The Brexit effect on ex-pat state pensions

By Amanda Newman Smith 29th July 2016 11:16 am

Membership of the European Union has been beneficial to British expats retiring to other member states, as they have the same state pension rights as those who reside in the UK. But Brexit inevitably means this situation cannot continue in its present form and the 1.2 million Brits estimated to be living in other EU countries have been left with an unclear picture as to how the leave vote will impact their state pension income.

Although the UK state pension can be paid out anywhere in the world, qualifying for annual increases under the triple-lock guarantee depends on where people emigrate. The triple lock, introduced by the coalition government in 2010, ensures that state pensions go up in line with the higher of inflation, average earnings or 2.5 per cent. People who retire to countries within the European Economic Area, which includes EU countries, qualify for annual pension increases under the triple-lock guarantee as if they were living in the UK. So do those who retire to Switzerland and Gibraltar.

Other parts of the world, such as the US and Barbados, have social security agreements with the UK that enable expats to qualify for the annual increases to their state pensions.

However, people who are retiring to countries that have no social security agreements with the UK – or Canada and New Zealand that have different ones – do not quality for state pension increases, so their pensions are frozen at their initial rate.

Calls for parity so everyone benefits from annual increases as a matter of fairness have been made in recent years but so far nothing has changed. Brexit takes the issue of what is fair and practical to another level, as it cannot be assumed the status quo will simply be replicated by a deal, however desirable this is. The concern for British expats is that they may be joining the ranks of those with frozen state pensions once the UK finally leaves the EU.

Expats need certainty

According to AJ Bell senior analyst Tom Selby, the Government needs to provide people living in the EU with certainty about their future as soon as possible. He points out that for British expats living in the EU to continue receiving their annual state pension increases – known as uprating – the UK will either need to agree a reciprocal arrangement with the EU as a whole or strike deals with individual member states.

He says: “It’s worth noting that, outside the EU, no reciprocal arrangement has been struck since 1981, primarily due to the costs involved in uprating the pensions of people who retire abroad. Ultimately, the Government must decide how best to allocate resources and it may prefer to focus on those who remain in the UK rather than those who retire abroad.”

Selby raises the possibility that people planning to retire to EU countries in the future might reconsider if they lose their uprating. “While an increase of 2.5 per cent a year might not sound like a lot, a 65-year-old receiving the flat-rate state pension of £155 a week who lived for 20 years would miss £50,000 of income in retirement if their pension was frozen,” he says.

For Graham Keysell, a director at The Spectrum IFA Group’s office in France, the UK Government will inevitably be tempted to save money by ending the increases to pensioners living in the EU.

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He says: “It is already estimated the Treasury saves around half-a-billion pounds a year from pensioners excluded from the increases. This could easily double if pensioners in the EU were to be treated similarly.”

Keysell thinks that because the number of overseas voters still on the UK electoral register is negligible, the Government might decide that upsetting these people would have a very modest negative effect. Indeed, as Royal London director of policy Steve Webb points out, expats' voting power is "almost nil" because so few are registered to vote.

He says: "The Government doing something about this won't be down to the political power of the expat voter, it will be driven by the Treasury. However, my hunch is that the Government will want to negotiate state pension deals. It builds uprating into its base line, so it doesn't have to find new money for this."

Saving money

Both Webb and Keysell think the Government will be under pressure to preserve the existing system as it would not want expats coming back to the UK and putting a strain on services such as healthcare.

Keysell says: "If access to free healthcare in the host country was also abolished, the UK Government could easily find that significant numbers of pensioners return to the UK, which is a situation it would want to avoid."

Webb agrees, pointing out that it is more plausible for people to return from European countries such as Spain than somewhere further afield, such as Australia. "The UK Government will not want older expats of, say, 75-plus coming home. With that in mind, I suppose a general deal will be done," he says.

Before a deal is done

Tisa policy strategy director Adrian Boulding is also cautiously optimistic about the bargaining process that lies ahead. He says: "British expat pensioners spend good money in the warmer European countries such as Spain, and this is something the EU will want to continue. So the generosity of reciprocal state pension deals for them are yet another negotiating card that will come into play. That said, while the eventual outcome will probably be no change, I'd prepare for a period of uncertainty, as the UK Brexit team can't give things away piecemeal before the whole deal is done."

The fall in sterling is presenting another big issue for expat pensioners who are now getting fewer euros for their pounds. Following the referendum result, the exchange rate between sterling and the euro fell from near €1.40 to less than €1.18.

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Expat advice firm AES chief executive Sam Instone says: “Brexit has caused sterling to drop to a 31-year low on currency markets. For the expat with pension assets or income denominated in pounds this is a big hit to value in their local currency.”

However, law firm King & Wood Mallesons lead pensions consultant Wyn Derbyshire highlights the fact the Government is yet to trigger Article 50 and says anything can happen in a political environment that has had more than its fair share of drama.

He says: “If all EU agreements fall by the wayside the default is that state pensions will be frozen unless Britain enters into individual agreements. However, I hope there is a common sense approach and that we find a way of working together – some way of compromise rather than taking hardline decisions.”