This briefing summarises existing pension arrangements in Scotland and what pensions might look like in the future under current UK Government plans. It also considers some of the issues that have been raised on the future of pensions in an independent Scotland. Consideration is also given to some of the demographic factors which are being faced in many economies across the world.
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EXECUTIVE SUMMARY

Pensions will be a major public policy issue in Scotland (and in many advanced economies) in the coming years, regardless of the constitutional direction of travel. This is due to a trend towards population ageing, driven by increasing life expectancy and fertility rates below 'replacement level'.

Pensions have also generated significant interest in the debate on Scotland's constitutional future. This briefing summarises the existing pensions system in Scotland and the UK and the recent UK reforms to State, Public and Private sector pensions. It then summarises the Scottish Government's position on pension provision should Scotland vote for independence.

Finally, the briefing attempts to summarise some of the issues to have been raised by stakeholders on the Scottish Government's proposals for pensions in an independent Scotland.
INTRODUCTION

Pensions are and will be a significant public policy issue in the coming years and decades in many advanced economies, with pension payments an important element of current and future government obligations. In the UK, state pensions are paid on a pay-as-you-go basis out of current government expenditure, and are a largely unfunded future financial commitment. These have been described as an “implicit debt” (Simpson 2014) alongside things like Public Private Partnership (PPP) unitary charge payments which must be added to the “explicit” Public Sector net debt which stands at 77.3% of GDP in 2014-15 (HM Treasury 2014a).

Pensions have taken on more political significance because of a demographic trend in the last two decades towards population ageing. Population ageing is driven by a combination of two factors: increasing life expectancy and declining birth rates. The influence of these two factors is measured via the old age support ratio, which is the number of people of working age relative to the number of people of pension age. This briefing will show the extent of these factors across advanced economies using OECD data.

This briefing goes on to summarise the existing State, Public and Private pension arrangements in Scotland and the UK. It also looks at the future of pensions in the UK based on current policy.

Pensions have also generated significant interest in the debate on Scottish independence. Pensions are unusual in that they are arrangements held by many voters that extend well beyond the projected date for independence in the event of a yes vote. There is evidence that voter behaviour may be influenced by expectations of the way in which pensions will be delivered after independence. In a BBC poll on what matters most to voters in the independence referendum debate, pensions was ranked 2nd behind the economy (BBC Scotland, 2014). As David Bell et al say in their paper, Funding Pensions in Scotland: would independence matter?:

“if voters place a high weight on post-referendum income, those promoting independence then have the task of reassuring both taxpayers and pensioners. Considerations of loss-aversion may then lead, perhaps counter-intuitively, to proposals from those promoting independence to maintain the status quo as regards pension policy” (Bell, et al 2014).

This appears to be the case in the Scottish Government Pensions in an Independent Scotland document (Scottish Government 2013a) which emphasises continuity and keeping “the best of existing State Pension system”. For example, the foreword to the document states:

“This means that the State Pension will continue as now, and planned reforms will be rolled out, including the single-tier pension. All pensions will continue to be paid as now and all accrued rights will be honoured and protected. Improvements include a commitment to apply the Triple Lock to the single-tier pension, the Basic State Pension and Guarantee Credit initially for the term of the first independent parliament, thereby protecting the value of pensions over time. We will maintain Savings Credit to benefit low-income households.”

And:

“independence will provide strong protection for individuals’ private pension savings via an effective regulatory system”.

The Scottish Government seems, as David Bell et al say, to be seeking to reassure on pensions in the event of a yes vote to independence. By producing a detailed paper on Pensions (not all areas of policy have had the same level of focus) the Scottish Government appears to
recognise the importance of pensions to the constitutional debate. In the foreword by the Deputy First Minister, it is stated in bold that:

“The main aim of this paper is to provide clarity and reassurance for existing pensioners, people of working age, employers and the pension industry.”

During the referendum debate, there has been much discussion on pension provision in an independent Scotland. The UK Government has also produced a “Scotland analysis” report on Work and Pensions (Department for Work and Pensions, 2014). Before looking at some of the issues that have arisen, it is important to understand the context for pension policy and understand how pensions currently work. The next sections of this briefing examine these.

**CONTEXT FOR PENSIONS POLICY**

**DEMOGRAPHICS**

Demographic pressures mean that there will be challenges facing pension schemes in the UK and in much of the developed world. As mentioned above, population ageing is driven by a combination of increasing life expectancy and declining fertility rates. In the OECD in recent years life expectancy has been increasing and fertility rates have been decreasing. Current life expectancy and fertility rates for Scotland, the UK as whole, OECD and EU27 are provided below.

At the age of 65, on average Scottish men and women can now expect to live for an additional 17.2 and 19.5 years respectively (General Register Office for Scotland (GROS) 2014a). This is up from 14.7 (male) and 17.8 (female) extra years of life at 65 at the time of the start of devolution in 1999 (GROS 2008). However, life expectancy at 65 in Scotland is lower for men in Scotland relative to the OECD and UK average. While women are expected to live longer than men, Scottish women are expected to live less than the average of their EU27, OECD and UK counterparts. This lower life expectancy suggests that Scots will enjoy fewer years in receipt of pensions and that pension provision might be more affordable in Scotland – a point made in the Scottish Government’s recent note on *Life Expectancy and the State Pension* (Scottish Government 2014). However, it is also important to recognise that there are offsetting costs to the State of lower life expectancy, around ill-health and resulting health and welfare expenditure. The Scotland wide figures also mask significant difference in life expectancy within Scotland – with best performing areas like East Dunbartonshire where men are expected to live for 80.1 years, 7.5 years longer than in Glasgow City (72.6 years) (National Records of Scotland 2014). The Annex to this briefing provides male and female life expectancy maps by local authority area.

**Figure 1: Life Expectancy at 65, 2010-15**

<table>
<thead>
<tr>
<th></th>
<th>UK</th>
<th>Scotland</th>
<th>OECD</th>
<th>EU27</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>18.1</td>
<td>17.2</td>
<td>17.3</td>
<td>16.4</td>
</tr>
<tr>
<td>2015</td>
<td>19.5</td>
<td></td>
<td>20.8</td>
<td>20.0</td>
</tr>
</tbody>
</table>

Scottish rate 2010-2012
Source: OECD 2013, National Records of Scotland 2014, ONS Personal correspondence
Total fertility rates\(^1\) averaged 1.74 across OECD countries in the period 2010-15, well below the level which ensures a population replaces itself from one generation to the next, without migration. The replacement level is roughly 2.1 children per woman in most countries, although it may modestly vary with mortality rates (Searchinger, 2013). Although Scotland has seen an increase in birth rate in recent years, at 1.69 it is below the OECD and UK averages, but above the EU27. The trend to fewer children has been going on across much of the developed world since the 1970s. “The fall in fertility rates reflects changes in both individual lifestyle preferences and in the constraints of everyday living, such as labour-market insecurity, difficulties in finding suitable housing and unaffordable childcare” (OECD 2013).

**Figure 2: Total Fertility rates, 2010-15**

![Graph showing total fertility rates for UK, OECD, Scotland, and EU27]

Scottish rate 2010-2012

Source: OECD 2013, GROS 2014b.

The old-age support ratio is a useful indicator of the pressures that demographics potentially pose for pension systems. It measures how many people there are of working age relative to the number of retirement age. The higher the old-age support ratio, the younger the society. Figure 3 below shows that the number of people of working age relative to retirement age is lower in Scotland relative to the UK as a whole, with the gap projected to increase in the longer term.

**Figure 3: Old-age support ratios**

![Graph showing old-age support ratios for Scotland and UK]

Source: National Population Projections, 2012-based projections

---

\(^1\) The total fertility rate is defined as the average number of children (per woman) that would be born to a cohort of women if they experienced, throughout their childbearing years, the age-specific fertility rates of the year in question.
These demographic trends form the backdrop to the current UK pensions regime, as well as proposed reforms to it, which are summarised below.

**CURRENT PENSIONS REGIME**

**THE STATE PENSION**

The current UK State Pension has two tiers: the Basic State Pension (BSP) and the Additional State Pension (ASP).

The BSP is a contributory, flat-rate benefit paid to individuals over the State Pension Age (SPA). It is calculated on the basis of qualifying years of National Insurance contributions or credits. The number of qualifying years for a full BSP is 30, for people reaching SPA on or after 6 April 2010. The level of the full BSP in 2014-15 is £113.10 per week or £5,881 per year (UK Government 2014a). Those who have fewer than 30 qualifying years receive a pro-rata BSP, although they may be able to top-up their pension via voluntary National Insurance contributions (NICs).

Pensioners with relatively low incomes may also be eligible for means-tested support through one of two forms of Pension credit.

- The Guarantee credit tops up weekly income to a “standard minimum guarantee” (£148.35 per week for a single person, £226.50 per week for a couple in 2014-15) (UK Government 2014a). Additional amounts are payable in respect of severe disability, certain caring responsibilities and housing costs.
- The Savings Credit aims to provide an additional amount for those aged 65 or over who have made some provision for their retirement. The maximum Savings Credit in 2014-15 was set at £16.80 per week for a single person and £20.70 per week for a couple (UK Government 2014a).

The second tier is the ASP, which is partly earnings-related. People have accrued entitlement through:

- The State Earnings Related Pension Scheme (SERPS) which operated between 1978 and 2002;
- The State Second Pension (S2P) which replaced SERPS from April 2002

SERPS and S2P derive from contributions on earnings with entitlements built up through working life. Since 1978 it has been possible to “contract out” of the ASP into a private pension scheme that meets certain requirements. Where an individual is contracted out to a salary-related scheme, they and their employer pay lower national insurance contributions (Thurley 2013). The rebate on national insurance contributions for those contracted out in Defined-benefit schemes is currently worth 1.4% of pay for employees and 3.4% of pay for employers on salaries between £5,564 and £40,040. From April 2012, the option to contract-out into a Defined Contribution scheme was removed, so that it is now only possible to contract-out into a Defined Benefit (or salary-related) pension scheme.
**Glossary**

**Defined Benefit pensions** pay the individual a specific income in retirement. The pension amount is linked to pensionable service (the number of years of membership of the scheme), pensionable earnings (this might be the scheme member’s final salary, average salary over their career or some other formula) and the proportion of earnings received as a pension for each year of membership. In a defined-benefit scheme, the employer has an obligation to ensure sufficient funds in the pension scheme to pay the accrued pension benefits to members. **The employer, rather than the employee, bears the financial and investment risk.**

With a **defined-contribution pension** you build up a fund which you then convert into an income at retirement. Unlike defined-benefit schemes which promise a specific income linked to your salary, the income from a defined-contribution scheme depends on factors including the amount you pay in and the fund’s investment performance. The accumulated funds are generally used to purchase an annuity (although the UK Government has recently announced changes in this regard, see below) from pension providers for an individual which gives an income in retirement. The value of the annuity depends on a wide range of factors, including life expectancy, the age and health of the person buying the annuity and annuity rates at the time of purchase (these depend on interest rates generally as well as on government gilt prices). Unlike defined-benefit schemes, there is no guaranteed value of the pension income in retirement, which depends on the investment performance of the fund and the annuity rate offered by the market at the time of retirement. **The employee, rather than the employer, bears the financial and investment risk.**

**PROPOSED CHANGES TO THE STATE PENSION**

**State Pension Age**

The SPA is rising. The Pensions Act 1995 planned increases in the SPA for women from 60 to 65 over the period April 2010 to April 2020. The Pensions Act 2011 accelerated planned changes to SPA, so that women’s SPA would reach 65 in November 2018. The same act also legislated for the SPA to increase to 66 for both men and women from December 2018 to October 2020. Part 2 of the Pensions Act 2014 includes provision to bring forward the increase to 67 to between April 2026 and March 2028. Future increases in the SPA are to be subject to periodic reviews in light of changes in life expectancy and other relevant factors (Thurley 2013).

**The Single Tier pension**

On 18 March 2013, the UK Government announced plans to combine the BSP and S2P to create a new “single tier” pension for individuals reaching SPA from April 2016. Current pensioners and those reaching state pension age prior to 6 April 2016 will continue to receive the state pension based on the existing rules. The single tier pension is to be set at a level that is high enough to ensure that anyone with full entitlement will not qualify for the means tested Pension Credit Guarantee. The main features of the single tier pension are as follows (DWP, 2013):

- It will be set above the basic level of means-tested support (the Pension Credit Standard Minimum Guarantee is £145.40 per week for a single pensioner in 2013/14) and will be increased each year at least in line with the percentage growth in average annual earnings.
• It will require 35 qualifying years of National Insurance Contributions or credits for the full amount. There will be a minimum qualifying period of 10 years. Those with fewer than 35 qualifying years, but more than the minimum, will receive a pro-rata amount.
• If an individual has made National Insurance Contributions or received credits under the current system, they will be converted into a single-tier amount. Providing an individual meets the minimum qualifying period of 10 years, the payments will be no less than the amount calculated under the current scheme rules.
• An individual is not able to inherit or derive rights to the single-tier pension of their spouse or civil partner.
• An individual can choose to defer claiming their state pension and later receive a higher weekly state pension in return. It will no longer be possible to receive deferred state pension as a lump-sum.

PUBLIC SECTOR PENSIONS

Occupational pensions policy – including on public sector pensions – is a reserved matter. The Scottish Government has certain executively devolved powers, which vary from pension scheme to pension scheme. The Scottish Government has responsibility for some policy aspects of five of the six main public sector schemes in Scotland (all but the Civil Service scheme), including aspects of scheme design. The Scottish Public Pensions Agency (SPPA) advises the Scottish Government on these matters. The Scottish Government has the following levels of discretion on pension schemes in Scotland:

• The **NHS and teachers’ schemes in Scotland** are separate from the equivalent schemes in England and Wales. Ultimately Scottish ministers and then HM Treasury ministers must both approve changes to these schemes in Scotland. Proposed changes made at the UK level or directed by the UK Government (such as around scheme Normal Pension Age) are considered in Scotland through separate negotiations between the Scottish Government, employers and trade unions. However, the UK government has an ultimate veto over decisions taken in Scotland, should it choose to exercise it.
• The **police and firefighters’ schemes** are also separate from their UK counterpart schemes. For any changes to them, the Scottish Government consults with staff associations, unions and the new unitary services to ensure a Scottish perspective. The SPPA and Scottish Government Justice Directorate also represent the Scottish Government at UK-wide discussions on the potential shape of these schemes.
• The NHS, teachers, police and firefighters schemes are known as unfunded or Pay As You Go schemes (see “scheme types” section below for more).
• The **Local Government Pension Scheme (LGPS) in Scotland** is separate from the equivalent scheme for England and Wales and for Northern Ireland, and unlike the other Scottish schemes is funded. Changes to this scheme are taken forward via tripartite discussions and negotiations involving the employers, trade unions and Scottish Government, however, these changes must comply with UK primary legislation. Differences between the Scottish scheme and those in England and Wales include a different system of tiered employees’ contribution rates.
• The **Civil Service and Armed Forces scheme** operates at a UK level, although the Northern Ireland Assembly has a legally separate scheme for civil servants. The Cabinet Office has overall management responsibility for the Civil Service Scheme with the MoD taking the lead on the Armed Forces scheme. The Scottish Government has no role in setting policy for or the operation of these two schemes.
• The only fully devolved pension schemes in Scotland are for some devolved public bodies – namely, Scottish Enterprise, Highlands and Island Enterprise, Highlands and Islands Airports Ltd, Caledonia MacBrayne Ltd, and the Scottish Legal Aid Board (SLAB) – and some judicial office holders working in devolved areas – namely, Stipendiary
Magistrates and Tribunal Chairs. MSPs’ pensions are also fully devolved. In these schemes, there is no requirement to consider primary or secondary legislation from Westminster.

Table 1: Membership and Management of Scottish Public Sector Pension schemes

<table>
<thead>
<tr>
<th>Powers</th>
<th>Scheme</th>
<th>Membership 2011-12</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Active</td>
</tr>
<tr>
<td>Executively Devolved</td>
<td>+</td>
<td>162,376</td>
</tr>
<tr>
<td>NHS</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Executively Devolved</td>
<td>🎓</td>
<td>80,260</td>
</tr>
<tr>
<td>Teachers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Executively Devolved</td>
<td>⚖️</td>
<td>17,596</td>
</tr>
<tr>
<td>Police</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Executively Devolved</td>
<td>🙅‍♂️</td>
<td>5,737</td>
</tr>
<tr>
<td>Firefighters</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Executively Devolved</td>
<td>🏡</td>
<td>202,338</td>
</tr>
<tr>
<td>Local Government</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fully Devolved</td>
<td>🏦</td>
<td>2,805</td>
</tr>
<tr>
<td>Devolved public bodies</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Adapted from Scottish Government 2013a
As is revealed in table 1, less than 1% of the 965,000 members of public service pension schemes in Scotland belong to schemes which are fully devolved.

Administration

As mentioned above, the UK Government sets overall pensions policy, while the Scottish Government, supported by the SPPA, has some influence on scheme design and reform.

As well as policy support responsibility, the SPPA directly administers the day-to-day operation of the biggest unfunded schemes, the NHS and teachers and, from April 2015, will also take on that responsibility for the Police and Firefighters’ schemes for Scotland. As administrators to these schemes, this Scottish Government Executive Agency maintains records of all members of these schemes, collects contributions and pays pensions as they become due. It prepares accounts for each scheme it administers.

The LGPS is administered by 11 local authorities, namely: Aberdeen City, Edinburgh, Dumfries and Galloway, Dundee, Falkirk, Fife, Glasgow, Highland, Orkney, Scottish Borders and Shetland councils.

SCHEME TYPES

There are two distinct financial models for meeting the costs of public service pensions across the UK – Unfunded (or ‘pay as you go’) schemes and Funded schemes.

Unfunded schemes are not backed by dedicated investment funds. Instead, Government receives contributions from active scheme members and their employers, which it uses as revenue to meet the cost of pensions to current pensioners. Under this model, which is unique to government-backed schemes, in-year cash surpluses of income (contributions) over expenditure (pension payments) are available for general government expenditure. Conversely, in-year cash deficits require government to top-up the difference from other sources. The various contribution rates ought, therefore, to have no direct relationship to the amounts required for pensions currently in payment and are set following quadrennial actuarial valuations.

In funded pension schemes, contributions from employees and employers are paid into a fund, which is invested, and from which the cost of pension benefits is met. Payments to current pensioners are paid from the pension fund’s own resources. The largest Scottish funded scheme is the LGPS. As at 31 March 2011, its assets were valued at £23.7bn against liabilities of £25bn, giving an aggregate funding level of 95% at that time. There are 11 different LG pension funds each of these is managed separately by a specific lead local authority, on a regional basis. Formal assessment of assets vs. liabilities takes place during separate actuarial valuations of the eleven LGPS funds which when combined comprise the LGPS in Scotland. The next actuarial valuation is not due to report until late 2014-15. It will be based on data as at 31 March 2014.

Of the five major Scottish schemes – those for Local Government, the NHS, Teachers’, Police officers and fire-fighters in Scotland – only the LGPS is a funded scheme (i.e. backed by assets held in investment funds). There are also a small number of small Scottish public sector schemes for arms-length bodies – those for Scottish Enterprise, Highlands and Islands Enterprise, Highlands and Islands Airports Ltd., Caledonian MacBrayne and the Scottish Legal Aid Board. All of these are trust-based schemes and all bar the SLAB scheme are funded (SLAB scheme is pay as you go).
CONTRIBUTION RATES

Employer’s contribution rates for the different pension schemes currently vary from 11.5% to 24.7%, while employees’ rates in 2013-14 varied from 1.5% for some in the civil service classic scheme to 15%. Employer contribution rates will be re-set for 2015-16, based on the outcome of quadrennial actuarial valuations. Employee (member) contributions for all of the pay as you go schemes were increased by an average of 3.2% of pensionable pay between April 2012 and April 2014, as a result of UK Government policy.

Table 2: Contribution rates by public sector pension scheme, 2013-14

<table>
<thead>
<tr>
<th>Scheme</th>
<th>Employee contribution</th>
<th>Employer contribution</th>
<th>Financial model</th>
</tr>
</thead>
<tbody>
<tr>
<td>NHS</td>
<td>9.2% average (Tiered by salary, from 5%-13.3%)</td>
<td>13.5%</td>
<td>Unfunded scheme, supported by AME*</td>
</tr>
<tr>
<td>Teachers</td>
<td>8.9% average (Tiered by salary, from 6.4%-11.2%)</td>
<td>14.9%</td>
<td>Unfunded scheme, supported by AME*</td>
</tr>
<tr>
<td>Police</td>
<td>13.5% average pre-2006 scheme (Tiered by salary from 13.5%-14%) 12.0% average post-2006 scheme (Tiered by salary from 10.7%-12%)</td>
<td>24.7%</td>
<td>Unfunded scheme, supported by Scottish DEL **</td>
</tr>
<tr>
<td>Firefighters</td>
<td>12.9% average pre-2006 scheme (Tiered by salary from 11%-15%) 10.4% average post-2006 scheme (Tiered by salary from 8.5%-11.1%)</td>
<td>Pre-2006 scheme: 21.8% Post-2006 scheme: 11.5%</td>
<td>Unfunded scheme, supported by Scottish DEL **</td>
</tr>
<tr>
<td>Local Government</td>
<td>6.3% average (Tiered by salary on a “banding” basis from 5.5%-12%)</td>
<td>16.6%-20.5% (depending on which of 11 LGPS funds)</td>
<td>Funded scheme supported by payments under Scottish DEL</td>
</tr>
<tr>
<td>Civil Service</td>
<td>4.1% average (Tiered by salary from 1.5%-6.25%)</td>
<td>18.9%</td>
<td>Unfunded scheme, supported by UK AME</td>
</tr>
</tbody>
</table>

Notes: all figures are for financial year 2013-14.
* Annually Managed Expenditure (AME) is spend which is set each year and is not readily predictable and thus annually managed. In the case of pensions payments, it is not part of the Scottish Government’s discretionary spend and is provided by UK Treasury.
** Departmental Expenditure Limits (DEL) funding is the discretionary element of the Scottish Budget (and is otherwise known as the block grant).
Source: Scottish Government 2013a.
In 2011-12, the total Scottish Public Sector Pension income from employer (£2,185.9m) and employee (£795.9m) contributions (excluding the Civil Service Scheme) was £2,981.9m, with total expenditure of £3,207.7m (Scottish Government 2013a, p95). As such, there was a total pension net cash flow deficit of £225.8m. However, as the Scottish Government paper also points out, in the years 2012-13 to 2013-14 there is a planned average increase in employee contributions of 3.2% which is estimated to add £250m per annum to employee contributions from 2014-15 (Scottish Government 2013a, p95).

UK GOVERNMENT’S PUBLIC SECTOR PENSION REFORMS

There have been reforms to public sector pensions in recent years which have sought to implement a number of the recommendations contained within the Hutton report on Public Service Pensions (HM Treasury 2011). These have had implications for public sector pension scheme design, how schemes are valued and indexed, the amount public service workers pay into their pension and scheme governance.

So far, policy changes have included:

- A change in basis of the annual indexation for public service pensions in payment, which took effect from April 2011. This moved the indexation measure to the Consumer Price Index (CPI) from the previously used Retail Price Index (RPI). This switch was controversial because in general, inflation measured by CPI tends to be lower than RPI. Between 1989 and 2011, RPI inflation tended to be around 0.7 percentage points higher than CPI on average (Thurley 2012); and according to the Office for Budget Responsibility (OBR), the gap between RPI and CPI is projected to be larger in the long term (OBR 2013, table 3.3).
- A change in the Discount Rate used to value unfunded schemes, which resulted in a counter-balancing increase in scheme liabilities.
- An increase in employee contributions by an average of 3.2% of pensionable pay in three annual increments between April 2012 and April 2014.

Other changes to be implemented from April 2015 include:

- Linking pension benefits for public service workers with career average earnings rather than final salaries
- Linking the Normal Pension Age (NPA) with the SPA; or, for Police and Firefighters and Armed Forces, setting NPA at age 60.

PRIVATE PENSIONS

Private pensions generally fall into two basic categories:

- Occupational pensions which form part of the remuneration package of public and private sector employers. There are two main types of occupational pension schemes: Defined Benefit and Defined Contribution.
- Personal pensions which are arrangements between an individual and a private sector pension provider, but can also be part of a workplace arrangement

Defined benefit schemes account for almost all public sector pension schemes, but only around 10% of private sector schemes. Most private sector schemes are now Defined Contribution (Scottish Government 2013a). As is mentioned in the Glossary box above, in Defined Contribution schemes the employee rather than the employer takes the financial and investment
risk (as opposed to Defined Benefit, where the employer takes the risk) and in recent years, there has been a marked shift away from Defined Benefit schemes in the private sector toward Defined Contribution schemes (Reform Scotland, 2014).

“In the light of steadily increasing pension costs in a very different general economic environment, more and more employers have opted to offer new employees a reduced level of pension coverage in a defined contribution scheme…..

An increasing number of employers are not only closing their defined benefit schemes to new members but also to the future accrual of benefits by existing members. Instead, these individuals will typically be offered the opportunity to accumulate future benefit rights on a defined contribution basis (just as for new employees)” (Reform Scotland 2014).

Personal pensions are defined contribution schemes and there are three main types:

- **Group Personal Pensions** – an employer chooses the pension provider and almost always commits to paying certain contributions (usually a percentage of the individual’s earnings). The pension provider offers terms based on the demographics of the employer’s workforce and the intended contributions.

- **Individual Personal Pensions** – are private pensions that an individual arranges for him/herself. You pay money into a pension fund which you use to buy a regular income when you retire. These are typically used by people who want to supplement their occupational pension, the self-employed who do not have access to a workplace pension, and those who are not working but can afford to pay into a pension (UK Government 2014b). An employer can also pay into an individual’s personal pension.

- **Stakeholder Pensions** – are a type of Personal pension but must meet certain minimum standards set by government. These include the management charges not exceeding 1.5% of the fund’s value in the first 10 years and 1% thereafter, being able to start and stop payments when you want or switch providers without being charged and having certain security standards, for example having independent trustees and auditors. Payments into stakeholder pensions can start at £20 per month, and can be in lump sums (UK Government 2014b). Companies can also use stakeholder pensions for their employees as a form of group personal pension and these are known as Group Stakeholder Pensions.

In 2011-12, 54% of employees were active members of an occupational and/or personal pension scheme in Scotland, which is the highest rate in the UK (Scottish Government 2013a). According to the Scottish Government report on Pensions in an Independent Scotland, 27% of self-employed people and 1% of economically inactive adults in Scotland are active pension scheme members (Scottish Government 2013a).
Table 3: Active membership of private pensions in Scotland by employees, 2011-12

<table>
<thead>
<tr>
<th>Pension Type</th>
<th>Proportion of employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employer-sponsored pension scheme</td>
<td></td>
</tr>
<tr>
<td>Occupational pension</td>
<td>35%</td>
</tr>
<tr>
<td>Group Personal pension</td>
<td>11%</td>
</tr>
<tr>
<td>Group Stakeholder pension</td>
<td>3%</td>
</tr>
<tr>
<td>Any employer-sponsored pension</td>
<td>51%*</td>
</tr>
<tr>
<td>Personal Pensions</td>
<td></td>
</tr>
<tr>
<td>Personal pension</td>
<td>5%</td>
</tr>
<tr>
<td>Stakeholder pension</td>
<td>1%</td>
</tr>
<tr>
<td>All-private pension participation</td>
<td>54%**</td>
</tr>
</tbody>
</table>

Notes: Occupational pensions are provided to public and private sector employees
* Includes pension where type of pension is unknown
** Individuals may belong to an employer sponsored scheme and have their own person pension.

AUTO-ENROLMENT

From October 2012 to October 2017 all employers in the UK will have to automatically enrol workers into a workplace pensions scheme if they are aged between 22 and SPA, earn more than £10,000 per annum and work in the UK. Auto-enrolment will be staggered over the period, depending on the number of employees in the company, with larger employers first.

RECENTLY PROPOSED CHANGES ON REQUIREMENT TO ANNUITISE

People with defined contribution pensions build up their pension fund via contributions, investment returns (if any) and tax relief. At retirement, most people (75%, HM Treasury 2014b, para 2.17) with a defined contribution pension use it to buy an annuity. Annuities provide individuals with a guaranteed income for life and mean that the individual no longer bears any investment risk. Until 2011, there was a “requirement to annuitise” at the age of 75, but this changed in 2011 when the UK Government ended this requirement.

In UK Budget 2014, the Government announced short-term changes to access to defined contribution pensions, increasing the size of pension that could be taken as a lump sum and introducing more flexibility into the income drawdown arrangements. It also launched a consultation on proposals to allow people from April 2015, whatever the size of their defined contribution pension pot, to take it from the age of 55 “how they want, subject to their marginal rate of income tax in that year” (HM Treasury, 2014b).

QUEEN’S SPEECH 2014

The Queen’s speech on 3 June 2014 announced a Pensions Tax Bill to give effect to some of the changes covered above on annuities. It also announced a Private Pensions Bill to make provision for “Defined Ambition Schemes” which are schemes that aim to encourage greater risk sharing between parties than is currently provided in Defined Benefit Schemes (where the employer carries the financial and investment risk) and Defined Contribution Schemes (where the employee carries the financial and investment risk) (Thurley 2014b).
PENSIONS AFTER A NO VOTE

The Scottish Liberal Democrats, Scottish Labour and Scottish Conservatives have now all published reports from their respective commissions into devolution and future governance in the event of a No vote in the September referendum. All three reports have recommended that pension provision remains reserved to the Westminster Parliament in the event of Scots opting to remain in the United Kingdom (Scottish Liberal Democrats, 2012, Scottish Labour 2014, Scottish Conservatives 2014).

PENSIONS IN AN INDEPENDENT SCOTLAND

STATE PENSION

Responsibility for the accrued entitlements of those of working age living in Scotland to a State pension and the practicalities of making payments to those who are currently retired would be a major feature of any formal negotiations between an independent Scottish Government and the UK Government (ICAS 2014).

The Scottish Government (2013a, 2013b) has emphasised that the best of the existing state pension would be retained, with certain “improvements where necessary”. In summary:

- Current recipients of the state pension would continue to receive these pensions as now, on time and in full.
- The basic state pension would be uprated by the “triple lock” for the first parliamentary term of an independent Scotland: either average earnings, CPI inflation, or 2.5%, whichever is highest.
- The Guarantee Credit element of Pension Credit would be uprated by the triple lock in first term of independent Scotland, unlike in the UK where commitment is for uprating in line with earnings.
- The Savings Credit element of the Pension Credit would be retained (plans are for this to be abolished in rUK).
- Planned UK Government reforms of the State Pension (for example, the single tier pension) will be rolled out in Scotland from 2016. The UK single-tier pension is estimated to be worth a minimum of £158.90 per week in 2016-17. The Scottish Government is committed to setting an initial rate of £160 per week or will match the UK rate if it is higher. The single tier pension will be uprated by the triple lock in first Parliament, compared with the UK legislative requirement to uprate in line with earnings. However, the main parties in Westminster have indicated that they intend to continue with the triple lock if elected after 2015 (Marr, 2014; Telegraph 2014; Hansard 2013).
- Protection of State Pensions based on spouse contributions for 15 years after the introduction of the single-tier pension (this provision is not planned in rUK).
- The Scottish Government accepts that the SPA should rise to 66 by 2020 as planned by the existing UK timetable. However, the Scottish Government has committed to a review of the SPA and notes the possibility of postponing further changes in Scotland to 67 and beyond. An independent Commission would consider this matter in the first two years of independence.

On the SPA, the Institute and Faculty of Actuaries have said that reviewing the Scottish SPA would allow the opportunity to establish a SPA that reflects the longevity characteristics of Scotland’s residents and Scottish-specific population projections. However, they also point out that Scotland has wide variations in life expectancies across the country and different socio-economic groups, and that a delay in accepting the 2026-28 increase in SPA may make future increases more difficult to implement (Institute and Faculty of Actuaries, 2013).
David Bell et al (2014) conclude that the “costs of the state pension would be lower in Scotland, due to Scotland’s lower life expectancy” and that this

“could, in theory, be used to reduce contributions or to delay increases in the state retirement age in Scotland, relative to the rest of the UK. However, Scotland has a relatively smaller working age population than rUK and therefore the costs of the state pension measured as a share of tax revenues will be higher in Scotland as the population ages. Nevertheless, the difference in the tax costs of the state pension is small relative to the increased taxes that will have to be raised to pay for population ageing throughout the UK.”

However, as mentioned above, there are other costs associated with lower life expectancy around health and other benefits. In a speech in April 2014, Gordon Brown argued that Scottish pensioners receive more per head than those in rUK when non-contributory and means-tested benefits are taken into account (Brown, 2014).

ICAS produced a report on Scotland’s pensions future: what pensions arrangements would Scotland need? (ICAS, 2013) in April 2013, setting out a number of questions on pensions it considered worthy of consideration during the referendum debate. The Scottish Government’s Pensions in an Independent Scotland (September 2013) and White Paper (November 2013) provided the Scottish Government’s plans for pensions under independence. ICAS produced a subsequent paper in February 2014 summarising what it considered to be remaining questions to be addressed in light of the Scottish Government’s pensions pronouncements.

On the State Pension issue, ICAS consider that there are a number of questions outstanding around the transitional arrangements that would apply after independence. ICAS acknowledge that some of these questions might not be answerable prior to the referendum. For example, the last two bullets below would form part of a negotiation between a Scottish and UK Government.

- What transitional arrangements would be needed to successfully migrate responsibility for the payment of the State pension to pensioners living in Scotland at the date of independence, including communication with individuals?
- What transitional arrangements would need to be made to ensure that the “accrued” entitlement to the State pension of those of working age living in Scotland at the date of independence are successfully transferred, including communication with individuals?
- How does the Scottish Government propose to define “living in Scotland at the date of independence” or “country of residence at the date of independence” for the purpose of determining entitlement to a Scottish State pension? How would this definition dovetail with arrangements for determining citizenship and any flexibility for individuals to choose, including any potential to choose dual citizenship?
- Would there be any scope for mitigating the possible effects of a minimum qualifying period for the single tier pension (currently proposed as 7-10 years) for both the Scottish and UK State pensions, given that EU law may not permit special arrangements between Member States?
- What amount or reimbursement would the Scottish Government seek to negotiate from the UK Government by way of providing for those with “accrued” entitlement to a UK State pension i.e. both individuals in receipt of a State pension and those of working age? How might this be calculated?
- Are there any legal barriers which would prevent the rUK, as a member of the EU, transferring responsibility for the “accrued” State pension entitlements of those living in Scotland at the date of independence?
The Scottish Government’s Expert Working Group on Welfare (Scottish Government 2013c) point out that UK Pension Centres located in Motherwell and Dundee are already responsible for administering State Pension and Pension Credit claims for everyone living in Scotland. The Scottish and UK Government would need to agree continued access to IT and other systems presently owned, operated and maintained by the UK Government. Again, this would form part of overall post-referendum negotiations.

David Bell, in evidence to the House of Commons Scottish Affairs Committee in May 2013, argued that the “working out of entitlements” would be an important element of negotiation between the Scottish and UK Governments.

Graeme Morrice: Good afternoon. My first question is for Professor Bell. Who would take responsibility for state pension entitlements built up prior to separation in the event of Scotland becoming independent?

Professor Bell: There is clearly an issue about entitlement. State pensions are pay-as-you-go systems, so they are met out of general taxation; they are not met from a fund that has been set up. There would be issues to be raised around the question of entitlement built up in England of someone who retires to Scotland, or vice versa. Presumably, exactly how that would work would have to be negotiated. Even more complicated would be someone who has worked for, say, half their working life in Scotland and half their working life in England and has retired in Spain. How that would be worked out would be a complex issue. Whereas the actual funding would come from the taxation in the two countries, the working out of the entitlements would be a more complex issue and would have to be agreed by the two Governments in some way or other. [...] People who have retired to Spain from the UK have accrued their rights in the UK and are paid by the British taxpayer. That is a very simple exemplar. It seems to me that whether a similar kind of arrangement could occur depends on the negotiations between the two Governments. [...] Of course, it is difficult for people who have already accrued rights prior to any arrangement that might happen between the two Governments, but I would have thought that, for people who are accruing rights, part of the post-independence agreement must be how you deal with exactly that kind of issue. I do think there is a problem for people who have now accrued rights and how things will develop for them (Scottish Affairs Committee, 2013).

Other points to have been made in recent months relate to the Scottish Government’s commitment to retaining the Savings Credit element of Pension Credit. The National Association of Pension Funds (NAPF, 2013) state that this “risks undermining one of the key principles of the reform [to the Single tier State Pension]: that people know what State Pension they will receive in retirement and are confident that they are not at risk of losing out on means-tested benefits as a result of saving privately for their retirement.” A similar point is raised by the Institute and Faculty of Actuaries (2013) who claim that this policy risks reducing incentives for individuals to save for their own retirement and adds a level of unnecessary complexity into the amounts pensioners might receive. The UK Government (Department for Work and Pensions, 2014) argue that:

“The central objective of the single tier reform is to simplify the State Pension, to provide a clearer foundation for saving. A key part of the design of the new system is to set the full rate of State Pension above the basic level of means-tested support. The Savings Credit, which was designed to give those with modest savings a means-tested reward, will no longer be needed. The costs of retaining the Savings Credit for people who reach State Pension age after 5 April 2016 on a UK-wide basis could rise to around £2 billion a year in around 20 years’ time (with increasing costs over time). If the impacts in Scotland were broadly in proportion to the number of pensioners, Scotland could expect costs of
around £20-£30 million in 2020/21 and £200 million a year in around 20 years’ time (all in current prices)"

The Scottish Government (2013a) reasoning for retaining the Savings Credit is to “ensure that those approaching retirement who would have received Savings Credit are not disadvantaged by the move to the single-tier pension.” They “cite evidence submitted by the Pensions Policy Institute to the House of Commons Work and Pensions Committee” which “showed how an individual who, under the current system, would have received an income from the BSP and the ASP of £142 and Savings Credit of £20 per week would be worse off under the single-tier pension of £144 with no Savings Credit” (Scottish Government 2013a).

PUBLIC SECTOR PENSIONS

The Scottish Government states that public sector pensions would not be affected by independence. In summary:

- All public service pension rights and entitlements which have been accrued will be fully protected and accessible and the Scottish Public Pensions Agency will deliver public sector pensions in an independent Scotland.

There is little detail as to how existing unfunded pensions might be split between Scotland and the UK. In the latest Whole of Government Accounts for 2012-13 (HM Treasury 2014c) unfunded UK pension liabilities were put at £1,072bn, equal to 91% of all UK public sector pension liabilities. The Scottish share of this liability would obviously be part of negotiations. ICAS make the point that due to the pay-as-you-go nature of unfunded pensions, it is not just a case of agreeing a split of the unfunded pension liability between governments. Rather “any liabilities arising from Scotland’s share of unfunded public sector pension liabilities acquired following independence, would need to be based on those individuals whose pensions the Scottish Government acquired responsibility for paying….. it is not a case of negotiating an amount with the UK Government but rather agreeing on a range of criteria to be applied to individual scheme members to determine which Government should be responsible for payment of a pension and the related liability” (ICAS 2014).

On Public sector pensions, ICAS consider that the following issues remain outstanding:

- What should the criteria be for determining which government would be responsible for the pensions of individual members of unfunded public sector pension schemes - for example, members of the Armed Forces Pension Scheme; the NHS in Scotland Pension Scheme and the Principal Civil Service Pension Scheme?
- What other transitional arrangements would be needed to successfully migrate responsibility for scheme members living in Scotland at the date of independence, including member communications?
- How does the Scottish Government propose to define “living in Scotland at the date of independence” or “country of residence at the date of independence” for the purpose of determining responsibility for paying the pension of members of an unfunded UK scheme? Issues of citizenship may be relevant here as they would be in relation to the State pension.
- What amount or reimbursement would the Scottish Government seek to negotiate from the UK Government by way of providing pensions for those with “accrued” entitlement to a pension from an unfunded UK scheme?

_Pensions in an Independent Scotland_ (Scottish Government 2013a) states that a newly independent Scotland will take on its “fair share” of liabilities and will negotiate with the UK
Government on the future operation of services that are currently delivered on a UK basis and on inward transfers of staff.

“Within that context, the pensions of those staff within the current civil service and armed forces who work in Scotland’s public service would be taken on by the Scottish Government. The Scottish Government would also take responsibility for existing pensioners and deferred members.”

PRIVATE SECTOR PENSIONS

The Scottish Government has stated that there would be a continuation of UK Private pensions law on independence, until it was replaced or amended by the Scottish Parliament. In a recent PQ response (S4W-20555), John Swinney stated: “the body of law governing private pensions, including legislation implementing the changes announced in the 2014 Budget, will continue to apply in Scotland until amended, replaced or repealed by the Scottish Parliament”.

The Scottish Government (2013a) has also said that there would be a close alignment of the structure and activities of the regulatory framework with the rUK; a continuation of the UK Government’s plan for auto-enrolment and the creation of a Scottish equivalent of NEST (the National Employment Savings Trust). NAPF (2013) which is strongly supportive of auto-enrolment has welcomed this Scottish Government commitment. However, they also state that

“the setting up of NEST was not a simple task and required significant capital from the UK Government. The Scottish Government’s paper does not provide any assessment of the costs of setting up SEST, how this would be funded and what this funding might mean for the charges SEST would levy on savers. Should NEST not wish to operate as a cross-border scheme, there may also need to be some unpicking of the pots of Scottish members who are already saving in NEST.”

On regulation, it is proposed that there will be a Scottish Pensions Regulator created who would work with the rUK Pensions Regulator and the UK Financial Conduct Authority. The Scottish Government state a preference for current arrangements for the protection of individuals’ pensions by the Pension Protection Fund (PPF) to continue, with Scottish schemes continuing to pay PPF levies. However, if that preference is not agreed to, the Scottish Government says “it would be entirely possible for the Scottish Government to establish a Scottish equivalent to the PPF. Individuals would have the same level of protection as they do now” (Scottish Government 2013a). On this issue ICAS (2014) has stated that in their view “it is questionable how having two regulators, two countries and only one protection fund would work in practice, especially when policy intentions or the interests of the different countries diverge, and it begs the question as to why the UK Government and the UK PPF might agree to such a degree of risk sharing.” Similar points are raised by the Institute and Faculty of Actuaries (2013) and by NAPF who state:

“there is uncertainty in the short term about which schemes would be overseen by which body; what would happen to Scottish schemes that have already entered the UK PPF in the short term; and how any schemes in the PPF, that may be identified as cross-border following independence, will be separated. In the long term, the separation of Scottish assets and liabilities for transfer to the Scottish PPF is likely to be a complex and costly undertaking.”

ICAS (2014) raise what they consider to be the following remaining questions:
How would Scottish pension law put into effect the regulatory and protection arrangements proposed in the Paper?

What would be the likely costs of establishing a regulatory structure for pensions in an independent Scotland from the date of independence and for new regulatory bodies to develop toolkits and codes of practice to support the governance of Scottish occupational pension arrangements?

What would be the likely cost to Scottish occupational pension schemes and employers of transitioning from one regulatory regime to another?

How would the Scottish Government approach negotiations with UK Government, so as to secure agreement on the continuation of the (UK) PPF for both the rUK and an independent Scotland?

What would be the options for establishing pension protection arrangements in Scotland if these negotiations were unsuccessful? How would this impact on the (UK) PPF?

If the negotiations were successful, how would the (UK) PPF respond in a future scenario to any divergence between pension regulation in Scotland and in the rUK?

Could a private sector provider, such as an existing master trust, be offered the opportunity to provide SEST?

How would arrangements established by employers and pension administrators, which will be necessary to accommodate the Scottish rate of income tax under the Scotland Act 2012, be adapted to meet the requirements of an independent Scotland’s tax system?

EU rules on cross-border funding of occupational pension schemes

The other main issue that has arisen on pensions in an independent Scotland relates to an EU directive on cross-border schemes (Directive 2003/41/EC dated 3 June 2003 on the Activities and Supervision of Institutions for Occupational Retirement Provision (IORP)). Under EU law, schemes which operate in more than one Member State must fund their liabilities in full and any underfunding must be rectified immediately rather than through a staged recovery plan.

“In the event of cross-border activity as referred to in Article 20, the technical provisions shall at all times be fully funded in respect of the total range of pension schemes operated.”

The Scottish Government accepts that this is an issue and proposes that “discussions with the UK Government and the European Commission on the application of the IORP Directive should start immediately, with a view to agreeing appropriate transitional arrangements for pension schemes that would be cross-border on independence.” The Scottish Government (2013a) states that transitional arrangements have been implemented previously and point to the example of legislation dealing with UK/Ireland cross-border schemes.

“…the UK Government’s implementing legislation provided for a three year grace period for existing UK/Ireland cross-border schemes to reach full funding levels.

Many schemes in the UK are working to achieve a stable funding position over a period of time through the use of a recovery plan. In schemes where recovery plans are already in place, these set out how a position of full funding can be gained as quickly as the employer can reasonably afford. Requiring schemes which became cross-border on independence to achieve full funding over a shorter time period would not be proportionate. The Scottish Government considers that it would be appropriate, in this instance, to allow a scheme with an existing recovery plan to be allowed to implement that plan in accordance with the period originally set for it.”
It had been expected that the EU would review and relax the cross-border obligations, but it was announced in March 2014, that the current regulations would remain in place (BBC 2014b, Scotsman, 2014).
Life expectancy at birth in Scotland, 2010-2012

Women

- Between 78.5 and 79.3 years old
- Between 79.3 and 80.8 years old
- Between 80.8 and 82.1 years old
- Between 82.1 and 83.4 years old

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Life expectancy at birth in Scotland, 2010-2012
Men

- Between 72.6 and 75.3 years old
- Between 75.3 and 76.6 years old
- Between 76.6 and 78.4 years old
- Between 78.4 and 80.1 years old

Based on Ordnance Survey material with the permission of Ordnance Survey. Scottish Parliamentary Corporate Body 10039291.
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