause a lot of problems to long-term finances. It can have much greater harm than starting off with a lower pension, that Chris rightly points out, because if you have to go into debt you have to pay a huge amount of interest on that, and that problem grows exponentially very quickly. I think it would be a decent option to provide for women. I accept that not all women would want it and many of them would think it was a bit of an insult and they deserved better compensation for their problems, but I do think it presents a viable practical alternative if a will can be found within Parliament to make it happen.

Q10 Chair: Chris, on looking at the huge savings the Chancellor had to make, has the Institute worked out how big a catchment this was of changing the women's pension age in the total package of cuts he had to make in social security? In other words, have we singled out a quite narrow group of people to bear the biggest burden of the reduction in the projected social security budget?

Chris Curry: We have not done any detailed breakdowns or analysis of that particular type, but I think if you look at the state pension ages generally then the fact that they were already increasing to 66 but that was brought forward and affected a particular group does mean that there was not an enormous number of people who were going to be that much affected by the particular issue. Everyone who was younger, born late in the 1950s, was already going to have a state pension age of 66. The way in which it was implemented did focus quite heavily on a particular group of people, but I am afraid I do not have any estimates of the numbers or the costs of how much or what proportion was on that group.

Q11 Chair: Might you do that for the Committee?

Chris Curry: It is something we can look at if we have enough evidence and data to look at, but we can take that away.

Chair: Thank you.

Q12 Heidi Allen: Just following on from Craig's point about this lady and yours, Alan, about means testing, where do you think a sweet spot might sit in terms of not being too onerous for the Government means testing, not costing too much but absolutely helping those who need it more than anything? Do you have a sense of who those women might be and where we should try to extend this half house generosity to?

Alan Higham: I don't know that this solution necessarily does much for women who are inevitably going to be on means-tested benefits, both now and for the foreseeable future. At the moment if you are on, say, £73 a week and you have to wait until you are aged 66 to be able to get to £155, what it might do is say to somebody who is aged, say, 63, "Why don't we give you £140 a week for the rest of your life instead?" just to give some simple numbers. While that solves an immediate short-term problem, it doubles somebody's practical income, they will have to then reflect on the fact they will be £15 a week short for the rest of their lives. The Government will have to put in systems to make sure that that does not trip them into getting that £15 back if it is to maintain the cost neutrality. They will have to put in place systems to make sure that they do not lose out on other means-tested benefits that they would have automatically got on qualifying for pensions credit. I would not want them to lose those benefits. There are some practical issues and it is just simply a question of spreading what is a very small amount of money around in a different way, but I think £70 a week is just so low when somebody has to spend money out of their pocket, which they perhaps get reimbursed, going for job interviews or job training, and I do think it would make a big difference immediately to people's quality of life.

The next three years is going to be very tough for a 63 year-old woman to get by between now and 66, so I think making that change will be a positive, immediate one and, who knows, maybe a future Government would look again at their position if they were in their 70s and £145 was really not enough for them. I do not think we would want to leave them in poverty, so to that extent I think that is probably the greatest risk, that this would eventually cost the taxpayer more money than any actuarial projection might forecast.

Chair: The next three years is a run-up to an election, isn't it?

Q13 **John Glen:** Can I ask you, Alan, about your thoughts on the public sector equality duty? When equalisation comes in for men born in 1954 onwards, would there not be a necessity to give the same flexibility to men and how would you overcome that, given the obligation of the equality duty?

Alan Higham: I think this is one of the big challenges for solving this problem. I have to say in fairness to all concerned, this is a hugely difficult problem to solve. When the opposition was mounted to the 2011 Act and the timetable for moving the state pension ages was eased somewhat and £1 billion was taken off the savings, quite a big chunk of that saving went to the group of men who would have moved from 65 to 66 a little bit faster than they are doing now and there was very little, if any, complaint from that group of the population. There is a big challenge when we look at solving this problem that we do not inadvertently spend significant sums of money on people who are not that unhappy.

That is one of the challenges with leaving this to go to a legal case. I am very mindful, I helped the Government, I worked for the DWP on the financial assistance scheme, which was over £3 billion worth of taxpayers money when occupational pension schemes went bust. A Government leaflet was found short in two or three sentences. I think the Government felt all the time it had a reasonable legal case but unfortunately it lost the legal case and loads of people who had never seen this leaflet at all ended up with a significant amount of compensation from the taxpayer. I think it would be sensible to look at this holistically and say, "Look, we have a problem. How do we solve it and what is the least worst way of doing so?" accepting that I don't think you can reach perfection for any one group.

Q14 **Chair:** Is there a legal challenge coming down the line, do you know?

Alan Higham: I don't know but it seems to me, looking at it objectively, if the Government are going to maintain their stance of zero change then the WASPI campaign people have very little to lose by bringing complaints en masse through the Parliamentary Ombudsman, which was the route the then campaigner Ros Altmann took with the pensioners back in the 1990s and 2000s and eventually led to the taxpayer having to pay what is probably going to cost £4 billion.

Chair: There is a certain irony, isn't there?

Alan Higham: There is.

Q15 Chair: Can you take us through the information both of you have on how flexible occupational schemes in this country are allowing people to draw early? What evidence do you have of state schemes abroad allowing people to draw early? Do you want to start, Chris?

Chris Curry: Occupational pension schemes are pretty flexible in this area and according to the occupational pension scheme survey from 2011, which is the latest one that published this information, 98% of active members of defined benefit schemes could access early retirement provisions in one form or another. They generally have a reduction in the benefit alongside that but not all of them. Some don't have a reduction; some actually have enhancements. Some of those are fixed amounts; some are at the discretion of either the scheme actuary or the scheme trustees. There generally is flexibility in this and generally it works for up to five years or so before the normal pension age, so between 60 and 65 in the majority of cases. Occupational pension schemes can offer that flexibility, although it is worth stressing that they work in a very different way from the state pension, both legally and the way that they are constructed and how they are funded.

Q16 Chair: Presumably when they are doing the calculations about what the reduction is, they take into account selection bias, don't they?

Chris Curry: They do, although because generally the early retirement is separate from ill health there is probably slightly less selection bias in these particular occupational schemes than there might be in the population as a whole in doing that, but it is something they would have to factor in. It is something that is probably factored into the way the scheme is designed and the contribution rates right the way through the operation of the scheme and not just towards the end.

In terms of international experience, there are in a large number of countries—I think something like 20 out of the 34 OECD countries covered in their "Pensions at a Glance" publication—some allowances for early retirement in at least part of the state scheme or public pension scheme. The one that there is most evidence available on is in the United States where the normal pension age is now 66 going up to 67 but it is possible to start drawing your pension from age 62. The evidence there is quite interesting. About 40% of women and about a third of men take their pension at age 62, so they take it as soon as they possibly can even though that reduces the value of their pension by around a quarter. It is the most common age for taking the pension. It is most likely to be taken by people who have been in blue collar work or manual work in the run-up to age 62. Women are more likely to take it than men. People with lower educational attainment are more likely to take it earlier and people who think they have lower life expectancy, interestingly, are also more likely to take it. There is some research that suggests that they are actually generally right and the people who take their pension earlier do tend to have a shorter life expectancy after that date.

Chair: Presumably they die happier though.

Chris Curry: Certainly probably slightly richer than they would have done if they had delayed taking their pension, so it does seem to have the impact that it is taken up by people who could benefit from it most. The reduction varies internationally, generally in a range of about 3.5% to 6% per year. The US, for example, has a two-tier system where you have a smaller amount taken the closer you are to retirement.

Q17 Chair: It does introduce an element of equity to a scheme, doesn't it, in that blue collar workers usually start work earlier and in a sense are fagged out quicker than other groups? By allowing people, even with this reduction, to take their state pension, they are at least getting something out of the scheme they have paid in for.

Chris Curry: That is true and it does start to bring into question the philosophical reason for having a state pension, whether it is like a contributory saving scheme or whether it is an insurance against old age. I think whether you had early access for something like that would probably lead you to start thinking about what was the purpose of the scheme in the first place.

Q18 Chair: The purpose of the scheme, I agree. That is fundamental. Alan, your comments?

Alan Higham: I am an actuary myself and what I would say about occupational pension schemes is that the relative fluctuation of take-up of early retirement options has never been a material consideration for actuaries running schemes. Of course, the selection bias manifestly exists but I do not think people game themselves in that way. In the current state pension system, there is the generous rate for deferring your state pension of 10.4% for people who have reached state pension age before April 2016. If you were thinking as an actuary virtually everybody should take it up because it is such a generous rate, but take-up rates have remained very low and only recently marginally increased, I suspect more to do with the level of income people have in retirement and their ability to work a bit later. I do not really feel people will game the system to any great extent. I don't think that is the way normal human beings behave.

Canada is another example. They introduced flexible retirement in 1987. You can retire any time between 60 and 70, with 65 being the age at which you get either no reduction or you get an increase after 65 or a reduction before. I looked back at the old actuarial reports, and when that was introduced they assumed take-up of around 26% of men and 31% of women and they thought it would gradually rise to around 37% of men and 38% of women. One of the issues with this option is how many people will take it up. Canada has seen significant fluctuations year to year, according to economic conditions, the job market, but also because they have tweaked the rules. At one point you had to say, "I've retired from all work" and that obviously depressed demand, and then they recently got rid of that restriction so anybody can draw their state pension earlier even if they have not manifestly agreed to retire from all work. The latest figures are that they are going to allow for around 34% of men and 38% of women to take it going forward but it has fluctuated from, as I say, 25% up to over 40%.

There is some difficulty in forecasting the short-term expenditure for the Treasury in terms of the take-up. I know you have the Government Actuary who can comment in more detail.

Q19 John Glen: Just on that, notwithstanding the uncertainties, and the Chairman asked about international examples, the Cridland review is inherently based on the assumption that we will see more flexibility in the state pension going forward. The previous Secretary of State, Iain Duncan Smith, talked about regional variation and clearly the workforce is quite complex in terms of the different burdens that different types of work put on people. In the context of that imminent likely flexibility in pensions, isn't this really along the same lines? It is not some great sort of bridge with the direction of travel in terms of how we deliver state pension, is it?

Chris Curry: I wouldn't like to second guess what the Cridland review is going to come out with but—

John Glen: Given the parameters that have been set by the person who commissioned it.

Chris Curry: I think at this stage it is a review of the evidence in that particular area that they are currently undertaking. Although I think they will be looking at variations in life expectancy on a number of different levels, for example by region, social class, occupation, that is only one of the factors that they are considering. As far as I know, there is no indication that they are likely to make recommendations in that particular area. I think it is one of the things that they will consider. There is a long way to go before a strong case is made that there should be variations in state pension age for different regions or different occupations or different classes. It is something that has been discussed in a number of different guises over a number of years, but it comes back to the point we were making earlier about what the role of the state pension is in this system overall as to whether you want it to be something that tries to take account of all of these differences or whether it is something that is there to insure against old age and there are other policies that might be better placed to try to reduce these variations rather than doing it through the state pension system.

Alan Higham: The problem I alluded to earlier, that there is always going to be a group of people who can't work up to their retirement age, whatever that retirement age is, is not going to go away. That group that can't work is usually not that well provided for generally and we have a problem, and this is going to build and build. I hear what Chris says, but as we drive the state pension age as a single figure and say we are going to move it upwards and upwards because people are living longer, behind that is not everyone is living longer and the gap between those who are living long and those who are not living very long is probably going to grow. If we are not careful what we are going to have is a group of people who are deemed to be of working age but for all practical purposes are not going to be able to work for a number of reasons. If the working age benefits are at, say, £70 a week, whereas the state pension is at, say, £155 a week, I think that group of the population is going to grow and there does need to be a policy for it.

Q20 John Glen: Alan, you have described the problem very well but the policy solution, the legislation would have to deal with the fact that you have different work capabilities, effectively, among the older generation of workers, and you risk, if you don't do it right, enabling some to retire early when they are perfectly capable of working. What is the policy suggestion that you have to deal with the issue that you have incredible variability and you have to put something that is publicly explainable and reasonably transparent and clear out there so people know what they are entitled to?

Alan Higham: There are a number of options. I haven't particularly analysed them so I don't give you any considered view on them. One option is, of course, the means test. One option is to say that, "You can access a state pension earlier in this situation but if you are already quite wealthy, you have lots of savings and you are probably going to enjoy a long lifetime, we are not sure we want to extend that option to you". There are a number of possibilities that you could have but, as I say, John, I have not analysed them so I don't want to shoot from the hip too much.

Q21 Heidi Allen: I always like to shoot from the hip. A completely bonkers idea, just going through my head when I am imaging this group of men and women as you are describing, in this brave new world where we are looking again, I hope, at ESA, PIP and all that good stuff, could there be an assessment around not just, "You are fit to work, not fit to work, the option for you is ESA, RAB, JSA", whatever it might be? Could there be a new category or that whole area looked at again that says, "For you, the early pension is the solution" and that is the point at which it is triggered to that median point of £140 or whatever it might be? Not wishing for one minute to write people off but in the same way as we do with illness, is there some transition here as society is changing? It feels all about inequality to me. Those poor women who cannot and never will work and life has been damn hard to them are just going to get squashed in the system if we are not careful. I don't know, just an idea.

Chris Curry: In a way, the group that we are talking about are on the cusp between the pensionable population and the working age population. They are on that transition.

Heidi Allen: Yes, stuck in the middle.

Chris Curry: That is a fluid situation, they were expecting to be in one group and now they are in another, but on a wider basis, as Alan says, there will always be people who are not able to work right up until the state pension age, whatever that state pension age is. It has always been the case. Even when it was 60 for women and 65 for men, not everybody was in work or was able to work up until those points. What we need to think about here is which is the right part of the system, what are the right parameters we could be looking at to flex that? One of options is the pension system and flexibility in the age; another, as we have been talking about, is in the welfare and welfare to work system and maybe looking at different solutions as part of that, but it also goes into employment policy, it goes into health policy. There are all sorts of different areas where it is probably worth thinking about it, as Alan says, in a holistic way, rather than focusing it through one particular avenue.

Q22 Chair: But there is not much evidence that any Government has been successful in running an ill-health benefit scheme, is there?

Chris Curry: The difficulty with all of these is what we are talking about or trying to target is a particular group in a particular way and targeting is always very difficult, whether you do it through it assessment or whether you do it through means testing. The alternative is to allow wider access, but that comes with an associated cost and potential behavioural consequences as well.

Q23 Craig Mackinlay: Alan again—sorry, Chris, I will ask you some questions later—

***Heidi* Allen:** He is the pensions guy.

Craig Mackinlay: —the deferral rate of 10.4% you said was quite high, but very few people are taking it up, which is a surprise. How was that 10.4% set? I know it was set some years ago. Is that set in stone in legislation or is that subject to Secretary of State SI adjustment? It does seem high and perhaps in this low-inflation world it is probably now at the wrong rate, even though people are not even taking it up at this very generous rate.

Alan Higham: Yes, and it is set that you get 1% extra for every five weeks you defer, you have to defer for a minimum of five weeks, and it has been like that for a long time. The exact mechanism of which piece of legislation it is sat in, I do not know. Maybe Chris does.

Chris Curry: I am very aware that the Government Actuary is going to be coming on later. He probably knows this much better than I do. It is also changing for the new state pension, so it will not be as generous as 10.4%. My understanding from discussions—I think it was only about 10 years ago that it was increased up to this level from what was considered an actuarially neutral level—was it set on the slightly generous side to try to encourage people to defer taking their state pension. As Alan said, it has not necessarily been successful, although I have not seen any figures from this Parliament to show how many people were deferring, but certainly it used to be the case that most deferrals happened accidentally, people were not aware that they could take their pension and so were accruing a deferral because they had not claimed rather than any conscious decision.

Alan Higham: It is about 7%.

Chris Curry: Yes. But I think it is quite interesting, that in some ways it is surprising because it is a very generous incentive. In other ways, it is not surprising because of the way that people behave more generally, and I think people have a bias towards taking money sooner rather than later. It takes someone quite strong-willed and quite confident in their income, in their own assets and in their own life expectancy to say, "I can have that money, but I am going to leave it until later".

Q24 Craig Mackinlay: Is it a one-time throw of the dice, a bit like an annuity, once you have taken a deferral you cannot dip back into work or take your pension for a bit and then defer for a bit? I am trying to think of the flexibility of the modern world, really.

Chris Curry: I will have to check that. I think you are right.

Craig Mackinlay: It is a one-off?

Chris Curry: Once you take it, you can no longer defer and accrue further beyond that point.

Alan Higham: You cannot accrue any more once you reach state pension age, but if you were, say, 70 years of age drawing your state pension, you have the right to suspend taking it and you would benefit from that 10.4% rate of increase if you did. Once you have done that once and restarted it—

Chris Curry: You can only do it once.

Alan Higham: You can only do it once. You can stop and start, but then you cannot defer again and get the benefit of it. It is one of the reasons why the new state pension system top-up that was created to pay extra national insurance and buy extra pension need not exist, because people could just use their capital to defer their pension. If you do the maths on it, it is far more generous doing that, so the state pension top-up is a white elephant that need not have been introduced.

Q25 Craig Mackinlay: You seem to know this very well. You can do it once, is that what you are saying?

Alan Higham: You can suspend drawing your payments once, yes.

Q26 Craig Mackinlay: You have started your pension at normal age, you have found a bit of work aged 68 or 70 and so you can suspend your pension. It will accrue up at 10.4% a year and then your work finishes and then you can start your pension again at this improved rate, but you can only do that cycle once?

Alan Higham: Yes, and if you stop claiming your state pension for a second time, then you would not then benefit from the 10.4% deferral.

Q27 John Glen: Can I get back to the interaction between the early state pension and the benefit system and how we can overcome this? In my mind, the concept is if people took it, say, three years early, and you come up with a figure—so you rebase at a lower rate that they take early and it goes up with inflation—but you then can see circumstances where the triple lock is in place where there is quite a big differential at some later point, say 15 years later. How do you deal with that, because you are either setting up future Administrations to take ameliorative action or you are setting up an additional cost at some point in the future. Also, given the Government have worked towards the principle of removing means-testing benefits and having a single-tier pension, or that is the destination of travel, you end up enshrining complexity and multiple tiers. It might be for this particular group, based on the way this acceleration happened, but do you have any thoughts on the interaction with the benefit system and how we could overcome it, rather than just like I have done, describe the problem?

Chris Curry: I think you have described the problem incredibly well. That is going to be the challenge, that either, as in the current system, I imagine that it would work that if someone did or was able to take their state pension early at a lower level, then in a way, under the current rules for means-testing benefits, they are almost depriving themselves of an income they could have had. The amount they could claim for the means-tested benefits would be reduced by that particular amount, in which you are not helping that particular individual, because they are not gaining an extra income than they would have if they had just claimed means-tested benefits instead or waited, the only difference being they get access to it earlier than they would otherwise have done. But if you do not do that, then there is a cost to the Government in terms of them having the income earlier and then still being eligible for means-tested benefits later in life, so in effect being paid twice for it.

Unfortunately, I do not think there is a simple answer to that. It could be that the Government would have to accept that there is an additional cost in doing this, if they wanted to work with the spirit of people being able to take pension earlier and not losing out later on as a result of doing that. I do not know how much additional cost that would be. I think there is a fairly high degree of uncertainty around how means testing will evolve in future anyway, given that we are having two state pensions for different cohorts running alongside each other with a single means-test system alongside it, which I think may need to be revised at some point anyway. There may be scope for looking at it as part of that review.

Q28 John Glen: Thank you, Chris. Alan, do you have any concerns about the interaction with the benefit system for this group?

Alan Higham: I think it needs to be made as simple as possible. You could say that you do not have eligibility for pension credit if you take early access, but if you would have been eligible for pension credit, the other benefits that automatically flow from that would still flow. You could say that if you are taking this early access pension instead of having some working-age benefit that that is reflected in the reduction that is done, or if you do not want to reflect the reduction and give a less penal reduction because of that, then you say it is paid on top of the working-age benefit. There are a number of possibilities. They all have advantages and disadvantages.

Q29 John Glen: None of them are cost neutral, are they, from the Government's point of view? You either deal with the difficulty that this group have and pay it to them at 63 now, give them some relief, but then if you do not spend more later on to supplement that lower base of pension when they get to the state pension age, it ends up meaning that the Government have to pay more and therefore the principle of this not costing the Government more cannot be held to. It is not easy.

Alan Higham: As I said in the answer earlier, John, the risk, the idea that the person pays you back at £10 a week for the rest of their life, from 66 to whenever, is undermined by the problems generally with means-tested benefits and their levels and whether it is appropriate to allow somebody to exist on the £145 a week. To me, it is probably the biggest issue in terms of future costs to the taxpayer in agreeing to this on a cost-neutral basis.

Chair: Thank you both very much. It was a good session. We are grateful to you.

Examination of Witness

Witness: **Martin Clarke**, Government Actuary, gave evidence.

Q30 Chair: Martin, the previous session announced your imminent questioning, but might you identify yourself for the record now?

Martin Clarke: I am Martin Clarke. I am the Government Actuary and my Department provides advice to various Government Departments on matters affecting pensions and other areas of financial uncertainty.

Q31 Craig Mackinlay: Nice to see you, Martin. In the previous session, there was one particular percentage in the US and Canada that was quite interesting, who have potential for early take-up of pensions. Broadly, there is more women likely to take it early than men, and it was around about 40% of women and around about 34% of men were attracted to taking pensions early. Given that is a reasonably big cohort, it would be interesting to know how such a scheme would be taken up in the UK. How uncertain would we be about the real effects of such an early take-up of pension scheme?

Martin Clarke: I suppose until we know precisely what the terms are and what the attitudes of the population and their particular circumstances as to the benefits or otherwise of going early, it is very difficult to judge. In my written submission I did suggest that this would be an area for research if it was very important. The whole area around the fiscal impacts of this scheme is it does depend on the level of take-up and any of those selection biases that have been spoken about. Broadly speaking, an early drawing of state pension scheme would bring forward Government expenditure in that period for which the terms were on offer and then levelling out by recouping it over a much longer period thereafter. The scale of the extra expenditure the Government have to bear in those early years would very much depend on the level of take-up, which may be as high as you suggest, depending on the circumstances and the terms. In the particular cohort, I think because of the focus and publicity around it, one might expect a great degree of interest in what those terms are and a greater degree of exposure and publicity for the option, so one might speculate it could be even higher.

Q32 Craig Mackinlay: Just following on from that, the history of actuaries, because of the increasing longevity of people's lives, there has been a history in the past of underestimating as you look 20 years ahead and medical advances and all the rest of it. If we make a mistake on this one, it could very costly. How confident might you be that an appropriate reduction percentage could be found that is right?

Martin Clarke: I think my brothers in the profession would probably think it remiss of me not to say that we are only forecasting. If we get the forecast wrong, they are not necessarily mistakes, but I understand the point you are making. I think in this particular instance though, the extent to which this early option is available is only for a limited span of ages and the impact of a differing outcome in terms of longevity is a lot smaller than one might think. We did run a sensitivity analysis on this and were the life expectancy around that age of early 60s to be one year longer than in the assumptions, then the impact on the reduction factor would only be 0.2%. We are not talking a major sensitivity around this, because we are talking only about bringing forward one or one and half years' worth of state pension for the people affected, though obviously the number of deaths expected in that period is quite a small number. The biggest sensitivities on coming to terms for this arrangement lay in the discount rate that is set for reflecting the time value of money between the different options, and indeed, the assumptions about future pension increases, including in particular whether we assume triple lock continues for longer than the lifetime of a Parliament, for example.

Q33 Craig Mackinlay: Martin, just on that, say you were to look back 20 years from today, what were the expectations of life expectancy? Have they been realised where we are now sitting, 20 years on, with the benefit of actual information? How accurate were you 20 years ago?

Martin Clarke: 20 years ago we would have been underestimating the rate of improvement that we are currently estimating. Off the top of my head, I could not give you a number of years, but it—

Q34 Craig Mackinlay: But you are saying a year wrong was not that sensitive, but if it is—

Martin Clarke: Over that 20-year period, I would be guessing, but I would say probably we would have been underestimating to the extent of about two years.

Q35 John Glen: One of the key decisions if we go down the route of this proposal is the level of the reduction per year. Different schemes across the public sector take a different formula, around 5% to 6%, but one of the challenges—in order to be helpful as we can to find a solution for the Government—is the additional cost. Presumably there is a mechanism, that you could factor the additional costs and the different take-up rates and the different costs and benefits further on into the reduction and you could make reasonable assumptions about that and, therefore, increase that level of the annual reduction. Is that a realistic way of looking at it?

Martin Clarke: Just for clarity, in terms of this is to take into account any subsequent experience?

John Glen: Yes.

Martin Clarke: In theory it is possible, so one would probably have to introduce a fairly complex process to feed the experience back into the terms on offer. If, for example, we were concerned about the selection bias issues, are these people going to be affected, are these people going to display a different characteristic of mortality in the future, then the slight problem would be getting sufficient data in the early years of this in order to adjust the terms later on, but in theory it is possible. I would suggest it would be harder to reduce the pensions of people even more; it would be more likely to make an adjustment in one way. If the costs of this scheme were also to embrace somehow the interaction with the means-tested benefits, again that could potentially offer the same feedback cycle as well, where you would look at the early cohorts taking advantage of the option, compare them against the assumptions that you had made about those people, and if the populations were different, one might be in a position to make some recommendations about changing the terms. I am describing a fairly short timescale for turning around all this information in what is a fairly complex area, bearing in mind we are only talking a limited span of people that might be affected by it, but in theory it is possible.

Q36 Chair: Have the Government referred a proposal like this to you to cost for them?

Martin Clarke: Not as yet. In the written submission I made to the Committee, I provided only illustrative figures. If the Government were to commission my Department to make a specific recommendation, then it would involve a process of establishing exactly what the rules of the scheme were, covering potentially the interaction with other benefits, if those were meant to be included as part of an overall cost-neutral approach, and also some steer on the assumptions to be used. That is why I have only so far produced some figures that are based on an illustrative factor. I would have to go into some more detail in order to produce something more definite.

Q37 Chair: If the Government did refer to you a proposal like that, how long would it take you, Martin, to work something up for them to consider for policy?

Heidi Allen: You took the words out of my mouth, Frank.

Martin Clarke: I feel like a plumber being asked to give a quote now. The condition would be getting clarity over exactly what the mandate was, but once that was given, it would only be a matter of a few short weeks to produce a final report.

Q38 Craig Mackinlay: Can I just make a comment? You highlighted two real complications. I would not want to try to spreadsheet this. You have the issue of triple lock—you mentioned that earlier—beyond a Parliament, which is a major factor in this, I think, and also the benefit system, where they may go in 10, 15, 20 years' time. Do you think you can put together a reasonable package with those two very huge uncertainties and variables?

Martin Clarke: I think it differs. The first one is probably easier, but one would have to make an explicit assumption, so the question would be do we assume pension increases at a particular level for a particular period of time, and that would be an explicit part of the instruction to me. Effectively it is not my judgment, it is whoever is commissioning me. That would be an integral part of the terms that were on offer. It would not necessarily mean that the triple lock was going to continue forever, if that was part of the assumption, but you have to make some assumptions.

On the integration with other benefits, I think that is much more difficult. If for argument's sake the reduction in pension for someone drawing it early entitled them in due course to more generous benefits through the pension credit system, in other words to compensate for that reduction, then one would look at a calculation that said, "What proportion of people are likely to be in the population that will be affected by that and what is the cost of that?" Assuming that the instruction was that that cost was to be spread across the entire portfolio or the entire group, if that population of people who were affected by pension credit is likely to be a sizeable proportion or even a material proportion of the total population of people taking advantage of this, then that would affect the results for everybody. Potentially, if it was half the group, you could be talking about effectively doubling the discount factor.

That is not a small change, from 4% to 6%, that is quite a large change. If that were the case, then you are producing terms for people who are not going to be eligible for pension credit that just do not make sense at all, and you will be influencing the proportion of people taking it up. I would suggest that if you are taking into account pension credit in terms of producing an aggregate cost that is cost neutral and spreading that across the entire cohort of people who are being affected in this way, then you would be producing something that was unworkable, because the terms would be too penal in some ways for the offer. I think that one would be much more difficult than simple assumptions about what to make about the future pension increases, or indeed the mortality of the folk that might be taking this on.

Q39 Craig Mackinlay: You obviously have the saving of JSA, if we are assuming many are on JSA during this sort of interim period.

Martin Clarke: Exactly. That might be more easy to factor in. I think it is more the pension credit question, which to my mind is a very big tilt and effectively would make the terms a bit divisive between those who were likely to be eligible for it and those who were not. Those who were not eligible for it would think that they were not being given a good deal in terms of the pension reduction, the early drawing of it.

Q40 Steve McCabe: I wanted to see if I can understand this actuarial reduction factor and the way you have applied it to people who might take early pension. I think you have explained reasonably well why you have arrived at that figure of 6% and why you have used that for illustrative purpose, but I wonder, is it reasonable to suppose you have consciously gone for a figure at the high end of the scale?

Martin Clarke: Hopefully not.

Q41 Steve McCabe: I am asking because I think the range is between about 5% and 6% and you have opted for 6%, haven't you?

Martin Clarke: Yes. What I chose to do, in the absence of having the actual scheme to cost up, or even a specific instruction on the factors that I ought to take into account, I looked at previous work that we had done in regards to the late payment of state pension, which was a report that we last produced a couple of years ago. The principles of the calculation are very similar, so I thought that that would be a pragmatic way of producing a figure to illustrate and that is where the 6% came from. I want to emphasise totally that any final recommendation that would be made would be based on precisely what the rules of the scheme were, things like pension increases and interaction with other benefits, whether selection bias such as mortality would have to be taken into account or spread more broadly. It is quite conceivable that the outcome of that would be a figure of 4%. Equally, it could be slightly higher than 6%, so I hope I have been clear that it is, as we say, for illustration purposes. It is important, because one of the questions was working through the potential fiscal impact, so I think that is sure. I do not think at this stage I would regard what I have done as anything other than a convenient finger in the air and that we would have to do much more work and much more dialogue with the commissioning authority to get a basis that we put forward as being the actual one to use in practice.

Q42 Steve McCabe: Does this question of selection bias effectively mean that we are talking about those who are unable to work, who are too ill to work or who have reason to believe they have a short life expectancy? Is that where it is going to be focused?

Martin Clarke: Yes. It is perhaps an unfortunate term, to call it selection bias in those cases, but quite clearly if it is to your advantage to take this option because you have no expectation of living long enough to suffer all the full effects of the reduction, then you would be well advised to do so. Yes, it would be those particular cases. It remains a question, as I implied earlier, as to whether under an instruction one would be encouraged to take account of that or whether, for example, the Government might express the policy intent slightly differently and say, "Just assume normal population mortality and the group taking this option experience the same mortality as the group not taking it" on the basis that they wanted to express that solidarity more widely rather than just in the narrow cohort that we are talking about. It is very much what the instructions would be as to whether that factor needs to be taken into account when producing the early retirement factors.

Q43 Steve McCabe: Based on your experience, if the Government did want to present these women with this opportunity to have these pensions earlier, albeit at a reduced rate, what kind of instruction would you speculate they are most likely to give to you?

Martin Clarke: I could not possibly speculate on that. It is very much a policy issue and my job would be to advise them of the choices and the consequences of some of those choices. For example, there are different approaches even to the selection of a discount rate to express the time value of money, depending on some of the issues that might be relevant. At one extreme one might take, "What is the cost to Government of this?" which would be, if you like, international borrowing costs of doing it. We heard in the previous session about how the cost to the individual might be based more on the credit rates that you could get, because if they are having to borrow money because they do not have the early pension, then their actual rate might be a lot higher. There is a range of assumptions, depending a little bit on the policy intent and a little bit on the other financial advice that I would be giving, so I think it would be a bit presumptuous to put myself in what is effectively the mind of a client and say, "That is what I think you really want to ask me". It would be a dialogue that one would have where I would point out the consequences and the options, but would take the instruction from the client.

Q44 Chair: Mrs T loved public servants who could help her achieve particular objectives. If we could imagine that Mrs T decided that her Government had behaved unfairly to this group and wanted to come up with a proposal that would help them, your paper seems to present this imaginary situation: real problems with the £2 billion public expenditure costs upfront. In that, she would have to face more toughness and in-house comments over that than the discount rates. Would she be able to give you a set of assumptions for you to work that would reduce that £2 billion upfront and would that just relate to the numbers that were going to claim?

Martin Clarke: The £2 billion is my estimate of how much is at risk if everybody took this option in a particular year, so in terms of one answer to your question, I might say that a solution that reduced that uncertainty, but not necessarily that it was cost neutral, might be more preferable. If you want to control that uncertainty, then it may be preferable to target the resources at those that are the most in need, rather than offer an option that potentially could encourage a more widespread population to take advantage of an early retirement option and then force this cash flow change back on to the Government's books. So there may be a lower-cost option in terms of the early years that was more targeted, but it would not be cost neutral over the longer period, because effectively it would be a one-off transitional relief.

Q45 Chair: Sure, but if in fact the take-up is on the Canadian scale, it would be 40% of your £2 billion hit, wouldn't it?

Martin Clarke: Yes.

Q46 Chair: 40% of £2 billion is the sort of figure that Chancellors sometimes are able to lose in their accounts, particularly when there is the jubilee year coming in the last year of this Parliament when it seems that all debts are going to be able to be met.

Martin Clarke: I cannot possibly speak for the Chancellor, but I regard my job largely to express the nature of the risk. As I say, I think amending or flexing the basis on which the reduction factor is set would change things at the margin. I think the principle is that there could be a large proportion of people taking the money early and causing the bring forward of Government expenditure, the scale of which we have talked about the numbers, but fundamentally it is a little bit uncertain because of the particular circumstances we have here. It may be that a better solution, if you were not prepared to take that risk, would be to go for more targeted compensation, if you could afford that as well.

Q47 Chair: But the uncertainties are merely about the take-up, Martin, or do they cover other issues as well?

Martin Clarke: I think that is the main one. We have talked about the potential interactions with other means-tested benefits, which I think would bring more uncertainty into the equation. If this was not a standalone piece but was also embracing the potential, as I said, for pension credit to expand to fill the gap that was created, then it would be the take-up and the nature of the people who were taking it up. If there was a high proportion of people who would likely qualify for pension credit, they would be getting early payment of state pension at a reduced rate and compensation for the gap that was created by the reduction in later life to negate the cost-neutral implications. I think that would be a high level of uncertainty, certainly.

Q48 John Glen: Martin, I am hoping you can clarify something on the national insurance issue for the women we are really talking about, because as I understand it, the advantages of some of the Government's changes is that there is a favourable accrual rate for that group of women near the pension age. If you give them their pension or give them the option to take it early, the burden of that, of the additional entitlement that would have accrued if they had been working, falls away from the Government, because they are not having to top up disproportionately more. Is that correct and would that not have a positive bearing on some of the calculations that you could make?

Martin Clarke: It is an area that would need to be clarified in defining how this scheme would work. In any calculations I have done so far, I have ignored that effect. There is the potential, as you say, for example, for a member of this cohort to effectively be still accruing national insurance at that age and, therefore, taking the pension early. If this was the way the scheme was designed, it might stop that occurring. I do not know, because that is the design. You could envisage a scheme where you could take your pension at the reduced rate early, but continue to accrue years under the national insurance scheme on top, if you were paying contributions and still working. In that respect, it would have no effect. If the consequence of taking the state pension early was to take you out of that equation completely, so you did not pay any more national insurance and did not accrue any other benefits, then you would have to take that net effect into the costings of the scheme.

Q49 Craig Mackinlay: Just a couple of things, Martin. Looking at the percentage discount rate, we have some figures here across civil service, NHS, teachers, so 6% is sort of in the field. That does not mean that we should all be chasing benchmarking, we might all go off over the cliff together, but 6% feels about right. I have been somewhat confused about the deferral rate. If you decide to take the state pension later, the deferral rate is 10.4%. That must have come out of your Department at some time and I have always been intrigued as to the generosity of that figure, and even at that figure there is only very few; we were told earlier 7% only take that up. Why did you come up with 10.4%? I have always been rather intrigued about that. I have one other question for you a minute.

Martin Clarke: It might be best if I answer that question by promising the Committee a note on the subject, because I think I will probably not be as well prepared for it just on the spur of the moment.

Q50 Craig Mackinlay: The other thing, the degree of uncertainty—we have discussed it at length here—is how many people would take up some sort of deal if it were available. I do feel that the Canadian and UK figures, that is a huge number of people, a huge number of choices with similar blue collar mixtures and all the variants that we may have in the UK, not dissimilar people, I wouldn't say, but the big confusion, the big elephant in the room is the benefits factor. I would assume—I do not know for a fact—that Canadian benefits are perhaps more generous than US benefits, so I would just think, my thumbs would tell me that if you have benefits in the mix, then your percentage taking it up would be less.

Martin Clarke: I think you are absolutely right. I do not know for sure the details of the American and US experience, but I would rephrase your question to me, "Is that a relevant number to work to?" My answer would be, "It depends". You have to look more closely at the circumstances in which that is happening. There are a lot of other factors at play in terms of people's behaviours around state pension age and earlier as to even cultural things like the attitude of employers to later working. Those are all factors that are environmental towards going into whatever that percentage would be. It is obviously relevant to look at examples from overseas, but I think you do have to look a little bit more deeply at the precise circumstances, as you say. I totally agree with you.

Chair: Martin, thank you very much for both your submission and evidence. It has helped the Committee in its approach, but it has also for me—and I am sure others—clarified if the Government wanted to do something on this front the sort of framework it might give you to work out for them what the costs would be. That is really helpful. Thank you very much indeed.