



Department
for Work &
Pensions

The single-tier pension: a simple foundation for saving

Presented to Parliament by the Secretary of State
for Work and Pensions by Command of Her Majesty
January 2013

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Foreword by the Minister of State for Pensions

December 2012 saw the 70th anniversary of the Beveridge report. The 300 page document was to become the blueprint for the welfare state, and was received with great enthusiasm: a queue reportedly a mile long gathered outside the Government Stationery Office on 1 December 1942 to get hold of a copy. Central to Beveridge's vision of a universal social insurance scheme was a basic non means-tested contributory retirement pension.¹

Seventy years on, much has changed:

- the Office for National Statistics projects that 36 per cent of people born in 2013 will live to become centenarians² – in the 1940s only a minority of men survived to 65;
- the number of women in work has seen a 50 per cent increase – in 1948 only around four out of ten women were in paid employment³;
- the number of divorces that took place has risen from 11 per cent of the number of marriages in 1948; to about 50 per cent in 2012⁴;
- the labour market has become a lot more diverse – over a third of those working today are either self-employed or in part-time work.⁵

Successive governments have sought to keep pace with this social and economic change, building on top of the Beveridge blueprint. But a piecemeal approach to pension reform has resulted in an extremely complicated pension system, where many do not know what they will get when they retire. An increasing reliance on means-tested benefits and a patchwork of add-ons, compensating for long-term decline in the relative value of the basic State Pension, compounds this complexity. In addition, even after the 2010 pension reforms, inequalities remain in the system: the National Insurance contributions paid by the self-employed do not give rise to State Second Pension entitlement and it will not be until the mid-2050s that men and women will receive equal state pension payments.

The Government published a Green Paper on state pension reform '*A state pension for the 21st century*' in April 2011⁶. We received over 1,600 written responses from individuals and 102 responses from organisations and in the period that followed undertook an extensive programme of consultation to help further develop our proposals. There was a consensus that the state pension system needs to be simplified, and around three-quarters of the organisations that responded supported the concept of a single-tier pension.

Despite seven decades of change, Beveridge's concept of a simple flat-rate pension set above the basic level of the means test to provide a firm foundation for saving continues to carry strong support. The reforms set out in this document return to the simplicity of Beveridge's model for the state pension, to support people to plan for and build towards a secure retirement income.



Steve Webb MP
Minister of State for Pensions

¹ Beveridge W, 1942, *Social Insurance and Allied Services*, Cmd. 6404, HMSO.

² Office for National Statistics, 2012, *Historic and Projected Mortality Data (1951 to 2060) from the UK Life Tables, 2010-Based*, ONS.

³ OECD, 1963, *Manpower Statistics: 1950-1962*, OECD. (http://webexchanges.oecdcode.org/aguJ8xa8/manpower__2_.pdf).

⁴ Office for National Statistics, 2011, *Divorces in England and Wales*, ONS.

⁵ Table 3 in Office for National Statistics, *Labour Market Statistics*, October 2012, 2012, ONS. (<http://www.ons.gov.uk/ons/re/lms/labour-market-statistics/october-2012/statistical-bulletin.html>).

⁶ Department for Work and Pensions, 2011, *A state pension for the 21st century*, Cm 8053, TSO.

Executive summary

The context for reform

1. Supporting pensioners has been a key Government priority since coming to office: enshrined in the coalition agreement is the commitment to protect the basic State Pension by the triple lock – increasing its value by the highest of price inflation, earnings growth or 2.5 per cent. In September 2012, the reference point for considering the level of the 2013/14 benefits, both price inflation and earnings growth were below 2.5 per cent for the first time since the triple lock was introduced. From April 2013, the triple lock guaranteed minimum will therefore be engaged and the basic State Pension will be increased by 2.5 per cent. As a result the basic State Pension will represent a higher share of average earnings than at any time since 1992.⁷
2. In a period of fiscal restraint, the Government has also protected key additional support for pensioners such as free bus passes, free prescriptions and Winter Fuel Payments. It has also taken action to address some of the most pressing issues facing the pensions system, including:
 - bringing forward increases in State Pension age to ensure the system remains sustainable; and
 - removing the default retirement age of 65 to ensure that older workers are able to continue to work where they wish to do so.
3. Pensioner incomes today are at an historic high having grown faster than average earnings over the longer term. The percentage of pensioners in relative poverty was close to an historic low in 2010/11 (at 14 per cent after housing costs)⁸ with pensioners less likely to be in relative poverty than the population as a whole.⁹ However, pensioner incomes represent a very complex aggregation of state and private payments, making it difficult for anyone to predict what income they will receive in retirement.

⁷ Source: DWP modelling, earnings data is based on Office for National Statistics, 2012, *Annual Survey of Hours and Earnings*, ONS.

⁸ The 2010/11 figures are the latest available. Department for Work and Pensions, 2012, *Household Below Average Incomes An analysis of the income distribution 1994/95 – 2010/11*, Department for Work and Pensions.

⁹ Figures from the Institute for Fiscal Studies, which has presented data since 1961, show rates of pensioner relative low income were only lower than their 2010/11 levels in 1984. (<http://www.ifs.org.uk/fiscalFacts/povertyStats>).

4. In addition, a significant decline in occupational pension saving since the 1970s threatens to change the outlook for future generations of pensioners. The number of people saving in an occupational pension scheme has fallen from a peak of just over 12 million active members in 1967 to 8.2 million in 2011¹⁰, with a particularly significant decline in Defined Benefit schemes in the private sector. Government estimates that almost 11 million people in the current workforce face inadequate retirement incomes.¹¹
5. In 2002 an independent Pensions Commission was established to consider the long-term challenges facing the UK pension system. It identified a number of key areas where reform was required, including:
 - **Undersaving for retirement:** millions of people were not saving enough to deliver the income they were likely to want or expect in retirement.
 - **Complexity:** the complexity of the state pension system stopped people from making informed decisions about whether, when and how much to save.
 - **Inequalities in the pension system:** concerns that some groups, in particular women, have reduced opportunities to save for a decent income in retirement.
 - **Sustainability:** to ensure that the system remains fair between the generations and sustainable, the State Pension age should rise to reflect increases in life expectancy.

Supporting saving

6. Government has had an increasingly important part to play in supporting people to save for retirement. This includes:
 - tax relief on retirement savings (in 2010/11 the cost of this relief amounted to £32.9 billion and over £45 billion including employer National Insurance relief)¹²;
 - tax relief on personal savings through Individual Savings Accounts (ISAs), and promoting financial engagement; and
 - the regulation of private pension providers.
7. The introduction of automatic enrolment from October 2012 extends to millions the opportunity of workplace pension saving – with the National Employment Savings Trust (NEST) playing a key role in ensuring that employers have access to a straightforward, low-cost scheme. November 2012 saw the publication of *‘Reinvigorating Workplace Pensions’*¹³, setting out the Government’s plans for restoring confidence in pension saving.

Reforming the state pension

8. A range of reforms have been introduced since the Pensions Commission reports to improve state pension coverage and provide a simpler and fairer state pension system. But these changes will take a long time to come into full effect. The proportion of pensioners in the scope of Pension Credit, for example, will fall gradually from around 40 per cent of pensioners today to around ten per cent by 2050. Also it will not be until the mid-2050s that male and female state pension outcomes equalise.

¹⁰ Office for National Statistics, 2011, *Occupational Pension Schemes Survey*, ONS.

¹¹ Department for Work and Pensions, 2012, *Estimates of the number of people facing inadequate retirement incomes*, Department for Work and Pensions.

¹² HM Revenue & Customs statistics. (www.hmrc.gov.uk/statistics/pension-stats/pen6.pdf).

¹³ Department for Work and Pensions, 2012, *Reinvigorating workplace pensions*, Cm 8478, TSO.

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9. Substantial complexity and uncertainty remain – meaning that many people do not have a clear starting point from which to plan and save for their retirement. In a Department for Work and Pensions (DWP) survey, 63 per cent of respondents identified with the statement that “sometimes pensions seem so complicated that I cannot really understand the best thing to do”.¹⁴
10. The Government believes that reform is needed now so that current generations of workers have a decent foundation on which to save for their retirement.

State pension reform: the single-tier pension

11. On 4 April 2011 the Government launched a public consultation on two options for state pension reform:
 - Option one, ‘faster flat rating’ would accelerate changes already under way to deliver a flat-rate two-tier pension.
 - Option two, ‘single tier’ represented a bolder reform to introduce a flat-rate pension set above the basic level of means-tested support.

Around three-quarters of the organisations who responded to the consultation preferred the concept of a single-tier pension.¹⁵

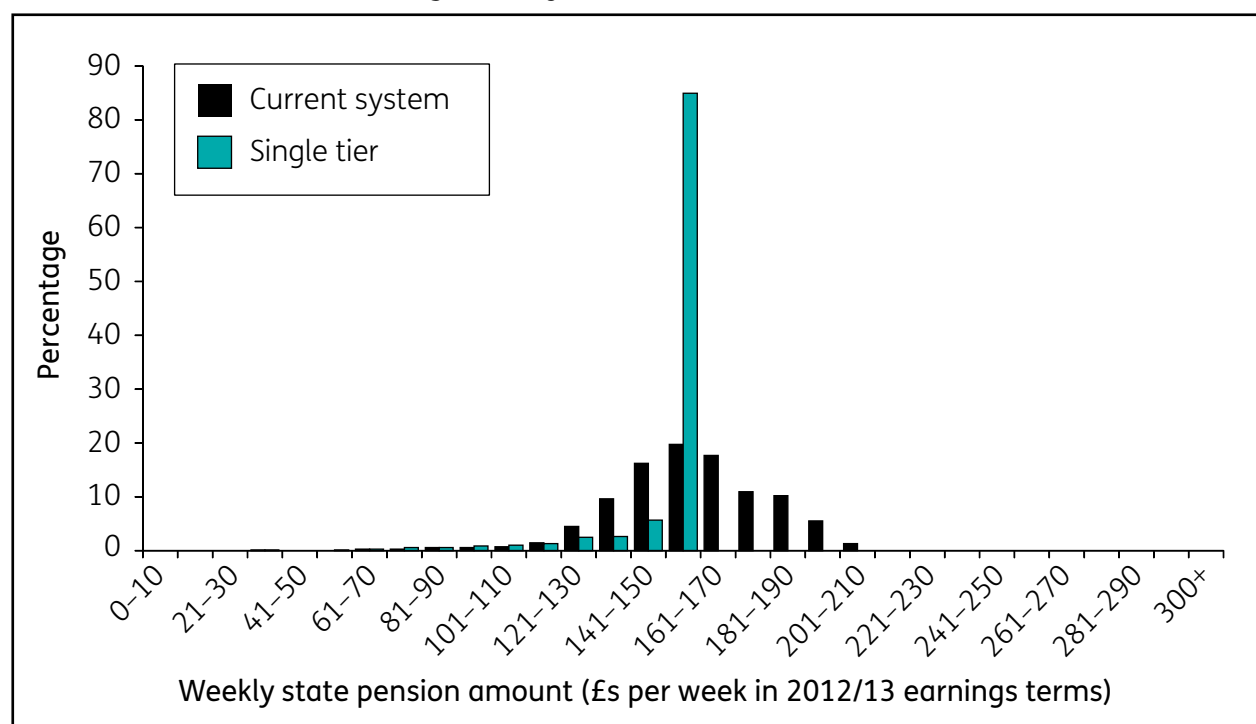
12. The Government has since built on the Green Paper single-tier model to develop a detailed proposition for state pension reform. Special attention has been given to the design of the transition to the new system, to ensure that the simplicity and clarity of the single-tier pension are achieved as quickly as possible after implementation. Legislation to reform the state pension will be introduced at the earliest opportunity, subject to the Parliamentary timetable. The Government intends to implement the single-tier pension in April 2017 at the earliest.
13. The single-tier reforms will restructure current expenditure on the state pension into a simple flat-rate amount, to provide clarity and confidence to better support saving for retirement. Those already over State Pension age when the reforms are implemented will continue to receive their state pension (and the Savings Credit, where applicable) in line with existing rules.
14. The single-tier pension will:
 - be set above the basic level of means-tested support (the Pension Credit Standard Minimum Guarantee, currently £142.70 per week for a single pensioner). The current legislative requirement to increase the basic State Pension at least in line with average growth in earnings will also apply to the single-tier pension. For illustrative purposes, this document assumes uprating of the single-tier pension by the triple lock, in line with coalition policy for uprating the basic State Pension;
 - replace the State Second Pension, contracting out and outdated additions, such as the Category D pension and the Age Addition. The Savings Credit element of Pension Credit will also close to pensioners reaching State Pension age after the implementation of the single-tier pension;

¹⁴ MacLeod *et al.*, 2012, *Attitudes to Pensions: The 2012 survey*, Department for Work and Pensions Research Report No 813, Department for Work and Pensions.

¹⁵ Department for Work and Pensions, 2011, *A state pension for the 21st century: A summary of responses to the public consultation*, Cm 8131, TSO.

- require 35 qualifying years of National Insurance contributions (NICs) or credits for the full amount. There will also be a minimum qualifying period of between seven and ten qualifying years (modelled as ten throughout this document). Those with fewer than 35 qualifying years but above the minimum qualifying period will receive a proportionally smaller single-tier amount;
 - be based on individual qualification, without the facility to inherit or derive rights to the state pension from a spouse or civil partner; and
 - continue to allow people to defer claiming their state pension and receive a higher weekly state pension in return. The deferral rate will be finalised closer to the planned implementation date. It will no longer be possible to receive deferred state pension as a lump-sum payment.
15. Additional transitional arrangements will protect the position of those who have a pre-implementation National Insurance contribution record and are described below.

Chart E1: Projected distribution of net state pension income for those reaching State Pension age in 2040 under the current and single-tier systems¹⁶



16. The implementation of the single-tier pension will significantly simplify the pension system, helping people to understand what they will get from the State when they retire. By the mid-2030s, over 80 per cent of people will receive the full weekly amount of single-tier pension, narrowing the range of pension outcomes in comparison to the current system and improving certainty. The proportion of people reaching State Pension age after the implementation of single tier who qualify for Pension Credit will be halved compared to the current system, and remains under 10 per cent through to 2060. The single-tier pension will also help to address gender inequality in the system, bringing forward by over a decade the point at which men and women achieve equal state pension outcomes.

¹⁶ Source: DWP modelling, based on Pensim2. The full single-tier amount in this chart is above the illustrative £144 because under triple lock updating it is expected that the single-tier pension value will grow slightly faster than average earnings over the long term.

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17. Single-tier reforms will modernise the state pension system by reflecting the society in which we live today: the large majority of individuals will build up a sufficient National Insurance record to become entitled to the full single-tier amount in their own right, instead of relying on their spouse's or civil partner's contributions. In an increasingly flexible labour market, the National Insurance contributions of the self-employed will be treated in the same way as employee contributions for state pension purposes.

Managing the end of contracting out

18. Integral to the single-tier reforms is the closure of the State Second Pension and, by extension, contracting out of the State Second Pension – the ability to give up entitlement in return for provision of at least a broadly similar Defined Benefit occupational pension. This element of the reforms will play a significant role in simplifying the pension system, standardising both state pension provision and National Insurance contributions across the workforce, and more clearly delineating the role of state and occupational pensions.
19. The Government recognises that ending contracting out will have a range of implications for employers, employees and schemes. Key aims in managing the end of contracting out are to minimise these impacts – to ensure that administrative processes are as straightforward as possible; to ensure amounts built up in schemes until the point that the single-tier pension is implemented continue to be paid and to ensure that the sustainability of Defined Benefit pension schemes is not undermined.
 - For employers, the end of contracting out will have cost and administrative implications, the largest of which will be the need to start paying the standard rate of National Insurance contributions. This will mean an increase for each contracted-out employee of 3.4 per cent of relevant earnings. Many employers will be able to offset these additional costs by reducing future pension benefits or by increasing employee contribution rates. In some cases, scheme rules can only be changed by the trustees or with the trustees' consent. To safeguard the ongoing viability of Defined Benefit pension schemes, the Government believes it is necessary to give employers limited powers to change scheme rules for these purposes without trustee consent.
 - Contracted-out employees will be brought fully back into the state system and will start to pay full National Insurance contributions – an increase equivalent to 1.4 per cent of relevant earnings. However, around 90 per cent of those reaching State Pension age in the first two decades after implementation will gain enough extra state pension over retirement to offset both the increased National Insurance contributions they will pay over the rest of their working lives and any potential adjustments to their occupational pension.
20. The Government will continue to work closely with the pensions industry and employer representatives, as well as those who represent employees, as implementation approaches.

Transition to the single-tier pension

21. The transition process for the single-tier pension will translate people's pre-implementation National Insurance records into a simple single-tier starting amount – the 'foundation amount'.
22. An individual's National Insurance record will be valued using single-tier rules as at the implementation of the single-tier pension. Where an individual has previously been contracted out of the additional State Pension, a deduction will be applied, reflecting the fact that they have paid lower National Insurance contributions whilst they were contracted out, as is consistent with current practice.
23. As an added safeguard, the Government will check to see if the rules of the current system would give a better outcome. The higher valuation will then become that individual's foundation amount.
24. Under this approach to transition, those reaching their State Pension age after the implementation of the single-tier pension will fall into four distinct groups:
 - Individuals with a foundation amount which is **equal to the full level of the single-tier pension**. These are likely to be people who have the necessary 35 qualifying years, little additional State Pension and have not been contracted out.
 - Individuals with a foundation amount which is **less than the full level of the single-tier pension**. These are likely to be younger people, with fewer qualifying years, or older people who have spent many years contracted out of the additional State Pension. These people will be able to increase their single-tier pension up to the full level, at the rate of 1/35th of the full rate (£4.11 to the nearest penny) for each additional qualifying year they gain before reaching their State Pension age.
 - Individuals with a foundation amount which is **more than the full level of the single-tier pension**. These are likely to be older people with many qualifying years, and who have not spent significant periods contracted out of the additional State Pension. These people will receive the difference between their foundation amount and the full single-tier amount as an extra payment on top of the full single-tier weekly amount.
 - Individuals with **no pre-implementation National Insurance record**. The simpler and easier to understand single-tier system will give them long term clarity of outcome. They will also be supported to save into a workplace pension scheme through automatic enrolment and the policy measures set out in the Government's *'Reinvigorating Workplace Pensions'* document throughout all of their working lives.
25. Case studies to illustrate how the transition will work are included at the end of the executive summary.

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26. The revised approach ensures that individuals' pre-implementation National Insurance contributions are recognised at the implementation of single tier, while also allowing people who had been contracted out to build up to the full single-tier weekly amount. In addition, people with low amounts of additional State Pension, for instance due to periods of caring or very low pay, are likely to see a boost in their state pension outcomes. For example, around 750,000 women who reach State Pension age in the first ten years after the single-tier pension is implemented will receive an average of £9 per week more in state pension because of the single-tier valuation.
27. Compared to proposals set out in the Green Paper, this approach speeds up the process of transition, significantly increasing the number of people who will receive the full single-tier pension. By the mid-2030s, over 80 per cent of people reaching their State Pension age will receive the full single-tier amount.

Affordability and assumptions

28. Under the pay as you go National Insurance system, any rises in age-related public expenditure will be borne by the working-age generation of the time, or by future generations through increased Government debt. Without the changes set out in this document, expenditure on state pensions and pensioner benefits is expected to rise from 6.9 per cent of GDP in 2012/13 to 8.5 per cent of GDP in 2060/61.¹⁷
29. In light of these fiscal pressures, single-tier reforms have been designed to cost no more overall compared to the existing pension system, restructuring current pensioner expenditure into a simpler state pension. For illustrative purposes, this document assumes a starting level for the full single-tier pension of £144 per week (in today's earnings terms) and uprating until 2060 by the triple lock (highest of growth in prices, average earnings or 2.5 per cent). Based on these assumptions, the single-tier pension reforms set out in this White Paper slow down the projected increases in state pension and pensioner benefit expenditure, bringing it to 8.1 per cent of GDP in 2060.
30. However, it is important to note that long-term expenditure forecasts are highly uncertain, as they rely on projections of demographic trends and the performance of the economy far into the future.
31. Decisions on the single-tier start amount and uprating method will be made by the Government shortly before implementation, taking into account the wider fiscal context at the time. Further decisions on uprating will be made by future Governments on a yearly basis, as part of the annual uprating process. Single-tier legislation will provide this flexibility, underpinned by a statutory requirement to uprate by at least earnings.

¹⁷ These figures are based on DWP projections. These differ from projections in the OBR Fiscal Sustainability Report 2012 because they cover Great Britain only and use different uprating assumptions for some pensioner benefits (e.g. disability benefits). The DWP projections have been updated to reflect the OBR's Autumn 2012 medium term economic forecasts.

State Pension age

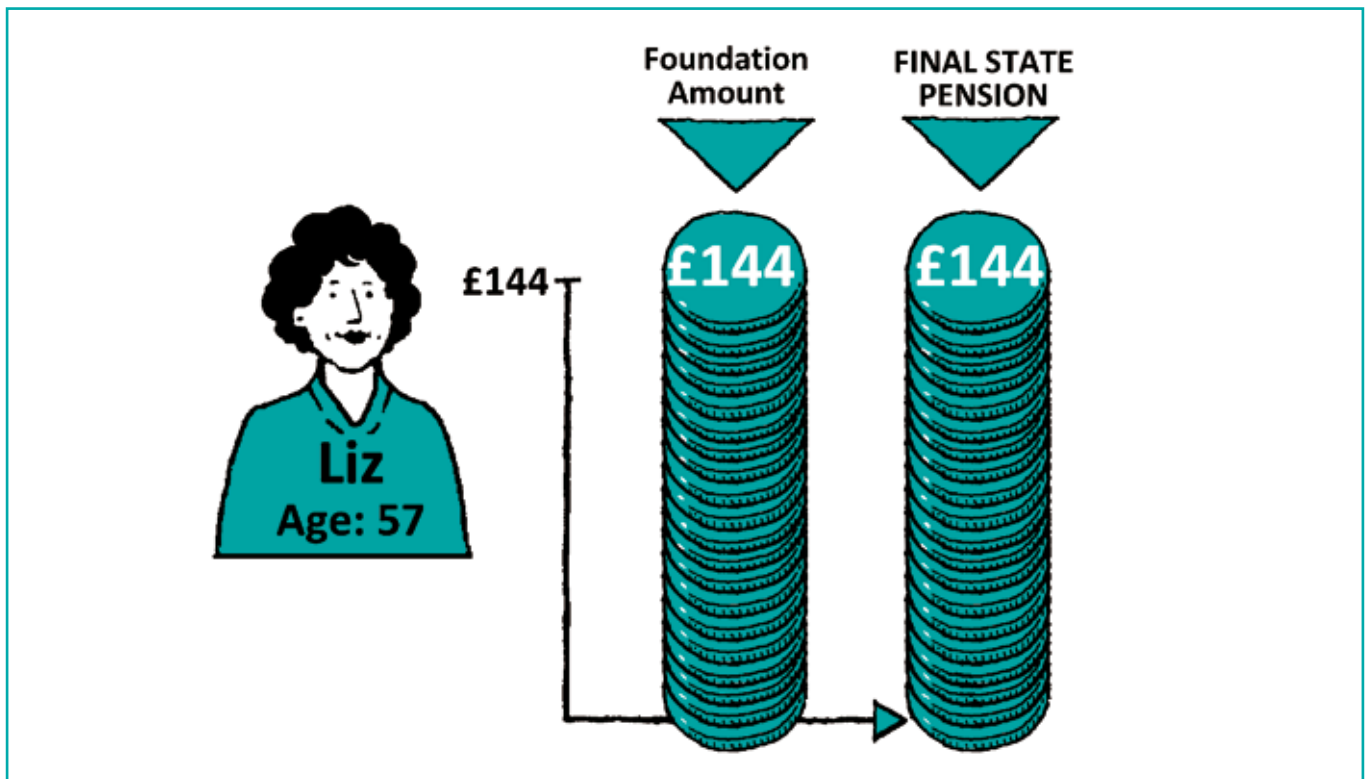
32. Containing the costs of the single-tier pension within the fiscal parameters of the existing pension system is important to ensure that reforms are sustainable. However, changes to demographic trends will impact the expenditure profile. State Pension age therefore plays a key role in ensuring the system remains sustainable and affordable in the long term.
33. According to the latest data from the Office for National Statistics (ONS), life expectancy at birth for men and women is at a record high. Increases in life expectancy are projected to continue into the future. In response to frequent upward revisions in life expectancy projections, in its 2005 report, the Pensions Commission recommended that the State Pension age should rise broadly in line with increases in life expectancy.¹⁸
34. When it came to office, the Government took immediate action to increase the State Pension age to 66 by October 2020 to ensure that the costs of the state pension system remain manageable in the light of rising life expectancy. However, longevity improvements will not stop in 2020 and the Government has announced that State Pension age will increase to 67 between 2026 and 2028 and will legislate on this basis at the earliest opportunity.
35. As life expectancy continues to increase, the Government believes there is a need for a more structured framework within which to consider changes to State Pension age in the future. This will help ensure that costs of increasing longevity are shared fairly between the generations and provide greater clarity around how State Pension age will change in future.
36. To this end, the Government will carry out a review of the State Pension age every five years, based around the principle that people should maintain a specific proportion of adult life receiving the state pension. This will be informed both by analysis of life expectancy projections by the Government Actuary's Department and by a report from an independently-led body on wider factors that should be taken into account when setting State Pension age, such as variations in life expectancy. The first review will take place in the next Parliament.

Single-tier pension case studies

37. The simplified case studies below illustrate the transition process for people in different circumstances at implementation. Consistent with the key aims of the single-tier reforms, we have sought to present these proposals as clearly as possible. The illustrations do not show the effect of uprating.

¹⁸ The Pensions Commission, 2005, *A New Pension Settlement for the Twenty-First Century*, TSO.

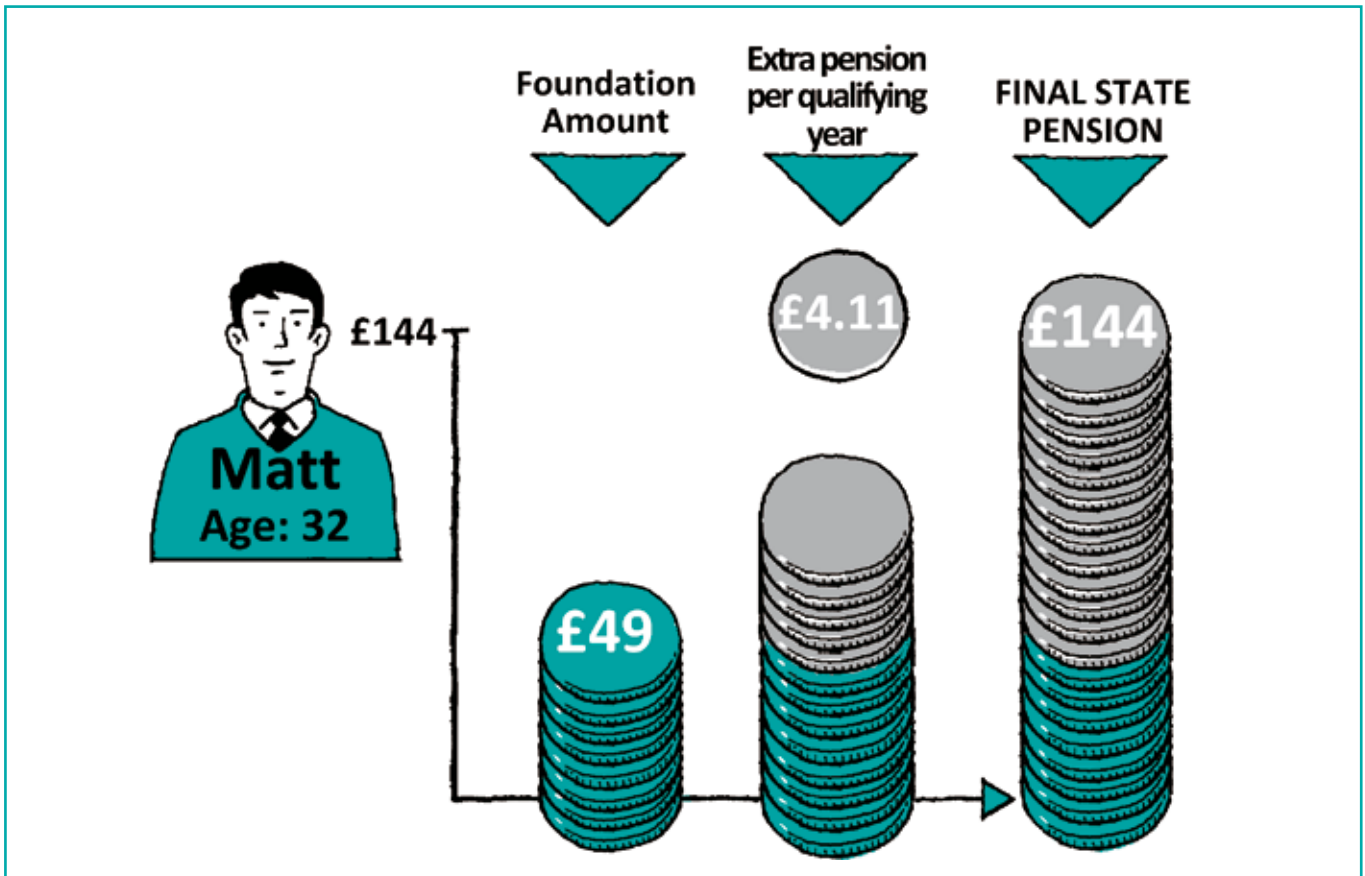
Case Study E1.1: Liz, at implementation aged 57, with a foundation amount which is equal to the full level of the single-tier pension



Liz's foundation amount is equal to the full level of the single-tier pension. She will therefore get £144 every week when she reaches her State Pension age.

- Liz has been running her own small business for the past 36 years.
- Her National Insurance record as at 2017 is valued under the single-tier rules, which take into account her qualifying years. Because she has not been contracted out, no deduction is applied.
- A check is performed to see if Liz would get a higher valuation under the rules of the current system. Time spent self-employed does not build additional State Pension, and so the maximum she could expect under the current system is the full level of the basic State Pension: £107 per week.
- In Liz's case, the single-tier valuation is higher, and so becomes her foundation amount.
- As her foundation amount is already £144, she will not be able to add extra pension by gaining post-implementation qualifying years.
- When she reaches her State Pension age, she will get £144 per week.

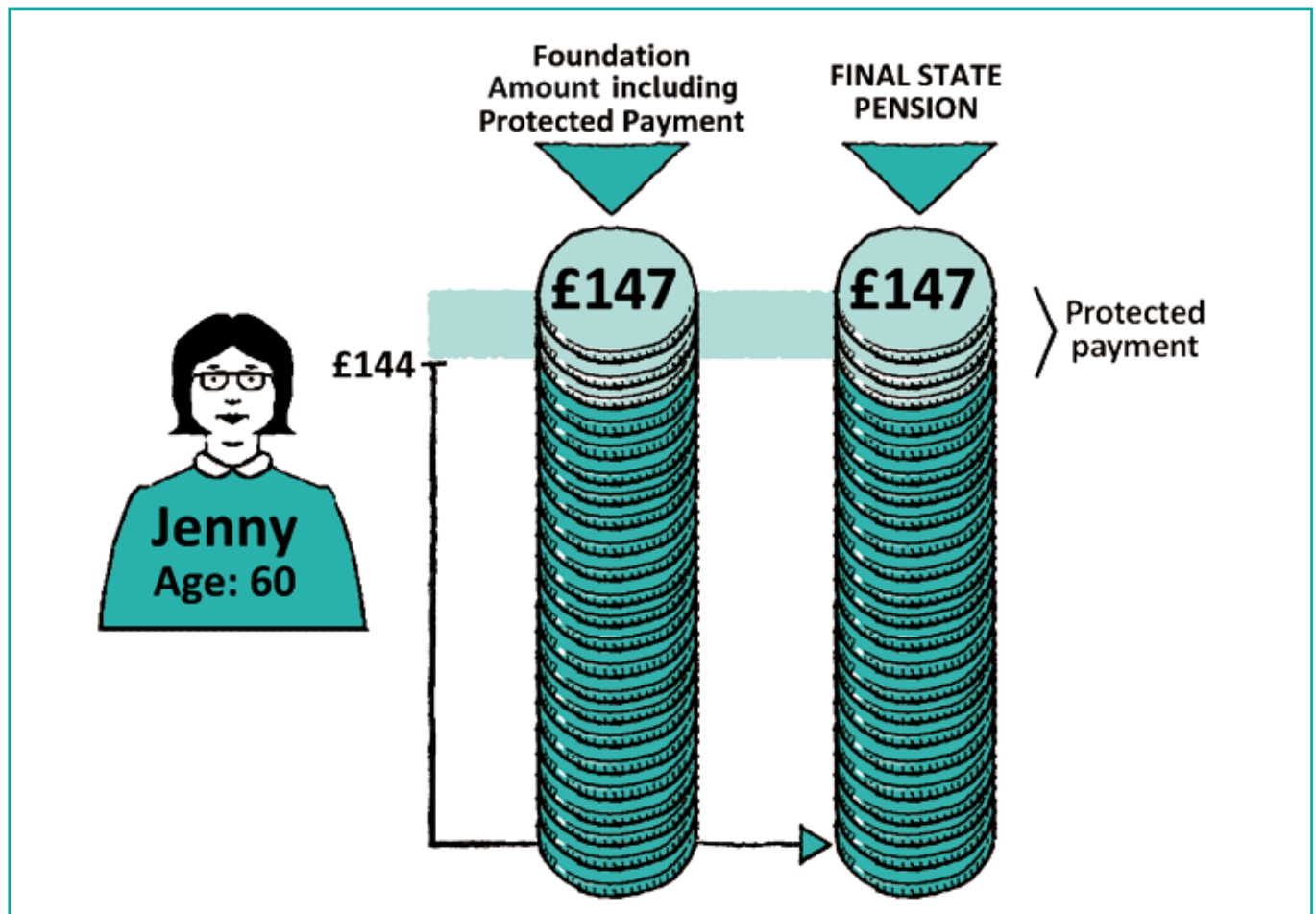
Case Study E1.2: Matt, at implementation aged 32, with a foundation amount less than the full level of the single-tier pension



Matt's foundation amount is less than the full level of the single-tier pension. He can build on this amount with every post-implementation qualifying year gained until he reaches his State Pension age, when he can receive the full single-tier amount of £144 per week.

- Matt has been working as a teacher for ten years prior to the implementation of the single-tier pension.
- His National Insurance record as at implementation is valued under the single-tier rules, which take into account his qualifying years, and also a deduction to reflect lower National Insurance contributions paid during his time spent contracted-out.
- A check is performed to see if Matt would get a higher valuation under the rules of the current system.
- In Matt's case, the current system valuation is higher, and therefore it becomes his foundation amount.
- As his foundation amount is less than £144, he is able to add extra pension at the rate of £4.11 (to the nearest penny) for every further qualifying year he gains, up to the maximum of £144.
- Matt needs 24 post-implementation qualifying years to receive the full level of the single-tier pension when he reaches his State Pension age.

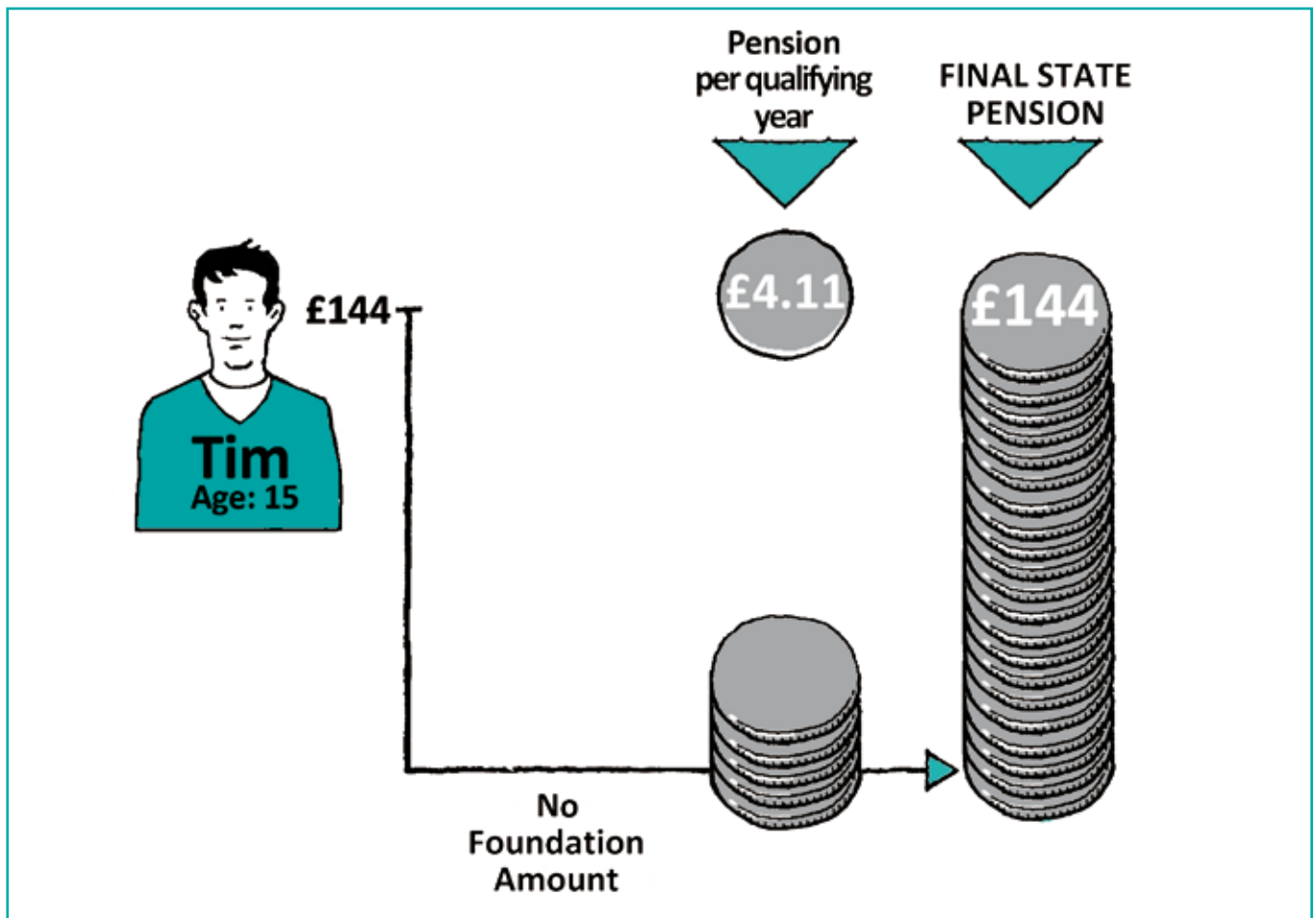
Case Study E1.3: Jenny, at implementation aged 60, with a foundation amount which is more than the full level of the single-tier pension



Jenny's foundation amount is more than the full level of the single-tier pension. When she reaches State Pension age, every week she will receive the full single-tier amount of £144, plus the extra amount.

- Jenny worked as a receptionist for 32 years, and has also spent a number of years working in part-time jobs.
- Her National Insurance record as at implementation is valued under the single-tier rules, which take into account her qualifying years. As she has not been contracted out, no deduction is applied.
- A check is performed to see if Jenny would get a higher valuation under the rules of the current system.
- In Jenny's case, the current system valuation is higher, and therefore becomes her foundation amount.
- As this amount is more than the full level of the single-tier pension, Jenny will not be able to get extra pension by adding post-implementation qualifying years.
- When she reaches State Pension age, she will get the full single-tier amount of £144, plus her 'protected payment' amount of £3 a week.

Case Study E1.4 – Tim, at implementation aged 15, secondary school student



Tim is still in school when the single-tier pension is implemented, therefore, he does not have a National Insurance record yet. For every qualifying year he gets he will add £4.11 per week to his single-tier pension, up to the full £144.

- As he does not have a National Insurance record prior to the implementation of single tier, Tim does not have a ‘foundation amount’.
- Instead, he simply adds pension at the rate of £4.11 for every qualifying year he gains. If he gains 35 qualifying years, he will receive £144 per week when he reaches his State Pension age.
- This puts him in a good position to understand how much he needs to be saving in his workplace pension scheme from the start of his working life.
- When Tim reaches the age of 22 he will be automatically enrolled into his workplace pension scheme, making it easier for him to save for his retirement.

The context for reform

1

The current UK pension system is a product of 70 years of expansion, reform and adjustment. Beveridge's original concept in 1942 was a simple flat-rate state pension that met basic income needs and provided a foundation for saving. However, the decline in the relative value of the basic State Pension, resultant growth of means-tested support and a move towards additional state earnings-related pension provision have made the state pension system increasingly complex.

Following the reports of the Pensions Commission in 2004 and 2005, reforms were enacted to simplify the pension system and help it remain sustainable over the long term. However, a number of significant problems persist:

- **Complexity and uncertainty** – many do not have clarity over what their state pension will be worth. This makes it much more difficult for people to plan and save for their retirement.
- **High levels of means testing** – currently around 40 per cent of pensioners are eligible for Pension Credit. This complicates pensioner income and makes it more difficult for people to recognise the value of saving. In addition, Pension Credit does not reach all of those who are eligible: around a third of those entitled do not claim.
- **Inequality** – men and women will not have the same average outcomes from the state pension until the mid-2050s. In addition, the National Insurance contributions paid by the self-employed do not count towards the State Second Pension.

Against a backdrop of increasing longevity, current generations of workers will have to take greater personal responsibility for saving to achieve the level of retirement income they are likely to expect. With the introduction of automatic enrolment, it is an appropriate time for Government to withdraw from the role of providing an earnings-related pension, and return to a single flat-rate state pension that keeps people out of poverty and provides a firm foundation for saving.

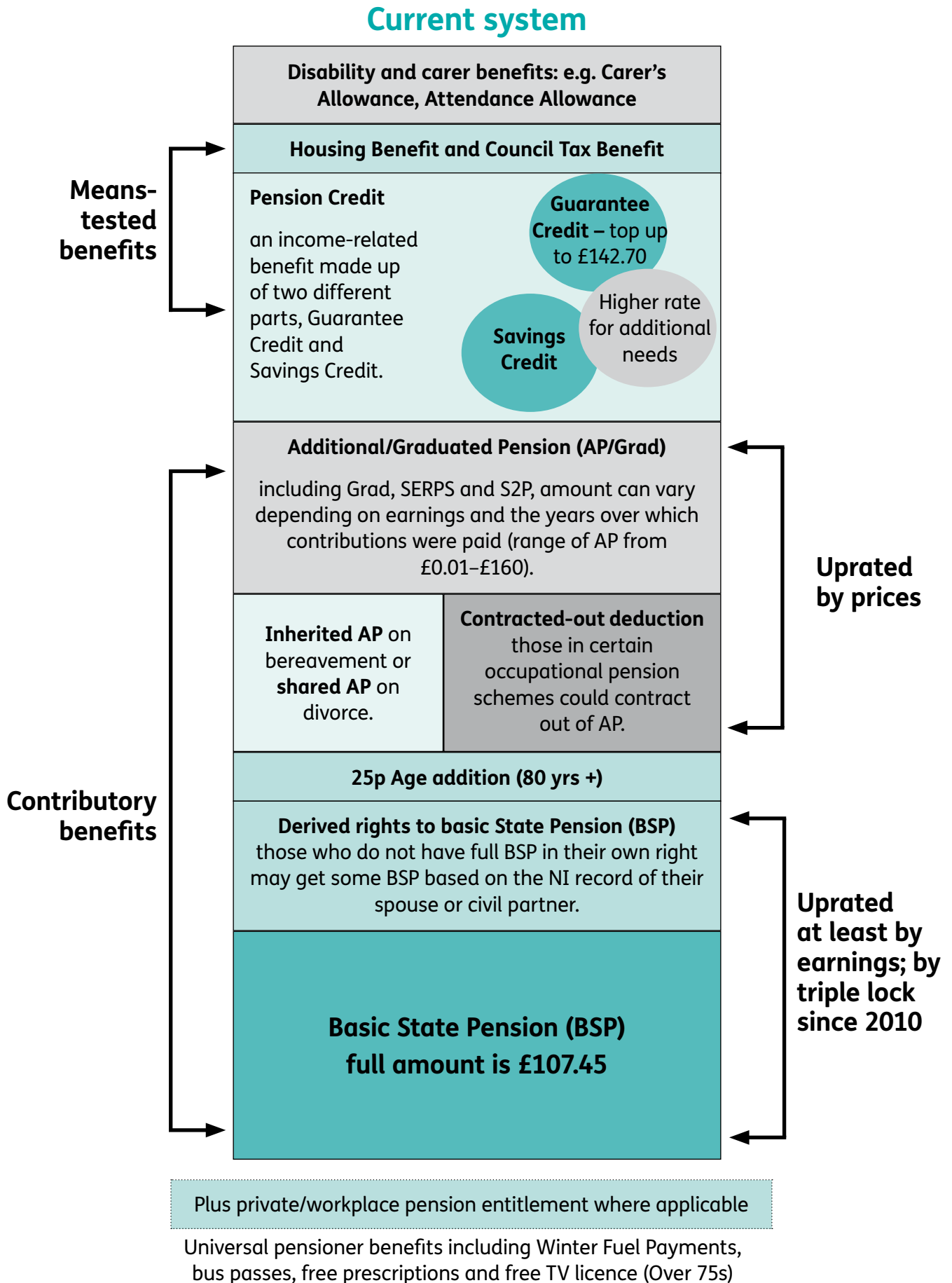
An overview of the evolution of the UK state pension

1. In his 1942 report, Beveridge had a clear vision for a social security system, including state pension provision, that offered a “national minimum, [which] should leave room and encouragement for voluntary action by each individual to provide more than that minimum for himself and his family”.¹⁹ A flat-rate state pension – the forerunner to today’s basic State Pension – was introduced in 1948 and closely followed Beveridge’s blueprint, but the pension system has since undergone a series of extensive reforms, blurring the role and basis of state provision:
 - the introduction of the Graduated Retirement Benefit (Grad) in 1961 and the State Earnings Related Pension Scheme (SERPS) in 1978 provided access to earnings-related provision for those without an occupational pension scheme. In 2002, SERPS was replaced by the State Second Pension (S2P);
 - modifications since the 1970s have introduced crediting arrangements and reduced qualifying requirements, to boost pension outcomes for low earners and those with caring responsibilities; and
 - further reform in the 1980s, designed to support the affordability of the state pension system, saw the Government move away from the practice of annually increasing (‘uprating’) the basic State Pension in line with earnings. This led to means-tested benefits playing an increasingly important role in pensioner incomes.
2. Fuller detail on the evolution of the state pension is provided in Annex 1.
3. In addition to their basic and additional State Pensions, pensioners are eligible for a Winter Fuel Payment and 40 per cent of current pensioners are eligible for means-tested support through Pension Credit. Housing and Council Tax Benefits are also available to poorer pensioners, as are additional allowances for those with a disability or caring responsibilities. In 2010/11, 70 per cent of pensioners also received an occupational pension.²⁰
4. The overall income of today’s pensioners represents a complex aggregation of state payments and private incomes, making it very difficult for anyone to predict what they will receive in retirement. The make-up of pensioner income is illustrated in Figure 1.1.

¹⁹ Beveridge W, 1942, *Social Insurance and Allied Services*, Cmd. 6404, HMSO.

²⁰ Department for Work and Pensions, 2012, *The Pensioners’ Incomes Series 2010-11*, DWP and ONS.

Figure 1.1: Components of the current state pension system



Pensioner incomes

5. The present Government has supported pensioner incomes through the introduction of the triple lock. Under this policy, the basic State Pension is increased each year by the highest of price inflation, growth in earnings or 2.5 per cent, providing protection for pensioner incomes in unusually uncertain economic times. In September 2012, the reference point for considering the level of the 2013/14 benefits, both price inflation and earnings growth were below 2.5 per cent for the first time since the triple lock was introduced. From April 2013, the triple lock guaranteed minimum will therefore be engaged and the basic State Pension will be increased by 2.5 per cent. As a result it is forecast to reach a level equivalent to almost 18 per cent of mean full-time earnings – a higher share than at any time since 1992.²¹ Under current plans the Government will also continue to protect other support including Winter Fuel Payments, free bus passes, free prescriptions, free eye tests and free TV licences.
6. In addition to direct support, the Government spends significant amounts to encourage people to save into private pensions. The total value of tax relief on pensions was £32.9 billion in 2010/11 alone and over £45 billion when employer National Insurance relief is taken into account.²² The Government also encourages non-pension saving by offering tax relief on personal savings and promoting financial engagement, for example through:
 - Individual Savings Accounts (ISAs), allowing individuals to save cash, stocks and shares in a tax-advantaged way;
 - The Money Advice Service, set up by the Government to improve consumers' knowledge and ability to manage their finances and encourage responsibility for personal savings; and
 - An independent steering group, established to develop simple financial products, which will support people to take responsibility for their finances and make better choices by helping them compare products effectively.
7. Chart 1.1 shows that pensioner incomes have risen faster than average earnings over recent decades. Between 1998/99 and 2010/11 the mean net pensioner income for pensioner households²³ rose by 33 per cent (before housing costs). This compares to a 'real terms' rise of 11 per cent in average earnings over the same period.²⁴
8. This acceleration is largely explained by changes to benefits and the state pension, including the introduction of the Minimum Income Guarantee in 2001 and Pension Credit in 2003. Pensioner incomes have further benefited from occupational pension schemes, reflecting the fact that many current pensioners have had access to relatively generous Defined Benefit schemes when in the workplace. As working past State Pension age is becoming more common, more pensioners also receive income from employment.
9. The percentage of pensioners in relative poverty was close to an historic low in 2010/11 at 14 per cent (after housing costs). Pensioners are less likely to be in relative poverty than the population as a whole.²⁵

²¹ Department for Work and Pensions modelling, earnings are based on Office for National Statistics, 2012, *2012 Annual Survey of Hours and Earnings*, ONS.

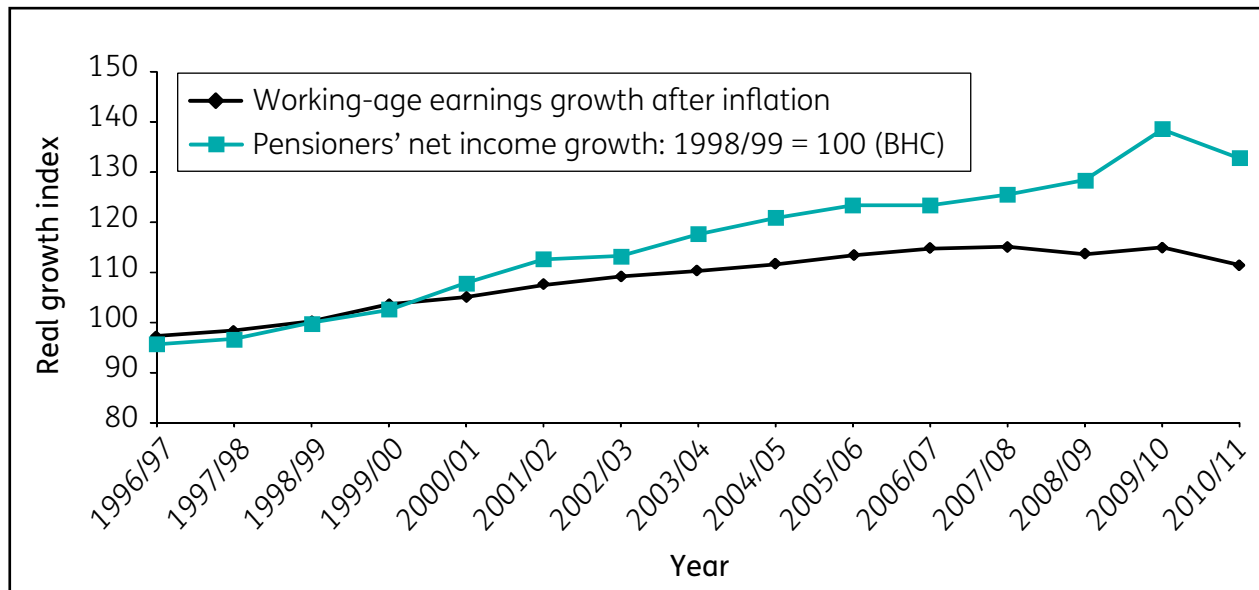
²² HM Revenue & Customs statistics, 2012, *Registered pension schemes - cost of tax relief, February 2012*, HM Revenue & Customs. (www.hmrc.gov.uk/statistics/pension-stats/pen6.pdf).

²³ Defined as a benefit unit that contains at least one person over State Pension age.

²⁴ Department for Work and Pensions, 2012, *The Pensioners' Incomes Series 2010-11*, DWP and ONS.

²⁵ Department for Work and Pensions, 2012, *Household Below Average Incomes An analysis of the income distribution 1994/95 – 2010/11*, Department for Work and Pensions.

Chart 1.1: The growth in pensioners' incomes and working-age earnings since 1996/97 (real terms, 1998/99 = index of 100)²⁶



Fewer are saving for their retirement

10. However, the number of people saving in an occupational pension scheme has declined from a peak of just over 12 million active members in 1967 to 8.2 million in 2011. There has been a particularly significant decline in Defined Benefit schemes in the private sector, from a peak of 8.1 million active members in 1967 to 1.9 million in 2011.²⁷ The shift towards Defined Contribution pension schemes has meant that individuals, rather than employers, are increasingly having to take on the responsibility and risk related to the level of their future pension.
11. Accessible forms of tax-relieved saving are more popular: an estimated 15.4 million people saved into an ISA in 2010/11.²⁸ But over half of ISA owners approaching State Pension age (aged 45-64) have less than £9,000 saved in their ISA,²⁹ an amount which is unlikely to go far in covering retirement expenditure.
12. Overall, the Government estimates that there are almost 11 million people of working age in the UK who face inadequate retirement incomes compared to the level they are likely to expect based on earnings during their working life.³⁰ Against a backdrop of record levels of life expectancy for both men and women, with people spending longer in retirement, it is critical that action is taken to improve the outlook for future generations of pensioners.

²⁶ Pensioners' net income is shown before housing costs (BHC). Graph based on data from the following: Office for National Statistics, 2011, *Retail Prices Index: quarterly index numbers of retail prices*, ONS; Office for National Statistics, 2011, *Average Earnings Index*, ONS; and Department for Work and Pensions, 2012, *The Pensioners' Incomes Series 2010-11*, DWP and ONS.

²⁷ Office for National Statistics, 2011, *Occupational Pension Schemes Survey*, ONS.

²⁸ Table 9.4 in HM Revenue & Customs, 2012, *Individual Savings Account (ISA) Statistics*, HM Revenue & Customs.

²⁹ Table 9.11 in HM Revenue & Customs, 2009/10, *Individual Savings Account (ISA) Statistics*, HM Revenue & Customs.

³⁰ In this research inadequacy is defined in terms of the standard of living in retirement, relative to working life. Department for Work and Pensions, 2012, *Estimates of the number of people facing inadequate retirement incomes*, Department for Work and Pensions.

Automatic enrolment into workplace pensions

13. To tackle the challenge of undersaving among today's workers, the Government committed to reinvigorate private pensions in the coalition agreement. The introduction of automatic enrolment into workplace pension schemes from 2012 means that employers will be required to automatically enrol all those who are eligible into a qualifying pension scheme and make a minimum level of contributions to that scheme. Overall, contributions must total at least 8 per cent of a band of earnings, though this will be phased in gradually to help individuals and employers adjust to the cost of the reforms. In steady state, the minimum employee contributions will effectively be doubled by the employer contribution and tax relief.
14. Evidence suggests that fewer than one-third of those automatically enrolled will take the active decision to opt out. The Government estimates this will eventually result in between six and nine million people newly saving or saving more in workplace pensions, and in steady state increasing pension saving by around £11 billion each year.³¹
15. Automatic enrolment gives all eligible employees access to a workplace pension scheme, creating double provision of earnings-related pension if the Government does not now move away from earnings-related state pension provision. Phasing out earnings-related state pension was a clear recommendation of the Pensions Commission in 2004.³² This is already underway, but the effects will only be seen very gradually as it will not be until around 2090 that the first person retires on a fully flat-rate pension. The Government believes that a clearer, quicker end to earnings-related pension is needed to achieve the simple foundation required to support individual saving.

Reinvigorating workplace pensions

16. In November 2012, the Government published '*Reinvigorating Workplace Pensions*'.³³ This document sets out the future landscape of private pensions, examining how we can further build confidence and clarity into pension saving in order to:
 - Increase the amount people are saving in pensions;
 - Increase the amount people receive for their savings;
 - Enable industry innovation and development of new products including those which will give people more certainty about their pensions and encourage more risk-sharing;
 - Increase transparency and build trust, confidence and engagement in pension saving as the norm; and
 - Ensure the sustainability and stability of the UK pension system.
17. In order to ensure that the state pension system provides a clear foundation for private saving, a number of key problems need to be addressed. These are outlined below.

³¹ Department for Work and Pensions, 2012, *Workplace Pension Reform: digest of key analysis* (Tables 1 and 6).

³² The Pensions Commission, 2004, *Pensions: Challenges and Choices The First Report of the Pensions Commission*, TSO.

³³ Department for Work and Pensions, 2012, *Reinvigorating workplace pensions*, Cm 8478, TSO.

Complexity and uncertainty

18. In a recent DWP survey on attitudes to pensions, 63 per cent of respondents agreed that “sometimes pensions seem so complicated that I cannot really understand the best thing to do”. Only 21 per cent agreed that they knew “enough about pensions to decide with confidence how to save for retirement”.³⁴ A number of responses to the consultation on state pension reform highlighted the complexity and uncertainty of the current state pension system.
19. Measures introduced by the Pensions Act 2007 to simplify the state pension by phasing out the earnings-related component of the State Second Pension will take time to reach steady state. If the pension system was left unchanged, the first person to retire with a completely flat-rate pension has not even been born yet. Beyond this change, much of the existing architecture of the state pension system remains untouched and, as a result, a significant amount of complexity remains.

High levels of means-testing

20. When Pension Credit was introduced in October 2003 it contained two elements of means-tested support – the Guarantee Credit and the Savings Credit. The former provided a Standard Minimum Guarantee, topping up the income for those falling below this, whilst the new Savings Credit was designed to prevent those with income above the basic State Pension, but below the Standard Minimum Guarantee, seeing this income withdrawn pound for pound. The Savings Credit sought to ensure this group of people were better off as a result of saving and removed the cliff edge whereby those with income of one penny more than the basic means test saw support withdrawn altogether.
21. However, the Savings Credit has increased the number of pensioners within the scope of means-testing. Currently, single people with income of nearly £190 per week are able to qualify for some Savings Credit. Around 40 per cent of pensioners are eligible for Pension Credit. Without the single-tier reforms, this is projected to fall gradually, reaching around ten per cent by 2050 as state pension coverage improves and pensioners benefit from a more generous uprating of the basic State Pension.
22. The Government is concerned that the interactions between Pension Credit and the state pension further increase complexity, making it more difficult for people to understand what they will get from the state when they retire, and more difficult to see the value of saving. In addition, around a third of those entitled to Pension Credit do not claim, each missing out on an average of £34 a week.³⁵

The current system is too complex. People cannot predict what they will receive from the state, making their decision to save in private pensions more difficult. Reform of the state pension must ensure that people will know what to expect from the state pension system and give them certainty that it will “pay to save”.

The National Association of Pension Funds³⁶

³⁴ MacLeod *et al.*, 2012, *Attitudes to Pensions: The 2012 survey*, Department for Work and Pensions Research Report No 813, Department for Work and Pensions.

³⁵ Department for Work and Pensions, 2012, *Income Related Benefits: Estimates of Take-up in 2009-10*, Department for Work and Pensions.

³⁶ Department for Work and Pensions, 2011, *A state pension for the 21st century: A summary of responses to the public consultation*, Cm 8131, TSO.

Inequalities in the system

23. When the state pension was introduced in 1948, around 4 out of 10 women were in paid employment.³⁷ Today this figure is around two in three.³⁸ The pension system was originally designed to reflect the social and economic realities of the 1930s and 1940s, when married women tended to have domestic roles while their husbands went out to work.
24. To obtain a full basic State Pension (and a full ‘married woman’s pension’ for their wives³⁹) men had to work for 90 per cent of their working lives with credits available to cover sickness and unemployment. Married women who worked could – prior to 1977 – opt to pay a reduced rate of National Insurance and rely on their husband’s contributions for their state pension. Until the introduction of Home Responsibilities Protection in 1978 there was no cover for the retirement position of women taking time out of work to care for children other than through their husband’s contributions.
25. When Home Responsibilities Protection was introduced in 1978 it operated prospectively: it only covered periods of caring responsibilities from 1978 onwards. This meant that it was of no benefit to those women – typically then in their 40s or 50s – whose children were already grown up, and of limited benefit to women – typically then in their 30s – who had started their families before 1978. The first cohort of women to have ‘lifetime’ cover under Home Responsibilities Protection were not born until the late 1950s and have not yet reached State Pension age.
26. In addition, because women tend to earn less than men, they receive less from the earnings-related additional State Pension too. Further prospective reform, such as the boost for the low paid and carers in the State Second Pension when it was introduced in 2002, have improved outcomes but, without further reform, changes would again take a long time to come into full effect.
27. Changes to entitlement conditions from 2010 improved basic State Pension outcomes for women but this was not in itself enough to make up for the disadvantages they had faced under the pre-2002 additional State Pension. The overall result of these factors mean that the first cohort with an equal proportion of women and men qualifying for a full basic State Pension in Great Britain (GB) is not expected to reach State Pension age until around 2020. Departmental modelling has shown it will take about a further 30 years, until the mid 2050s, before male and female State Second Pension outcomes are equal.
28. In addition, National Insurance contributions paid by the self-employed, who make a key contribution to the economy and are also a significant element of the labour market, do not count towards the State Second Pension.

³⁷ Organisation for Economic Co-Operation and Development, 1963, *Manpower Statistics: 1950-1962*, OECD.

³⁸ Office for National Statistics, *Labour Market Statistics, October 2012*, 2012, ONS. (<http://www.ons.gov.uk/ons/rel/lms/labour-market-statistics/october-2012/statistical-bulletin.html>).

³⁹ A lower-rate basic State Pension worth around 60 per cent of a full basic State Pension.

Bold reform: the single-tier pension

29. In the consultation document '*A state pension for the 21st century*', the Government outlined two options for state pension reform – faster flat rating of the additional State Pension, and a single-tier pension⁴⁰. Following an extensive consultation, the Government has decided to introduce a single flat-rate state pension set above the basic level of the means test for future pensioners. This will simplify the state pension and better support saving for retirement.
30. The Government believes that faster flat rating would not deliver the simplification and clarity that is needed to provide a clear foundation for saving. An assessment of faster flat rating against the principles for reform outlined in the consultation document is provided in Annex 2.
31. The next chapter describes how pension reform will address the problems of the current state pension system.

⁴⁰ Department for Work and Pensions, 2011, *A state pension for the 21st century*, Cm 8053, TSO.

The single-tier pension

2

The single-tier pension will be implemented for people reaching State Pension age from April 2017 at the earliest. Single-tier reforms will deliver a simple and fair state pension that provides clarity and confidence to better support saving for retirement.

The reforms will achieve four key outcomes. They will:

- improve clarity of outcomes by simplifying the state pension – complex and outdated aspects of the current system will be removed or modified;
- reduce means testing, altering the balance between means-tested and contributory support;
- bring forward the equalisation of state pension outcomes between men and women. The reforms will modernise the state pension system to reflect the lives and contributions of today's working-age people, with the vast majority of people becoming entitled to a full state pension in their own right instead of relying on the National Insurance record of their spouse or civil partner;
- help to ensure the sustainability of the state pension in the longer term.

Transitional arrangements will apply for people with pre-implementation National Insurance records. These are described in Chapter 4.

32. The implementation of the single-tier pension will fundamentally reshape the state pension system. It is designed around modern society, with a clearly defined function: to provide a foundation to support people saving for retirement. The single-tier pension will replace the current two-tier system of basic and additional State Pension with a flat-rate payment set above the basic level of means-tested support. This will significantly simplify the system, allowing people to know what they will get from the state and be more certain that they will benefit from saving.

Note on illustrations

In order to ensure the sustainability of the state pension system, reforms have been designed to cost no more than the current system overall. Variables that impact the cost profile of single tier include:

- the start level of the single-tier pension;
- how Government increases the pension over time ('uprating');
- the level at which the minimum qualifying period is set.

In this document, these variables have been kept constant for illustrative purposes, using the following assumptions:

- A start level of £144 per week (in 2012/13 earnings terms).
- Uprating the single-tier full rate by the triple lock each year (the highest of earnings growth, prices growth defined by the Consumer Price Index or 2.5 per cent) continues until at least 2060.
- The minimum qualifying period is set at ten qualifying years.

Start level and uprating policy are discussed further in Chapter 5. Final decisions will be made nearer to the date of implementation.

The core features of the single-tier pension

33. The core features of the single-tier pension are summarised below. These features will apply to those whose working lives (and National Insurance records) begin after the single-tier pension is implemented. Transitional arrangements for those who have paid or been credited with National Insurance contributions prior to this are described in Chapter 4. Detailed information on the single-tier features listed below and transitional arrangements can be found in Annex 3.

- **Level of the full rate**

The full rate of the single-tier pension will be set above the basic level of means-tested support (the Pension Credit Standard Minimum Guarantee, currently £142.70 per week). This will help clarify the incentive to save privately for retirement. Like the basic State Pension, the single-tier pension will be uprated at least by the average growth in earnings and this will be specified in legislation. For illustrative purposes in this document it has been assumed that the single-tier pension will be uprated by the triple lock.

- **Eligibility for the full rate**

To receive the full weekly rate of the single-tier pension, an individual will need 35 qualifying years of National Insurance contributions or credits. This contrasts with the model set out in the Green Paper, which was based on an assumption that those with 30 qualifying years would be eligible for the full single-tier pension, consistent with the eligibility requirements for the basic State Pension.

This new requirement strikes a balance between achieving wide coverage, maintaining the contributory principle and ensuring the overall affordability of single-tier reforms, following changes to the single-tier model to enhance transitional arrangements. It also reflects the fact that working lives are lengthening.

Those with fewer than 35 qualifying years, but who satisfy the minimum qualifying period, will receive a proportionately reduced amount of single-tier pension.

National Insurance contributions made by the self-employed will count towards the single-tier pension in the same way as those paid by employees. This will better help people plan for retirement in a more diverse labour market.

- **Minimum qualifying period**

A minimum number of qualifying years will be required to gain single-tier entitlement; this will be between seven and ten years. This is to ensure that state pension expenditure is targeted at those who make a significant economic or social contribution to the country. In this document, the minimum qualifying period is modelled to be ten qualifying years.

- **An individual pension**

The single-tier pension will be based solely on an individual's own National Insurance records – it will not be possible to derive or inherit single-tier pension from a spouse or civil partner. The vast majority of men and women now have the opportunity to gain a full pension using their own National Insurance record. There will, however, be transitional arrangements to recognise shared or inheritable additional State Pension in the current system, and for certain women who have paid reduced rate National Insurance contributions.

- **State pension deferral**

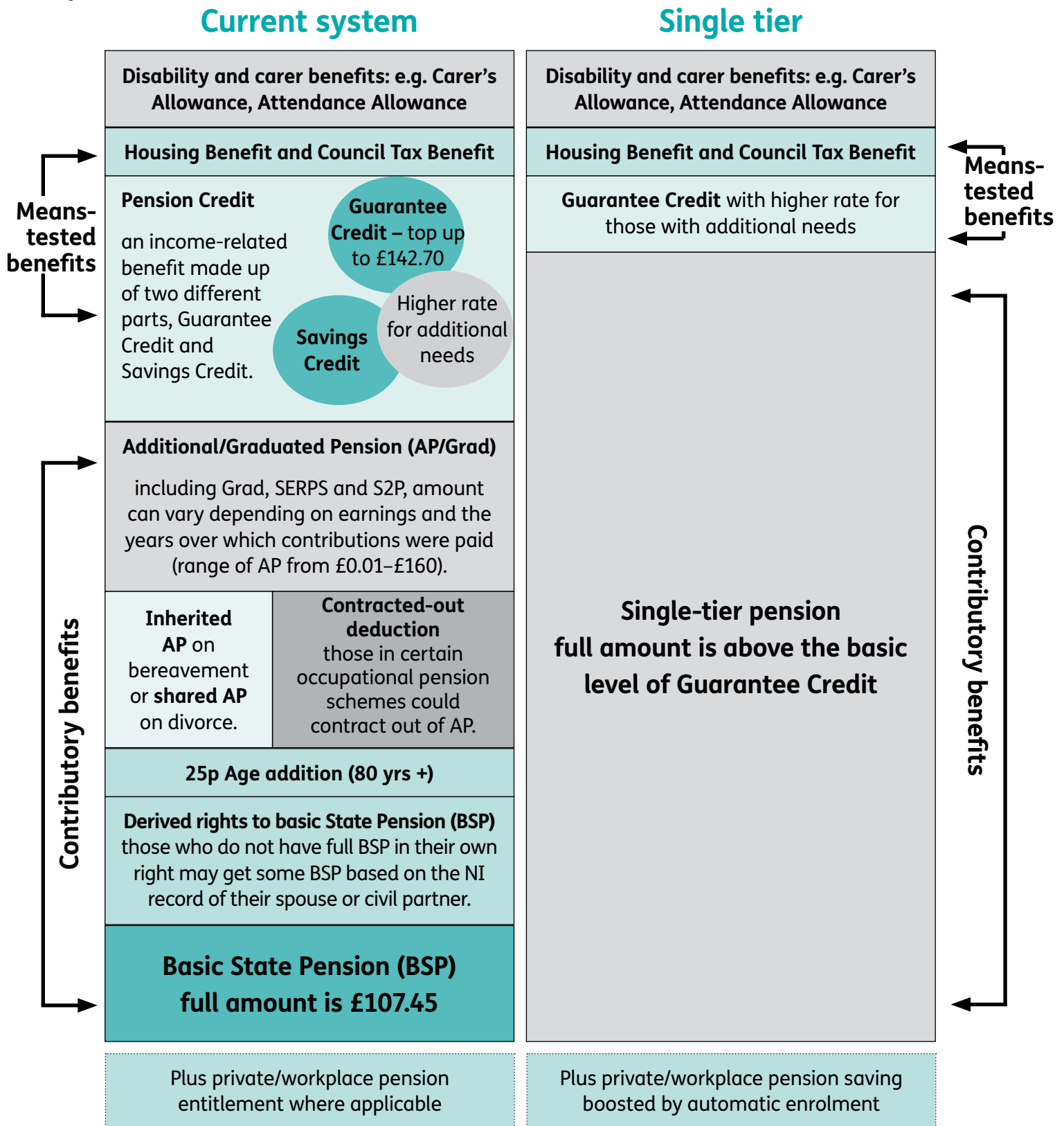
The Government believes that the option to defer the state pension is an important flexibility to retain, though in a simplified and modernised form that is consistent with single-tier principles. Under single tier it will still be possible to defer claiming state pension, and get an increased weekly pension in return. The rate will be finalised closer to the implementation date. In this document, the deferral rate is modelled to be one per cent for every ten weeks of deferral. There will be no option for individuals to receive a lump sum deferred payment.

Key outcomes of the single-tier pension

A. Clarity

34. A key objective of reform is to move to a simpler pension system that gives people clarity over what their state pension will be worth when they retire. This will ensure that people of working age have a solid foundation for saving. Figure 2.1 illustrates how the reforms will radically simplify the state pension and remove outdated or complex aspects of the current system.

Figure 2.1: A comparison of the components of the current and steady state single-tier state pension systems⁴¹

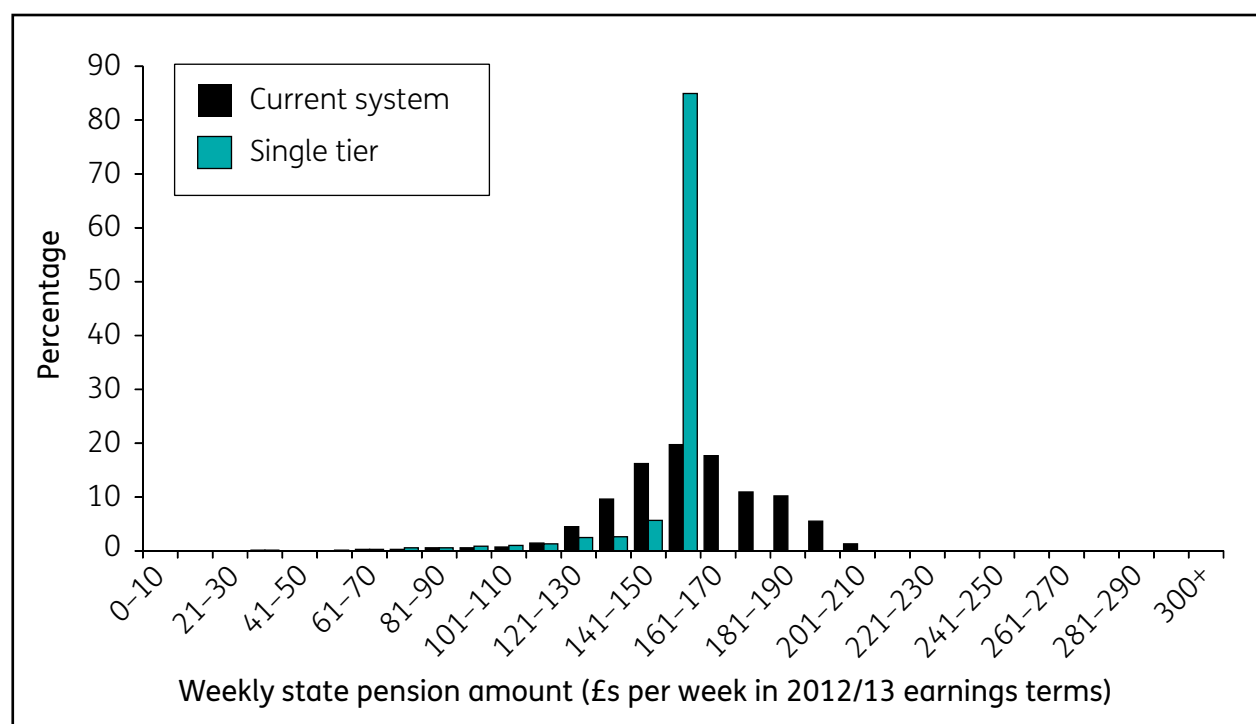


Universal pensioner benefits including Winter Fuel Payments, bus passes, free prescriptions and free TV licence (Over 75s)

⁴¹ The current system of means-tested support for pensioners is due to change in April 2013 with the localisation of council tax support. The implementation of the Welfare Reform Act 2012 will also bring changes to means-tested support for pensioners (from 2014 on latest planning assumptions).

35. Under the single-tier pension three of the most complex elements of the current system will end. These are:
- the two-tier system of basic State Pension and State Second Pension, including the option to contract out of the State Second Pension;
 - the Savings Credit element of Pension Credit; and
 - the ability to derive, inherit, or share a pension based on National Insurance contributions of a spouse or civil partner.
36. State pension outcomes under the current two-tier system vary widely, largely due to variation in the amount of additional State Pension that individuals receive. As Chart 2.1 shows, without single-tier reforms this variation would persist, even with the gradual flat-rating of the State Second Pension that is already underway.
37. By contrast, under single tier the large majority of pensioners could expect to retire on the full weekly amount of single-tier pension: by the mid-2030s the Government expects that over 80 per cent of pensioners will qualify for the full single-tier pension, rising to around 85 per cent by 2040. This will make it much easier to give those of working age a clearer idea about what their state pension will be when they retire, providing a firm foundation to support saving.

Chart 2.1: Projected distribution of net state pension income for those reaching State Pension age in 2040 under the current and single-tier systems⁴²



⁴² The full single-tier amount in this chart is above the illustrative £144 because under triple lock uprating it is expected that the single-tier pension value will grow slightly faster than average earnings over the long term.

38. Simplicity was seen as a clear benefit of the single-tier pension in recent DWP qualitative research.⁴³ A set, clear amount with just one set of qualifying criteria was seen as much more straightforward than the current system, where entitlement to basic State Pension is based on one set of rules and entitlement to the two types of additional State Pension and Graduated Retirement Benefit are based on different sets of rules and complex calculations. The simplification was considered to give people more confidence in thinking about the future, a better starting point from which to plan and to offer peace of mind.

“If you know what you’re getting from the start it’s a sort of building block, you can plan what you need for your lifestyle.”

(Medium Income, 35-50, Birmingham)⁴⁴

39. Similarly, qualitative research carried out by IFF Research for Age UK found that the participants (current pensioners) strongly supported the idea of the new flat-rate pension system.⁴⁵ A survey carried out by Age UK found that 62 per cent of respondents supported the concept of a single-tier pension. Support was high in all age groups.⁴⁶

Text Box 2.1: Communicating the move to the single-tier pension

The Government recognises the importance of providing clear and engaging information to support the simplification of the state pension system and to help people to understand what it means for them.

The Government will:

- provide clarity about who is impacted by the changes and focus on the important questions people have about the state pension – how much they will receive and when;
- provide information in layers so individuals can get a basic overview of their position and can find more detailed information if they wish;
- use clear, jargon-free language; and
- actively dispel myths and help people to overcome preconceptions about planning and saving for retirement.

Customer research has informed this approach, and practical examples can be found in Chapter 4 and Annex 4 of this document, where the State Pension statement is explained.

B. A reduction in means-testing

40. The single-tier pension will be set at a rate that is above the basic level of means-tested support. As a result there will no longer be a need for a complex savings reward under single tier. Removing Savings Credit will simplify means-tested support and help to ensure Pension Credit is re-focused on providing a safety net targeted at the poorest and most vulnerable.

⁴³ Thomas *et al.*, 2013, *A simpler State Pension: A qualitative study to explore one option for State Pension reform*, Department for Work and Pensions Research Report No 787, Department for Work and Pensions.

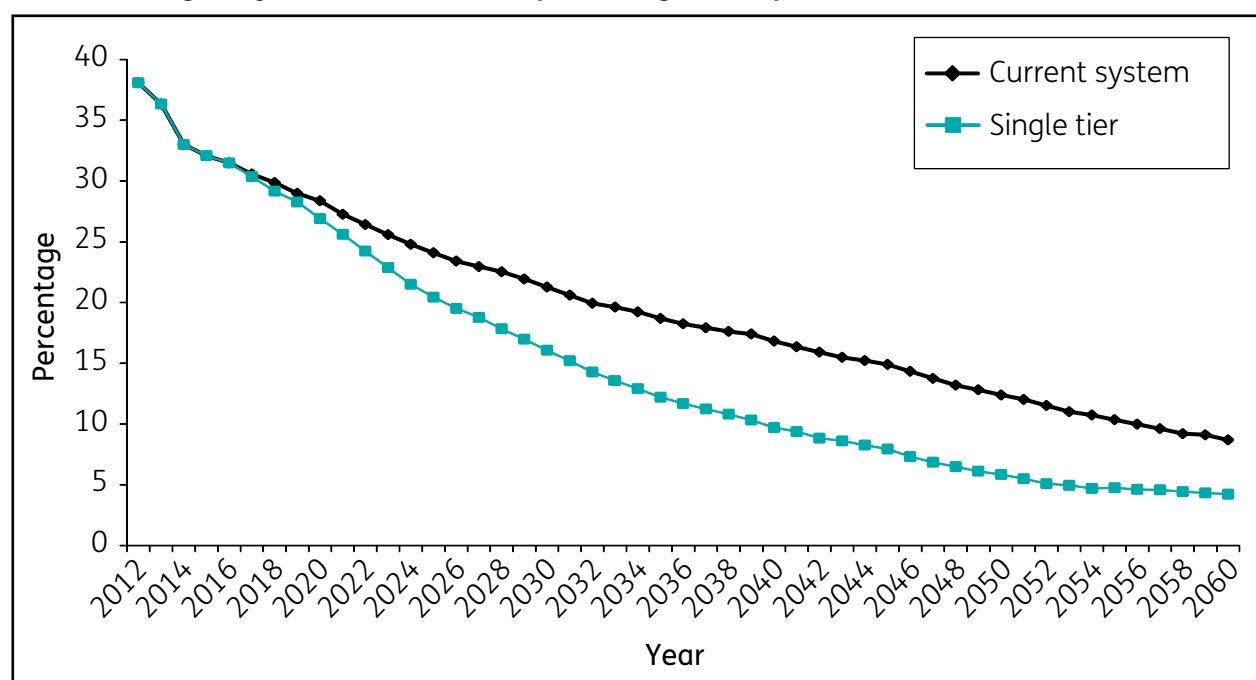
⁴⁴ Department for Work and Pensions, 2011, *A state pension for the 21st century: A summary of responses to the public consultation*, Cm 8131, TSO.

⁴⁵ IFF Research, 2012, *Older People’s Views on State Pension Reform Prepared for Age UK*, IFF Research.

⁴⁶ Age UK website accessed 29 November 2012. (<http://www.ageuk.org.uk/latest-news/millions-uncertain-over-pensions-future>).

- 41. Other income-related benefits will remain, and support will be retained for a period of five years for those people who may have received more help with housing costs by virtue of the availability of the Savings Credit.
- 42. The reforms will mean that an individual will have confidence that, with 35 qualifying years of National Insurance contributions or credits, they will be able to retire on a state pension that lifts them clear of the basic level of means-tested support and keeps them above it throughout their retirement. This is because the full weekly amount of single-tier pension will be uprated at least in line with earnings, so would hold its value relative to the earnings-uprated means test.
- 43. Chart 2.2 below shows that overall eligibility for Pension Credit is expected to fall under the current system. This reflects growth in pensioner incomes associated with the triple lock, automatic enrolment, women’s labour market participation and previous State Pension reforms. It is also partly driven by the reduced scope of Savings Credit under current uprating policy and by the implementation of Universal Credit. The impact of the single-tier reforms is to further reduce the proportion of pensioners in the scope of Pension Credit, halving it by 2050 compared to the current system, with only five per cent of pensioners entitled. Amongst people who reach State Pension age after the implementation of single tier, the number qualifying for Pension Credit is halved immediately.

Chart 2.2: Eligibility for Pension Credit (percentage of all pensioners)

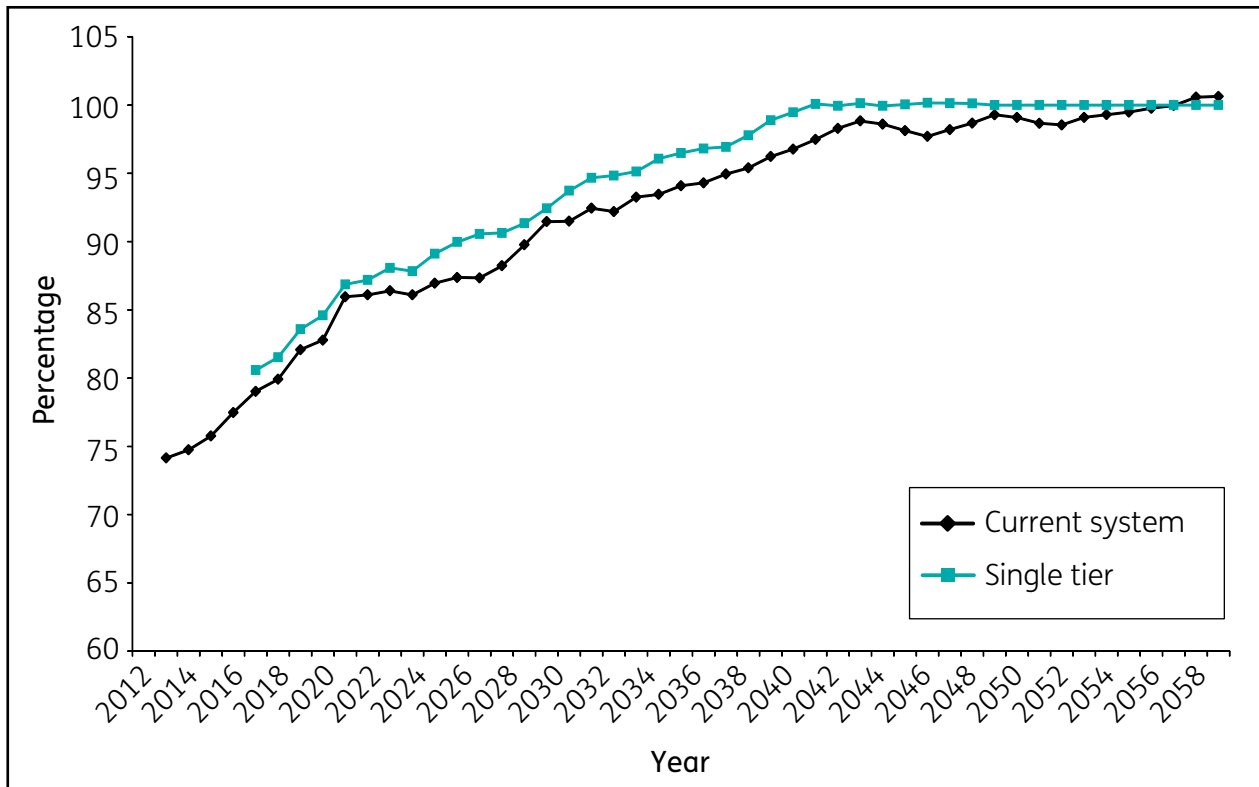


- 44. The removal of Savings Credit under single tier will reduce the number of taper rates that pensioners face. This will simplify the pension system and reduce the interaction that any additional income may have with means-tested benefits for those with modest incomes. This will enable affected pensioners to see greater benefits from retirement savings or working past State Pension age.

C. Equalisation of state pension outcomes between men and women

45. Single tier brings forward by over a decade the point at which women reach equivalent state pension outcomes to men (by the early 2040s instead of the mid-2050s). This is because new accruals to the earnings-related State Second Pension end, from which women have historically had poorer outcomes, and because a single-tier qualifying year will give rise to a higher benefit entitlement than a basic State Pension year.⁴⁷

Chart 2.3: Median female gross state pension outcomes as a proportion of median male gross state pension outcomes for those reaching State Pension age under current and single-tier systems

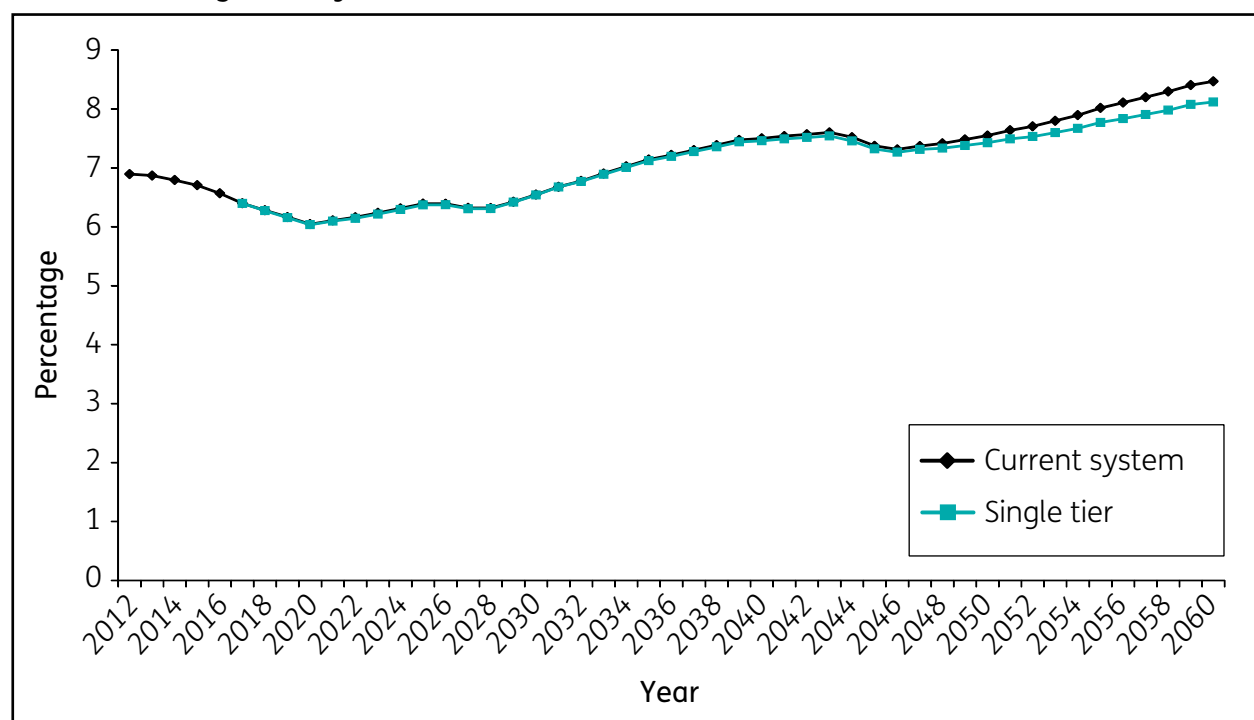


⁴⁷ Based on the 2012/13 level of the basic State Pension, and a single-tier starting level of £144: a qualifying year is worth £3.58 (1/30 x £107.45) in basic State Pension and £4.11 to the nearest penny (1/35 x £144) under single tier.

D. Affordability and sustainability

46. Chart 2.4 shows the cost of the single-tier pension as a proportion of GDP compared to the current system rolled forward. The expenditure profile is based on the assumptions outlined above (a £144 starting level, uprating to 2060 by the triple lock and a minimum qualifying period of ten years).

Chart 2.4: Expenditure as a proportion of GDP on state pensions and pensioner benefits under the current and single-tier systems



47. In order to ensure the sustainability of the state pension system, single-tier reforms have been designed to cost no more than the current system overall, including expenditure on Savings Credit. National Insurance revenue is not factored into forecast expenditure. In the longer term, state pension expenditure under single tier is projected to increase at a slightly slower rate than under the current system: by 2060, pension expenditure under single tier is around 8.1 per cent of GDP, compared to 8.5 per cent if the current system was rolled forward. This difference can largely be explained by the closing of the State Second Pension. However, it is important to note that such long-term projections are highly uncertain, due to the difficulties around projecting demographic trends and the performance of the economy so far into the future. Chapter 6 contains further detail on profiled expenditure for the single-tier pension.

Text Box 2.2: Note on expenditure projections

The GDP figures in this paper are based on forthcoming DWP projections. These differ from projections in the Office for Budget Responsibility (OBR) *Fiscal Sustainability Report 2012* because they are based on Great Britain (GB) only and due to different uprating assumptions for some pensioner benefits. OBR uses higher uprating assumptions and therefore projects higher costs.

Based on the last set of projections, DWP estimates for pensioner benefit expenditure by 2060 under the current system are around one per cent of GDP lower than OBR estimates for the same reasons:

- different uprating of some benefits: DWP policy is to uprate Attendance Allowance and Disability Allowance by CPI to 2060 whereas the OBR assumes earnings uprating in the longer term (there are similar differences with some other smaller benefits). This has the effect of reducing DWP estimates of pensioner benefit expenditure by around 0.7 per cent of GDP by 2060 compared to the OBR estimate.
- GB instead of UK: GB costs rather than UK costs are presented in this document. This reduces DWP estimates by around a further 0.2 per cent of GDP by 2060 compared to the OBR estimate.

The projections reflect the OBR's Autumn 2012 update of their medium term economic forecast.

48. As indicated above, for people with pre-implementation National Insurance records, transitional arrangements will apply. This important aspect of the reforms is described in further detail in Chapter 4.

Managing the end of contracting out

3

Integral to the single-tier reforms is the closure of the State Second Pension. Contracting out of the State Second Pension for Defined Benefit schemes – giving up entitlement in return for a broadly similar occupational pension and payment of a lower National Insurance (NI) rate for employer and employee – will therefore come to an end. All employees will pay the same rate of National Insurance and become entitled to state pension in the same way. The state pension system will be significantly simpler as a result.

The Government's objectives for managing the end of contracting out are to minimise the impacts on employers, schemes and individuals, ensuring that the administrative processes of ending contracting out are as smooth and as simple as possible; that amounts built up in schemes to 2017 continue to be paid; and that the sustainability of Defined Benefit pension schemes is not undermined.

Background on the current system of contracting out

49. Under the current system it is possible for Defined Benefit schemes⁴⁸ that meet certain minimum criteria, to be contracted out of the additional State Pension. The original rationale for this was to allow employers already providing an earnings-related occupational pension to contract out of the State Earnings Related Pension Scheme (SERPS) when it was introduced in 1978, thereby avoiding part of the new higher National Insurance contributions. This also prevented employees already in earnings-related schemes being over-provisioned.

⁴⁸ Defined Benefit schemes are also known as salary-related or final salary schemes because the pension an individual gets when they retire is calculated with reference to their salary. For the purposes of this chapter the term Defined Benefit is used to refer to such schemes.

50. The ability to contract out was extended to Defined Contribution or money purchase schemes from 1988, but this ended in April 2012 to simplify the pensions landscape ahead of the introduction of automatic enrolment. Further detail on how occupational pensions interact with the State Pension under the current system of contracting out is provided in Text Box 3.1.
51. In 2011, around 5.3 million public sector employees and 1.6 million private sector employees were active members of contracted-out Defined Benefit pension schemes.⁴⁹ However, the majority of people working today have been contracted out at some point in their working lives: 80 per cent of those who reach State Pension age in 2035 will have been contracted out at some point. This chapter considers the impact of ending contracting out on those employers, schemes and individuals that are contracted out immediately prior to the implementation of reforms. Information about the treatment of the National Insurance records of those who have spent periods contracted out of the additional State Pension can be found in Chapter 4.

Text Box 3.1: How occupational and state pensions interact under the current system of contracting out

Employers offering a Defined Benefit scheme that meets certain minimum criteria can contract out of the additional State Pension. The employer and employee pay a lower rate of National Insurance contributions and in return the schemes are required to provide a pension that meets a minimum standard.

Between 1978 and 1997 the pension scheme had to provide individuals with a Guaranteed Minimum Pension (GMP) – this was based on a similar calculation to SERPS. A ‘contracted-out deduction’ is applied at State Pension age to the individual’s additional State Pension, to take account of the lower rate of National Insurance paid: the deduction is based on their GMP.

From 1997 a contracted-out scheme had to satisfy a minimum scheme (rather than individual) standard – known as the ‘reference scheme test’. While members of such a scheme, individuals gain little or no additional State Pension entitlement.

The intention of both the above safeguards is that an individual becomes eligible for an amount of pension in their contracted-out scheme which is broadly equivalent to the additional State Pension to which they may otherwise have become entitled.⁵⁰

For individuals who have been members of contracted-out Defined Contribution schemes, the same principles apply, with the exception that the contracted-out deduction is based on their notional GMP.

52. With the implementation of the single-tier pension, the earnings-related component of the State Pension will end. Instead, individuals will be able to build up private pension savings themselves through enrolment into workplace pension schemes. Without the additional State Pension, the original rationale for contracting out will no longer exist and there will be nothing to contract out of.

⁴⁹ Office for National Statistics, 2011, *Occupational Pension Schemes Survey*, ONS.

⁵⁰ Changes to the additional State Pension in 2002 mean that for some people, the contracted-out pension would no longer provide ‘broadly equivalent’ value. This difference is made up in additional State Pension entitlement.

53. Ending contracting out plays a key role in simplifying the state pension under single-tier reforms. It will remove the connection between state and occupational pension schemes that can cause misunderstanding and confusion for individuals, difficulty in providing accurate estimates of State Pension and that adds to the administrative burdens for both schemes and HMRC. It will reduce the number of different National Insurance rates paid by employers and employees and ensure people are able to claim the state pension on the same basis.
54. Many organisations who responded to the Government’s consultation, ‘*A state pension for the 21st century*’, told us about the significant implications that ending contracting out for Defined Benefit schemes would have for sponsoring employers, schemes and employees.⁵¹ These impacts are set out in this chapter alongside the measures that the Government will take to help employers, individuals and schemes to adjust to and manage the end of contracting out.

Impact of ending contracting out on employers

55. For employers, the end of contracting out will have cost and administrative implications, the largest of which will be paying higher employer National Insurance contributions. They will have to pay the same rate of National Insurance as all other employers, meaning an increase in respect of each contracted-out employee of 3.4 per cent of earnings between the Lower Earnings Limit (LEL) and Upper Accrual Point (UAP).⁵²
56. Some respondents to the Green Paper indicated that they thought it unreasonable that employers had to bear the cost of paying higher National Insurance contributions whilst maintaining the same occupational scheme benefits. They therefore wished to reduce the level to which they must fund their scheme by the same amount as the increase in National Insurance contributions, reflecting the fact that employees would be brought fully back into the state pension system when contracting out ends. This could be done by reducing future pension benefits or by increasing employee contribution rates to their pension schemes.
57. Many employers will be free to do this as the minimum standards for being a contracted-out scheme (the reference scheme test⁵³) will no longer apply when contracting out ends. Minimum standards apply under automatic enrolment, which will, however, impact employers wishing to use the same scheme for automatic enrolment purposes.
58. However, some private sector employers are limited in their ability to modify the scheme benefit structure by legislation or by the scheme rules themselves. In many cases, scheme rules can only be changed by the trustees or with the trustees’ consent. As changes in response to the end of contracting out are likely to be detrimental to members’ workplace pension income, it is possible that trustees may not consent to them.

⁵¹ Department for Work and Pensions, 2011, *A state pension for the 21st century: A summary of responses to the public consultation*, Cm 8131, TSO.

⁵² The LEL is £5,564, the UAP is £40,040 (2012/13 annualised figures). Whilst National Insurance liability does not begin until earnings reach the primary threshold the contracted-out rebate is calculated from the LEL.

⁵³ The reference scheme test is the current standard a contracted-out DB scheme must meet. This is broadly $(1/80 \times \text{final salary between LEL and UAP}) \times \text{years of service}$.

59. The Government recognises that losing the rebate will be a challenge for sponsoring employers of Defined Benefit schemes. The Government believes it is right to enable private sector employers to change their scheme design to adjust for the additional cost since this is a direct result of a government policy change. The Government therefore proposes to give employers powers to change scheme rules for this purpose without trustee consent.
60. Though this could result in employees' workplace pension benefits being reduced, those affected will be brought back into the state pension system. These powers would only enable changes in respect of the benefits that schemes offer for the future. Any benefits already accrued would not be affected.
61. The Government has taken into account the importance of protecting members' benefits and as a result these modification powers will only exist for a limited period and only allow changes to the extent that they offset the cost of additional employer National Insurance contributions. The Government believes that such a measure is necessary to ensure that state pension reform does not undermine the ongoing viability of Defined Benefit pension schemes. The Government will work with the pensions industry, employers and member representatives to determine exactly what type of change should be allowed and what safeguards will be needed.

Protected Persons Regulations

62. In some formerly nationalised industries, employers and trustees are limited in their ability to change scheme rules by legislation made at the time of privatisation. Protected Persons Regulations prevent employers from reducing the pension provisions of those employees who were previously employed by the State. In these situations, employers would face the additional cost of paying full-rate National Insurance contributions without being able to make a corresponding change to their occupational scheme benefits.
63. The Government is therefore considering whether it is fair and appropriate to override the Protected Persons Regulations for employers who wish to make this limited change to future benefits. However, the Government recognises the need to balance the rights and expectations of both employers and employees and will consult on the issue before coming to a decision over whether Protected Persons Regulations should be overridden for this purpose.

Consulting over pension scheme changes

64. Employers wishing to make certain changes – including to accrual rates and employee contributions – are required to conduct a consultation with affected members in accordance with requirements prescribed in legislation. Some stakeholders suggested in response to the Green Paper that the Government should reduce the consultation requirements for employers who are amending their scheme rules as a result of the end of contracting out.
65. However, the Government recognises the importance of consulting with active members and wants to strike an appropriate balance between the needs of employers and employees. Given its intention to enable private sector employers to change scheme rules without trustee consent, the Government does not propose to also remove the requirement to consult on scheme redesigns. It will, however, remove the requirement to consult on ending contracting out as this is the direct result of a Government policy change.

66. The Government is also committed to working with employers and the pensions industry to support communications activity, for example, through joint DWP/HMRC standard fact sheets for use in consultations with employees.

Guaranteed Minimum Pensions

67. Stakeholders in the pensions industry have also told the Government that the legislation applying to Guaranteed Minimum Pensions (GMPs) created additional complexity for the administration of contracted-out Defined Benefit pension schemes. Whilst this is not directly related to the end of contracting out, some respondents to the consultation suggested that the Government should use the opportunity to investigate whether this legislation could be simplified in any way.
68. DWP has worked closely with stakeholders, and sought input from the Government Actuary's Department (GAD), to explore whether it is possible to simplify this legislation. However, at present the Government believes that it is not possible to make any further significant simplifications, beyond the GMP conversion legislation introduced in 2009, without interfering with employees' property rights. Nevertheless, the Government remains committed to the principle of simplifying private pensions regulation where possible and is keen to engage with pensions industry stakeholders over the issues where they feel simplification could be achieved.

Public service pensions

69. Of the nearly seven million active members of contracted-out Defined Benefit schemes in 2011, 5.3 million were in public service schemes. All Defined Benefit public service schemes are contracted out.
70. In 2010, the Government invited Lord Hutton to undertake a fundamental structural review of public service pension provision. His Independent Public Service Pensions Commission set out recommendations for reform in March 2011,⁵⁴ which formed the basis of extensive consultation with trades union and other representative bodies to develop new scheme designs. Proposed Final Schemes Designs have been announced, and the Public Service Pensions Bill, which was introduced to Parliament on 13 September 2012, sets out the framework for these new schemes.
71. The Government has given a commitment to Parliament that the reforms to public service pensions should endure for 25 years, setting a high bar for future scheme changes in the Public Service Pensions Bill. Public service employers will therefore not be able to pass the cost of increased National Insurance contributions onto their employees by reducing the value of pension scheme benefits or by increasing employee contribution rates to their pension schemes.

⁵⁴ Independent Public Service Pensions Commission, 2011, *Independent Public Service Pensions Commission: Final Report*, Independent Public Service Pensions Commission.

Impact of ending contracting out on employees

72. When the single-tier pension is introduced and contracting out ends, all employees who were members of a contracted-out scheme immediately before introduction will cease to receive the 'contracted-out rebate' and will start to pay full National Insurance contributions. This will mean an increase in the rate of contributions that they pay equivalent to 1.4 per cent of their earnings (between the LEL and the UAP⁵⁵), bringing them into line with the rate of National Insurance that is paid by other employees. In return, contracted-out employees' qualifying years after the implementation of the single-tier pension will count towards the single-tier pension in the same way as others.
73. As noted previously in this chapter, many private sector employers have indicated that they would expect to adjust their scheme to take account of the fact that the National Insurance rebate will no longer exist. This means that employees potentially face a reduction in the value of their scheme benefits or an increase in pension contributions as well as an increase in the rate of National Insurance that they pay.
74. However, under the single-tier pension the vast majority of those who pay a higher rate of National Insurance as a result of the ending of contracting out will be able to get extra state pension for years worked or credited after the single-tier pension is implemented. Further, around 90 per cent of individuals who reach State Pension age in the first two decades of single tier will gain enough extra state pension to offset both the increase in the National Insurance contributions they will pay over the rest of their working lives and any potential adjustments to their occupational pension.

Ensuring a smooth end to contracting out for employers and schemes

75. The Government plans to implement the single-tier pension in 2017 at the earliest. It recognises that employers and schemes will need a sufficient notice period to ensure a smooth end to contracting out, given the financial and administrative impacts that this will bring. The Government will work closely with employers and the pensions industry to set a date for the implementation that allows employers to plan their approach and prepare for the impact of the changes, and is exploring with stakeholders the scope for streamlining this process.
76. Respondents to the Green Paper emphasised the importance of ensuring that the end of contracting out is managed as smoothly as possible. Some highlighted the Government's role in communicating how and why contracting out is ending to employers and employees. The Government will work with employers and the pensions industry to develop standard information products. Further detail on communication is provided in Text Box 3.2.

⁵⁵ The LEL is £5,564, the UAP is £40,040 (2012/13 annualised figures). Whilst NI liability does not begin until earnings reach the primary threshold, the contracted-out rebate is actually calculated from the LEL.

Text Box 3.2: Communicating the end of contracting out

Careful planning and proactive communications will help the three key audiences (scheme members, employers and scheme administrators) understand why the changes are happening and how they will be affected.

The Government's communications strategy will incorporate the good practice that was developed for the end of contracting out for Defined Contribution pension schemes in April 2012. This will involve working closely with HMRC in order to reach employers, scheme administrators, trade associations and their members. The Government expects to make use of existing communications channels, such as annual statements to members, complementing this by developing new materials, such as online factsheets and frequently asked questions.

77. The Government aims to close all open periods of contracted-out employment and update National Insurance records with minimum cost and administrative burden to both HMRC and schemes. A key operational challenge will be reconciling the information which schemes have on their members with that held by HMRC. The process currently used when a single scheme ceases to contract out was not designed for mass closure. HMRC will therefore work closely with scheme administrators, considering the lessons learned from the abolition of Defined Contribution contracting out, to develop a new way to close all contracted-out records with the minimum impact. This includes exploring whether new IT for real time Pay As You Earn (PAYE) submissions by employers could be used to gather more information in advance.

Working with the pensions industry

78. The Government is happy to discuss any aspects of ending Defined Benefit contracting out with employers and the pensions industry. The Government would also welcome views on what information the DWP and HMRC could produce for employers, employees and trustees of schemes. Please use the following email address for all enquiries relating to the ending of Defined Benefit contracting out as covered in this chapter of the White Paper:
Strategy.contractingoutresponsestowp@dwp.gsi.gov.uk

The transition to the single-tier pension

4

Most people of working age will have made National Insurance contributions prior to the implementation of the single-tier pension. The Government has designed a transition process which translates people's pre-implementation National Insurance records into a simple starting amount for the single-tier pension – the 'foundation amount'.

Under this approach to transition, those reaching their State Pension age after the implementation of the single-tier pension will fall into four distinct groups:

- Individuals with a foundation amount which is **equal to the full level of the single-tier pension**. These are likely to be people who have the necessary 35 qualifying years, little additional State Pension and who have not been contracted out.
- Individuals with a foundation amount which is **less than the full level of the single-tier pension**. These are likely to be younger people, with fewer qualifying years, or older people who have spent many years contracted out of the additional State Pension. These people will be able to increase their single-tier pension up to the full £144 level, at the rate of £4.11 (to the nearest penny) for each qualifying year they gain before reaching their State Pension age.
- Individuals with a foundation amount which is **more than the full level of the single-tier pension**. These are likely to be older people with many qualifying years, and who have not spent significant periods contracted out of the additional State Pension. These people will receive the difference between their foundation amount and the full single-tier amount as an extra payment on top of the full single-tier weekly amount.
- Individuals with **no pre-implementation National Insurance record**. These people will benefit from the simpler and easier to understand single-tier system which will give them long term clarity of outcome. They will also be supported to save into a workplace pension scheme through automatic enrolment and the policy measures set out in the Government's *'Reinvigorating Workplace Pensions'* document throughout all of their working lives.

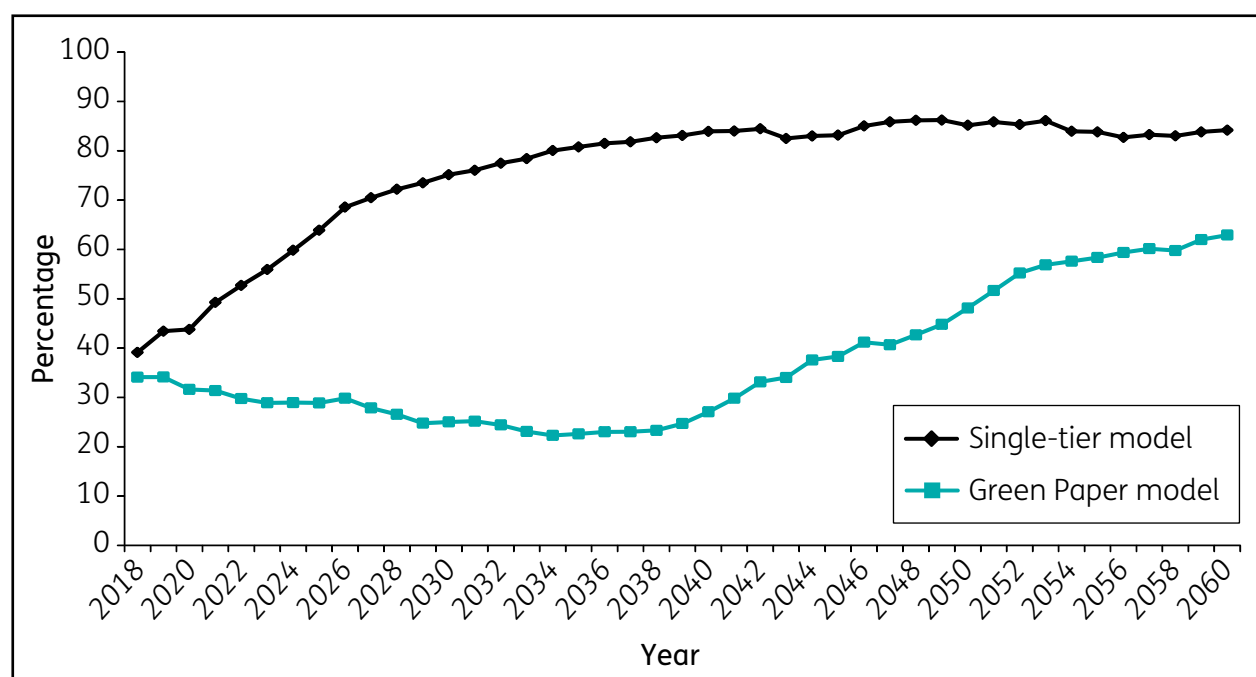
Compared to proposals set out in the Green Paper, this approach speeds up the process of transition, significantly increasing the number of people who will receive the full single-tier pension. By the mid-2030s, over 80 per cent of people reaching their State Pension age will receive the full single-tier pension.

Over the coming decades, a majority of future pensioners will have a higher income in retirement as a result of the reforms, compared to under the current system rolled forward. The single-tier reforms have been designed to cost no more than the current system overall. As such, they result in some future pensioners receiving slightly more income in retirement than if the existing system continued and others receiving slightly less. However, for future pensioners, all qualifying years up until implementation will be recognised, subject to them satisfying the minimum qualifying period.

Green Paper approach

79. In 'A state pension for the 21st century', the Government outlined an approach to transition that would have resulted in a relatively low proportion of people reaching State Pension age in the coming decades getting the full single-tier pension. This result, shown in Chart 4.1, arose because anyone who had ever contracted out of the additional State Pension would have had a deduction applied to their single-tier pension at State Pension age, as happens now in relation to the additional State Pension.
80. Importing this mechanism into the single-tier transition, as a way of recognising the reduced levels of National Insurance contributions paid by persons in contracted-out employment and their employers, brought with it complexity. The Government has developed an improved approach to transition that recognises individual contributions whilst also delivering the simplicity and clarity of the single-tier reforms more quickly. Under the revised method, the deduction to reflect the 'contracted-out rebate' will be applied as at the point of implementation of the single-tier pension, instead of at State Pension age. As a result, many people who have been contracted out will be able to increase their future pension by gaining further qualifying years before they reach their State Pension age.

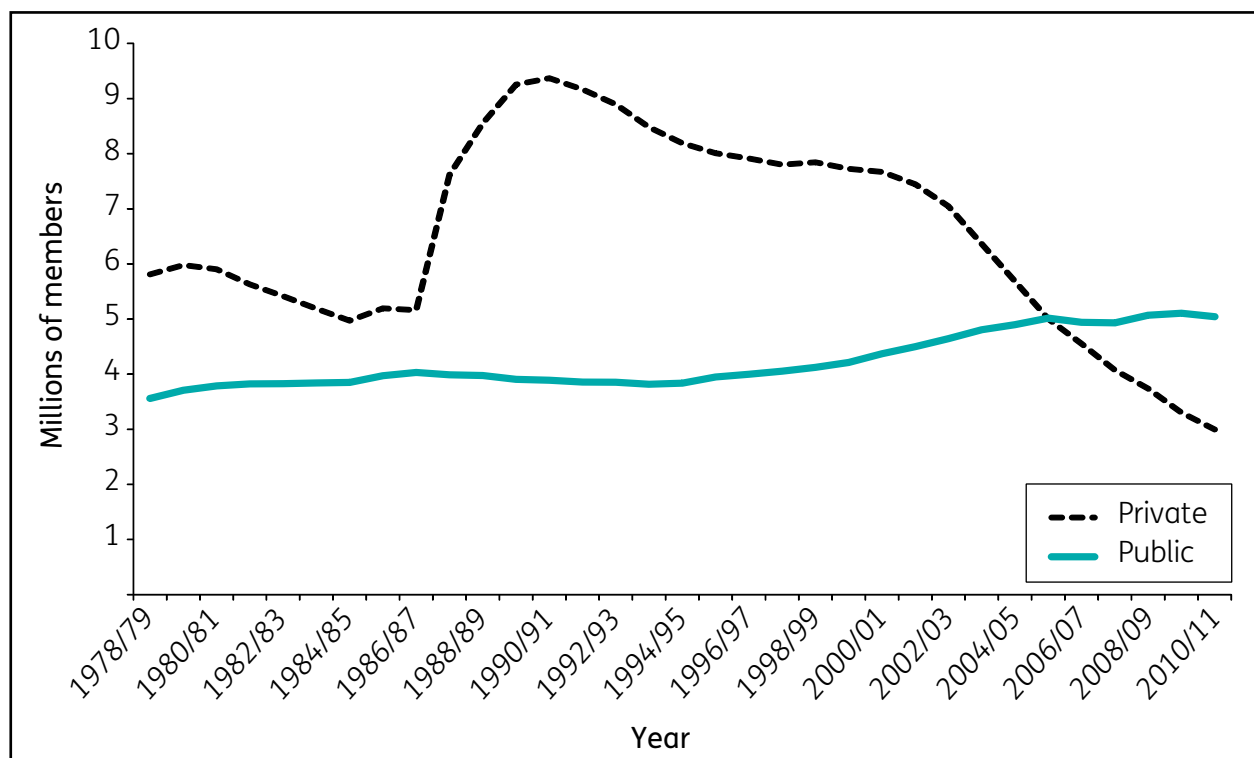
Chart 4.1: Proportion of pensioners reaching State Pension age who receive the full single-tier pension under the approach outlined in the Green Paper versus the revised approach⁵⁶



⁵⁶ Source: Departmental modelling using Pensem2. This chart shows a three year moving average.

81. Most people have, at some time, been contracted out of the additional State Pension. Historically, most of these people were in private sector schemes, as illustrated in Chart 4.2, and between 1988 and April 2012 contracting out was possible for members of both Defined Contribution and Defined Benefit schemes. A significant number of people, in both the private and public sectors, will therefore benefit from this revised approach.

Chart 4.2: Members belonging to a contracted-out pension scheme by sector – both Defined Benefit and Defined Contribution schemes⁵⁷



Proposed approach in detail

The foundation amount

82. The transition process will translate people’s pre-implementation National Insurance records into a simple single-tier pension starting amount – the ‘foundation amount’. The method for reaching an individual’s foundation amount is described below.
83. An individual’s National Insurance record will be valued under the rules of the single-tier system. The calculation will be as follows:

Single-tier valuation:

$$\frac{\text{Number of pre-implementation qualifying years} \times \text{£144}}{35}$$

⁵⁷ Graph based on data from: Department for Work and Pensions Tabulation Tools. (http://statistics.dwp.gov.uk/asd/asd1/tabtools/stpp_summary.xls)

84. For those who have been contracted out, a deduction – the ‘rebate-derived amount’ – will be applied to the single-tier valuation, as of the date of the implementation of single tier, to reflect the lower rate of National Insurance contributions paid when contracted out.

85. This calculation will be as follows:

Single-tier valuation for people who have contracted out:

$$\left(\frac{\text{Number of pre-implementation qualifying years} \times \text{£144}}{35} \right) - \text{‘rebate derived amount’}$$

86. There will be cases where some people’s National Insurance records, when valued under the rules of the current state pension scheme, would give them a higher valuation than the calculation set out above. Therefore, as a safeguard, after calculating an individual’s single-tier valuation, a check will be performed to see if the current system rules would give them a higher valuation. Where this is the case, these people will receive that higher valuation as their foundation amount. This will ensure that everyone’s National Insurance record keeps its value at the point the single-tier pension is implemented. Annex 3 includes further detail on specific elements of transition, including how additional State Pension in the current system will be recognised for inheritance purposes.

The minimum qualifying period

87. Everyone who reaches their State Pension age after the implementation of the single-tier pension will be subject to the minimum qualifying period, as discussed in Chapter 2. This means that only people who have at least the required number of qualifying years upon reaching State Pension age, will be eligible for a single-tier pension. The minimum qualifying period will be set between seven and ten years; modelling in this document has assumed a ten-year minimum qualifying period.

Case Studies

88. People’s foundation amounts will vary depending on their National Insurance record. There are four possible positions an individual could find themselves in, which are illustrated in the simplified case studies below:

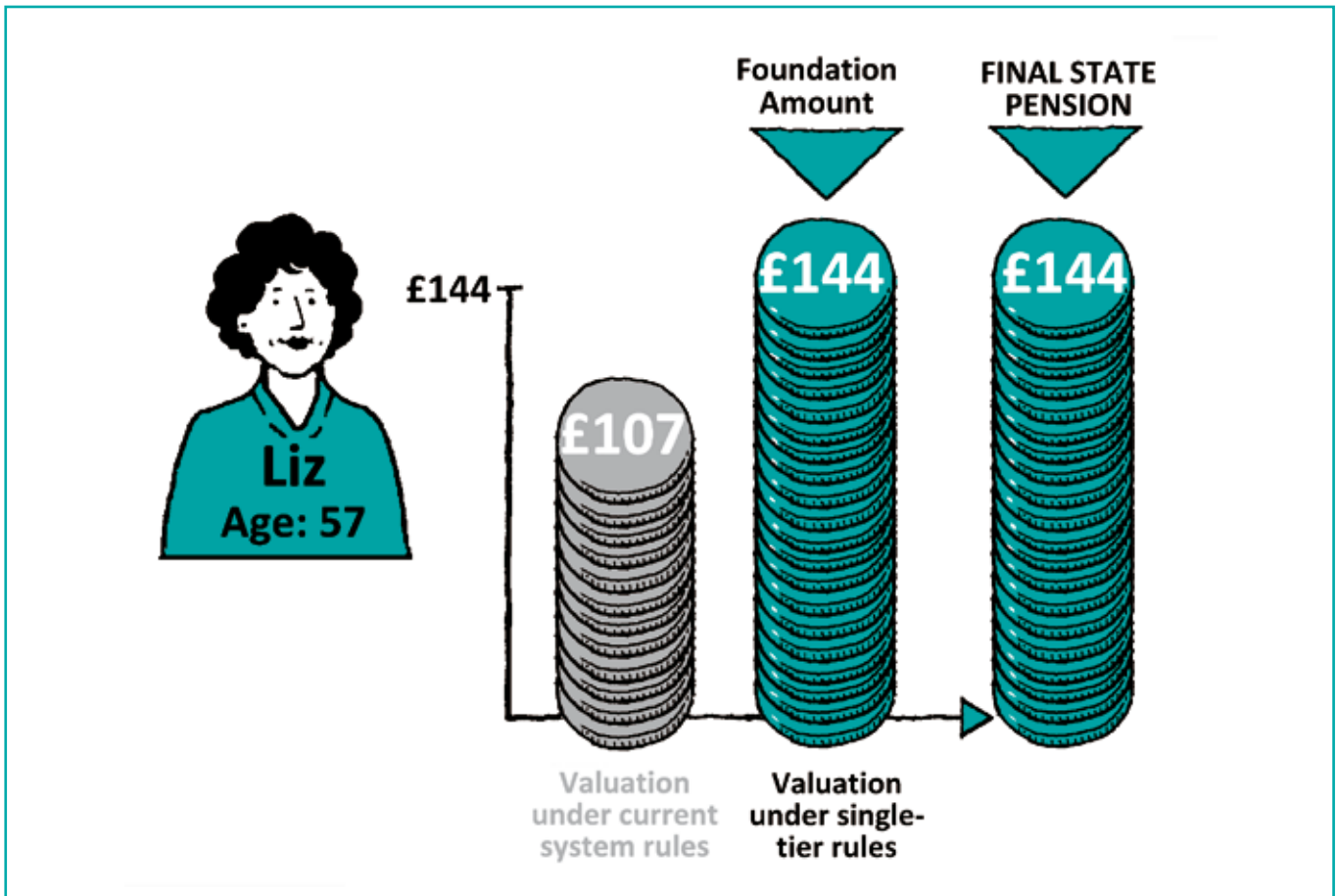
- 1) foundation amount is **equal to** the full level of the single-tier pension;
- 2) foundation amount is **more than** the full level of the single-tier pension;
- 3) foundation amount is **less than** the full level of the single-tier pension; or
- 4) **no pre-implementation National Insurance record** exists.

Section 1: People who have a foundation amount which is equal to the full level of the single-tier pension

89. At the implementation of the single-tier pension, the National Insurance records of some people will give them a foundation amount that is equal to the full level of the single-tier pension.
90. People who are in this category are likely to share the following characteristics:
- are older workers; and
 - have worked the majority of their working lives as lower earners; or
 - have been self-employed for the majority of their working lives; or
 - have spent significant periods receiving National Insurance credits.

These people will get the full amount of the single-tier pension, and will not get extra state pension by gaining more qualifying years.

Case Study 4.1: People who have a foundation amount which is equal to the full level of the single-tier pension



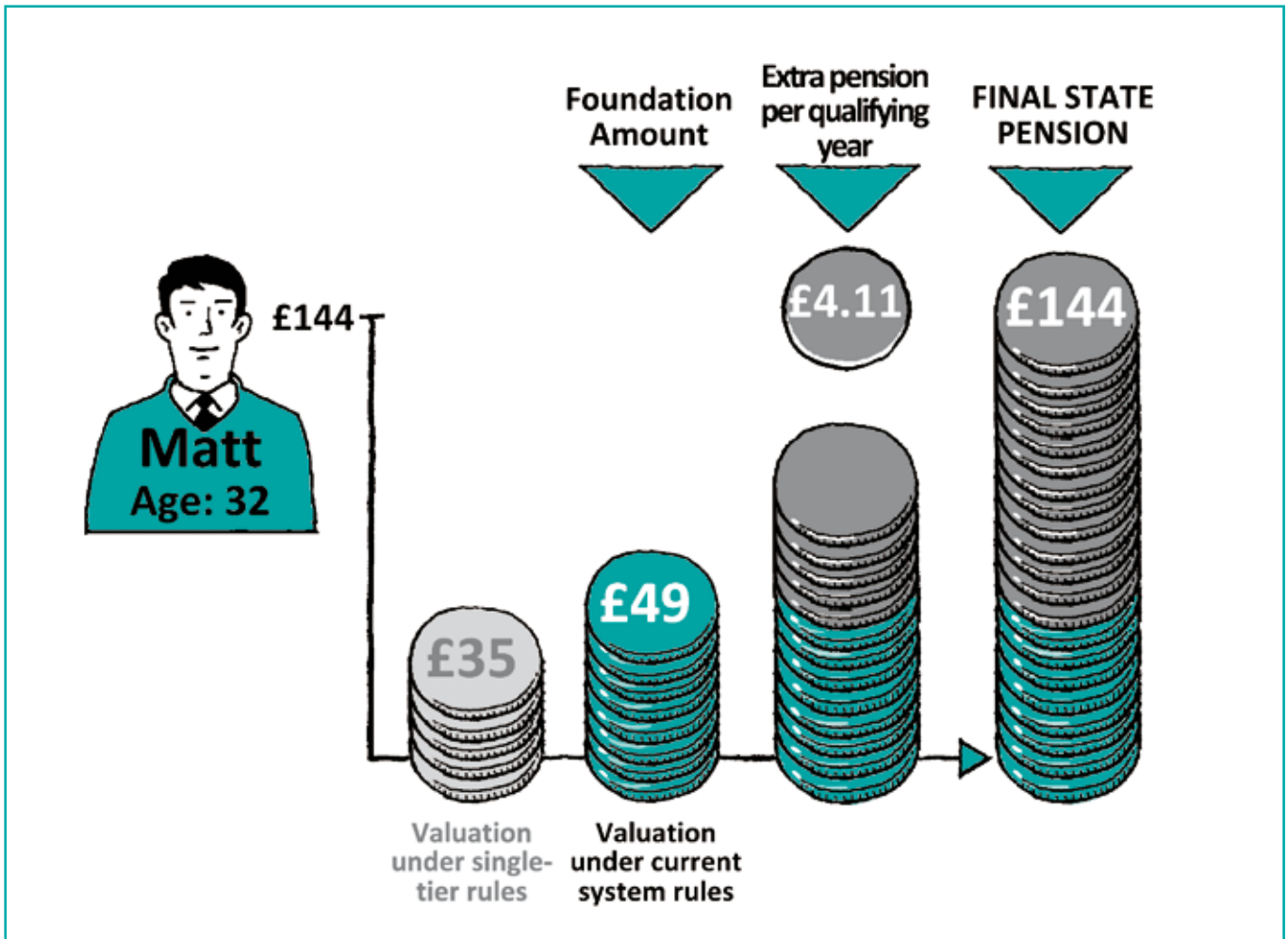
Liz's foundation amount is equal to the full level of the single-tier pension. She will therefore get £144 every week when she reaches her State Pension age.

- Liz has been running her own small business for the past 36 years.
- Her National Insurance record as at 2017 is valued under the single-tier rules, which take into account her qualifying years. Because she has not been contracted out, no deduction is applied.
- A check is performed to see if Liz would get a higher valuation under the rules of the current system. Time spent self-employed does not build additional State Pension, and so the maximum she could expect under the current system is the full level of the basic State Pension: £107 per week.
- In Liz's case, the single-tier valuation is higher, and so becomes her foundation amount.
- As her foundation amount is already £144, she will not be able to add extra pension by gaining post-implementation qualifying years.
- When she reaches her State Pension age, she will get £144 per week.

Section 2: People who have a foundation amount which is less than the full level of the single-tier pension

91. At the implementation of the single-tier pension, the National Insurance records of some people will give them a foundation amount that is less than the full level of the single-tier pension.
92. People who are in this category are likely to share the following characteristics:
 - are younger people, many years from their State Pension age; and
 - have spent fewer years in work or receiving National Insurance credits; or
 - are older people, closer to State Pension age, who have spent significant periods contracted out of the additional State Pension.
93. These people will be able to build upon their foundation amounts by gaining post-implementation qualifying years until they reach their State Pension age. This will increase their single-tier pension by 1/35th of the full amount of single tier (£4.11 to the nearest penny) per week for every extra qualifying year gained, up to the full single-tier amount.

Case Study 4.2: People who have a foundation amount which is less than the full level of the single-tier pension



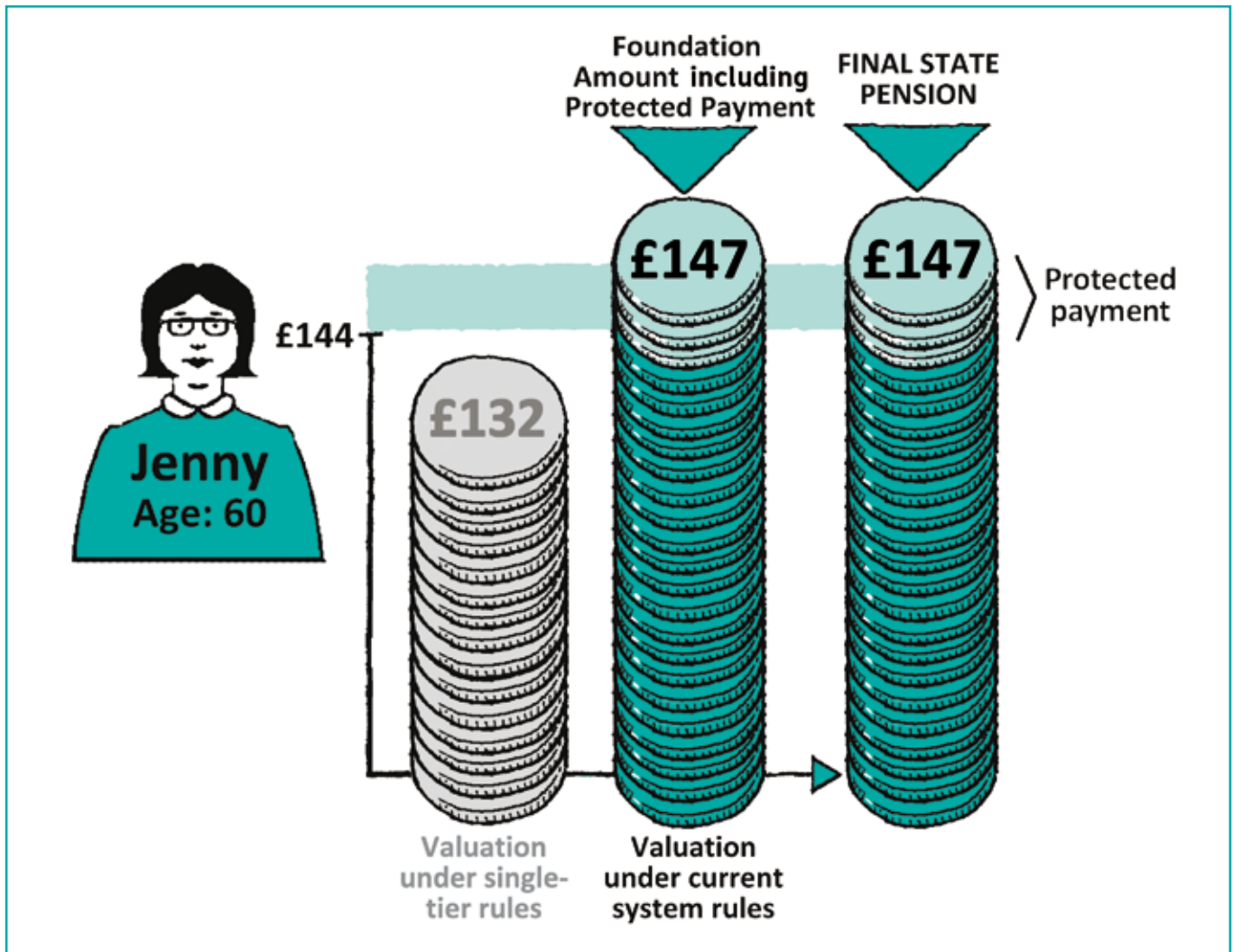
Matt's foundation amount is less than the full level of the single-tier pension. He can build on this amount with every post-implementation qualifying year gained until he reaches his State Pension age, when he can receive the full single-tier amount of £144 per week.

- Matt has been working as a teacher for ten years prior to the implementation of the single-tier pension.
- His National Insurance record as at implementation is valued under the single-tier rules, which take into account his qualifying years, and also a deduction to reflect lower National Insurance contributions paid during his time spent contracted-out.
- A check is performed to see if Matt would get a higher valuation under the rules of the current system.
- In Matt's case, the current system valuation is higher, and therefore it becomes his foundation amount.
- As his foundation amount is less than £144, he is able to add extra pension at the rate of £4.11 (to the nearest penny) for every further qualifying year he gains, up to the maximum of £144.
- Matt needs 24 post-implementation qualifying years to receive the full level of the single-tier pension when he reaches his State Pension age.

Section 3: People who have a foundation amount which is more than the full level of the single-tier pension

94. At the implementation of the single-tier pension, the National Insurance records of some people will give them a foundation amount which is more than the full level of the single-tier pension.
95. People who are in this category are likely to be those who share the following characteristics:
 - are older workers; and
 - have spent the majority of their working lives in work; and
 - are less likely to have been contracted out of the additional State Pension for a significant period of time.
96. These people will get the full level of the single-tier pension, and keep any amount above this as a 'protected payment' when they reach State Pension age. Uprating arrangements for the protected payment are described later in this chapter.
97. People in this situation will not get extra pension for further qualifying years because they already have more than the full level of the single-tier pension.

Case Study 4.3: People who have a foundation amount which is more than the full level of the single-tier pension



Jenny's foundation amount is more than the full level of the single-tier pension. When she reaches State Pension age, every week she will receive the full single-tier amount of £144, plus the extra amount.

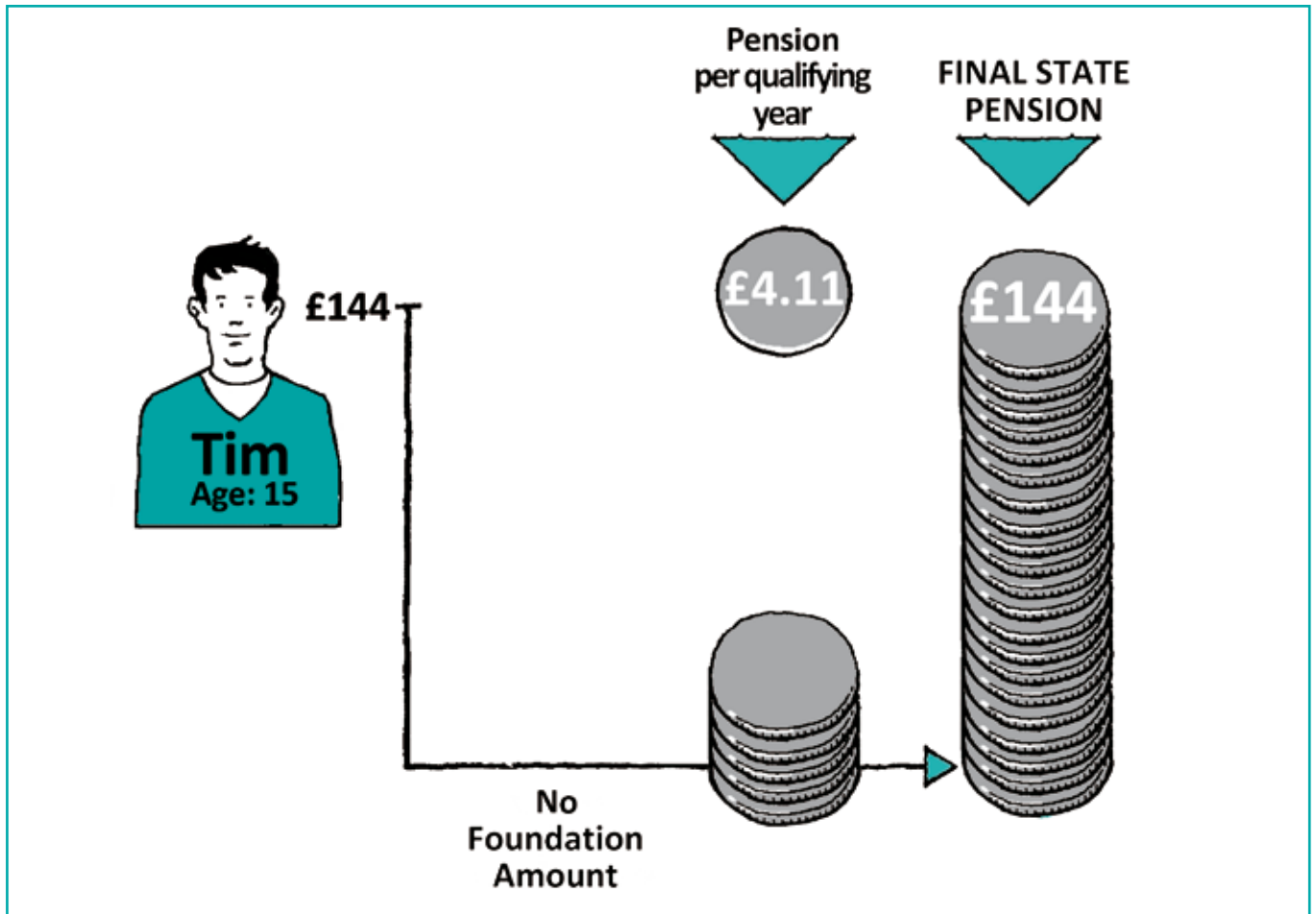
- Jenny worked as a receptionist for 32 years, and has also spent a number of years working in part-time jobs.
- Her National Insurance record as at implementation is valued under the single-tier rules, which take into account her qualifying years. As she has not been contracted out, no deduction is applied.
- A check is performed to see if Jenny would get a higher valuation under the rules of the current system.
- In Jenny's case, the current system valuation is higher, and therefore becomes her foundation amount.
- As this amount is more than the full level of the single-tier pension, Jenny will not be able to get extra pension by adding post-implementation qualifying years.
- When she reaches State Pension age, she will get the full single-tier amount of £144, plus her 'protected payment' amount of £3 a week.

Section 4: People who have no pre-implementation National Insurance record

98. At the implementation of the single-tier pension, some people will not yet have started to build up a National Insurance record and will only start to do so after implementation. The simpler and easier to understand single-tier system will give them long term clarity of outcome. They will receive the flat rate single-tier payment as a foundation on which to save, and will be further encouraged and supported to save into a workplace pension scheme through automatic enrolment and the policy measures set out in the Government's *Reinvigorating Workplace Pensions*⁵⁸ document throughout all of their working lives.

⁵⁸ Department for Work and Pensions, 2012, *Reinvigorating workplace pensions*, Cm 8478, TSO.

Case Study 4.4 People who have no pre-implementation National Insurance record



Tim is still in school when the single-tier pension is implemented, and so does not have a National Insurance record yet. For every qualifying year he gets he will add £4.11 per week to his single-tier pension, up to the full £144.

- As he does not have a National Insurance record prior to the implementation of single tier, Tim does not have a foundation amount.
- Instead, he simply adds pension at the rate of £4.11 for every qualifying year he gains. If he gains 35 qualifying years, he will receive £144 per week when he reaches his State Pension age.
- This puts him in a good position to understand how much he needs to be saving in his workplace pension scheme from the start of his working life.
- When Tim reaches the age of 22 he will be automatically enrolled into his workplace pension scheme, making it easier for him to save for his retirement.

Up-rating the single-tier pension

99. The simplified illustrations leave the full level of the single-tier pension at £144 at implementation and at State Pension age. However, as the single-tier pension will be up-rated each year, at least in line with the growth in average earnings, the value of the pension will increase over time. Further information can be found in Chapter 5.

Up-rating the protected payment

100. In the current system, each individual's additional State Pension is revalued up to their State Pension age in line with average earnings. It is then up-rated in line with the increase in prices (CPI) when in payment. The protected payment – the difference between an individual's foundation amount and the full level of the single-tier pension – will be both revalued and up-rated in line with prices.

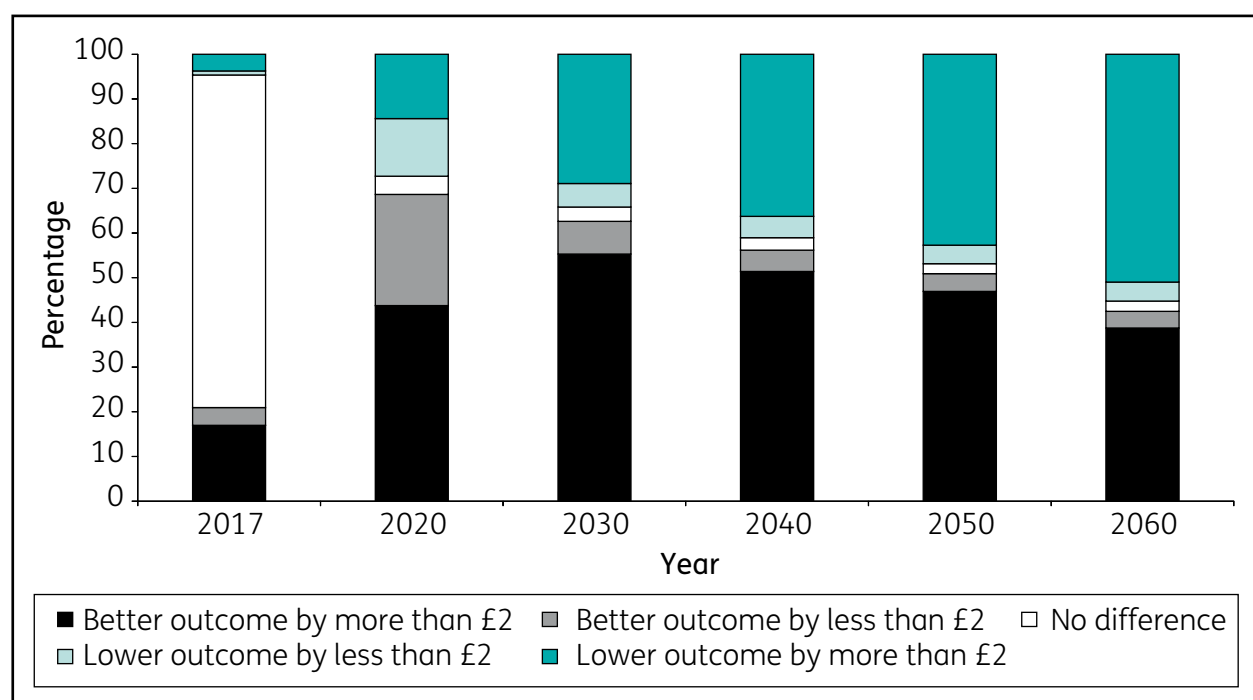
Greater clarity, better outcomes

101. The Government's revised approach to transition has many advantages over the approach put forward in the Green Paper:
- transition is accelerated, meaning that by the mid-2030s over 80 per cent of people reaching their State Pension age will receive the full single-tier pension;
 - approximately 750,000 women reaching State Pension age in the first ten years after implementation, will receive an average of £9 per week extra state pension;
 - people can have clarity from day one about how much single-tier pension they are already eligible for; and
 - everyone's National Insurance record will keep its value at the point the single-tier pension is implemented.
102. In addition, valuing qualifying years to the point that the single-tier pension is implemented means that all the complexity linked to people's pre-implementation National Insurance records is removed. All the elements of an individual's contribution history will be consolidated into a single amount – the foundation amount – which will be the starting point for the much simpler single-tier system.

Impact of single-tier reforms

103. The single-tier reforms have been designed to cost no more than the current system overall. As such, they result in some future pensioners receiving slightly more income in retirement than if the existing system continued and others receiving slightly less. However, subject to the satisfaction of the minimum qualifying period, future pensioners will not receive a state pension amount lower than the valuation of their National Insurance record as at implementation under existing system rules.
104. Departmental modelling allows a comparison of projected incomes for future pensioners under the single-tier system and the current state pension system rolled forward. This is illustrated in Chart 4.3.

Chart 4.3: Proportion of pensioners reaching State Pension age after implementation with notionally higher or lower incomes compared to the current system⁵⁹



105. When the Government implements the single-tier pension, planned for 2017 at the earliest, the vast majority of people will either see no change in outcome compared to what they would have received had the current system continued, or they will have a better outcome under single tier. At least half of all people reaching State Pension age before 2050 are likely to have a better outcome under single tier, compared to if the current system were to continue, of whom the majority will be better off by at least £2 per week.
106. In the very long term, the influence of the legacy pension system declines: those who would have gained high levels of additional State Pension if the current system was rolled forward will, in future, only be able to receive the maximum single-tier payment as a foundation for workplace or private pension saving. By contrast, those who would have had low State Second Pension outcomes (mainly pensioners in the lower income quintiles) are more likely to see improved incomes under the reforms.
107. As described above, the single-tier pension forms part of a broader package of pension reforms, designed to respond to an ageing society and a marked decline in the number of people who are saving for their retirement. Single-tier cohorts will have the opportunity to enhance their incomes by the introduction of automatic enrolment. Once contributions have been fully phased in, this will provide a boost to Government support already available to encourage private pension saving. Automatic enrolment is anticipated to lead to around £11 billion in additional pension savings each year.⁶⁰

⁵⁹ Source: Departmental modelling using Pensim2. These figures exclude the impact of the minimum qualifying period, deferrals policy and the impacts on overseas pensioners, as these factors cannot be estimated within Pensim2. The years shown in Chart 4.3 refer to all pensioners that reached State Pension age after the implementation of single-tier reforms. Thus, 2020 shows those people who reached State Pension age from 2017 to 2020.

⁶⁰ Department for Work and Pensions, 2012, *Workplace Pension Reform: digest of key Analysis*, Department for Work and Pensions.

108. The key elements of the single-tier reforms that could influence projected outcomes for future pensioners, compared to a rolling forward of the existing system, are as follows:
- **the single-tier pension will be set above the basic level of means-tested support** (the Pension Credit Standard Minimum Guarantee, currently £142.70 per week) compared with a basic State Pension of £107.45 per week – this will mean that the value of each qualifying year under the single-tier pension will be worth more for people who have little or no additional State Pension, like the self-employed;
 - **facility to gain qualifying years after implementation** – individuals who have not managed to achieve the full single-tier rate at implementation can continue to gain qualifying years towards the full amount of the single-tier pension until they reach State Pension age. This particularly benefits those who have been contracted out in the past;
 - **the single-tier pension will be uprated at least by earnings** – this ensures the State Pension holds its value over time in relation to earnings and the means test. For illustrative purposes this document has assumed that the single-tier pension would be uprated by the triple lock;
 - **closure of the State Second Pension** – this means that the amount of state pension that an individual can get will be limited to the full amount of single tier (with a protected payment to recognise pre-implementation qualifying years);
 - **changes to means-tested benefits** – the Savings Credit element of Pension Credit will be removed for those reaching State Pension age after the single-tier reforms are implemented, affecting those who would have been eligible;
 - **inheritance and derived rights** – under the current system it is possible for an individual to boost their own basic State Pension entitlement based on the National Insurance record of their spouse or civil partner and to become entitled to inherited or shared additional State Pension. Under the single-tier reforms there will not be a facility to inherit, share or derive a pension (although transitional provisions will apply, as described in Annex 3);
 - **a minimum qualifying period of between seven and ten years** to be eligible for the single-tier pension – this is most likely to affect those who have spent significant periods of their working lives outside the UK, the European Economic Area and states with which the UK has bilateral agreements for reciprocity in social security matters. Modelling in this document assumes a ten-year minimum qualifying period.

Communicating how the implementation of single tier will affect people

109. The Government recognises the importance of communicating in a clear and simple way how the implementation of single tier will affect people. Even where people are not eligible for the full single-tier pension amount straightaway, they will be able to request a State Pension statement. This will give them both a clear picture of what their state pension would be, based on their National Insurance contribution record to that point in time, and also information explaining how further qualifying years could affect this position. Text Box 4.1 provides further detail on the State Pension statement.

Text Box 4.1: Helping people to understand what the single-tier pension means for them – the State Pension statement

In October 2012 a new simpler State Pension statement replaced State Pension forecasts. The State Pension statement gives straightforward, relevant information about an individual's current State Pension position.

After the implementation of the single-tier reforms, people will be able to get personalised information about their own position, including:

- an up-to-date estimate of the future single-tier state pension they could get. This will be based on their National Insurance record as it stands at the time of the request;
- clear information explaining how further qualifying years will affect this estimate;
- if appropriate, the number of further qualifying years the individual still needs to get the full single-tier pension amount;
- the earliest date they can receive their single-tier state pension; and
- clear signposts to where more detailed information can be found.

An example State Pension statement, based on Case Study 4.2 above, can be found in Annex 4.

Sustainability and assumptions

5

Over the next 50 years, age-related public expenditure is projected to increase significantly. To ensure that the State is able to provide a secure retirement income for future pensioners, without placing an unsustainable burden on future taxpayers, any options for pension reform have been designed to cost no more than the current system overall.

The single-tier start level and uprating policy will be set shortly before implementation, taking account of the cost implications and the fiscal context at the time. Further decisions on uprating will then be made on a yearly basis, as part of the annual uprating process. This document has used assumptions about these elements of single-tier design for illustrative purposes, to demonstrate how the single-tier pension will work.

This chapter discusses the implications of variations in starting level and uprating assumptions on total expenditure, and considers how Government uprating policy has varied over time.

110. Over the next few decades age-related public expenditure is projected to increase significantly. Even allowing for decisions already taken to increase State Pension age, expenditure on the state pension and pensioner benefits is expected to rise from 6.9 per cent of GDP in 2012/13 to 8.5 per cent in 2060/61⁶¹, equivalent to an extra £300 billion in 2012/13 prices.
111. In a pay as you go state system, funding liabilities are passed from generation to generation: the National Insurance contributions of the working population provide for today's state pensions for their parents' and grandparents' generations. Any increasing cost in the state pension system will be borne by the working-age population at the time or by future generations through increased government debt.

⁶¹ These figures are based on DWP projections. These differ from projections in the OBR *Fiscal Sustainability Report 2012* because they cover Great Britain only and use different uprating assumptions for some pensioner benefits (e.g. disability benefits). The DWP projections have also been updated to reflect the OBR's Autumn 2012 medium term economic forecasts.

112. The Pensions Commission report of 2005 described reform of the state pension system as an ‘unavoidable long-term trade-off’ between increases in public expenditure on pensions and rises in State Pension age.⁶² Changes to State Pension age, a key lever in maintaining the system’s long-term sustainability, are described in detail in the next chapter. But to avoid creating additional expenditure to be absorbed, beyond that created by longevity improvements, the single-tier pension has been designed to cost no more than the current system overall. National Insurance revenue is not factored into forecast expenditure.
113. It is important to note that all of the projections in this chapter are sensitive to a range of underlying assumptions, for example, the economic outlook, and become increasingly uncertain when projected as far forward as 2060. In light of this uncertainty, two further levers for controlling state pension expenditure, the starting level and future uprating policy of the single-tier pension, will not be finalised until shortly before implementation, taking into account the wider economic factors that are relevant at the time.

Starting level

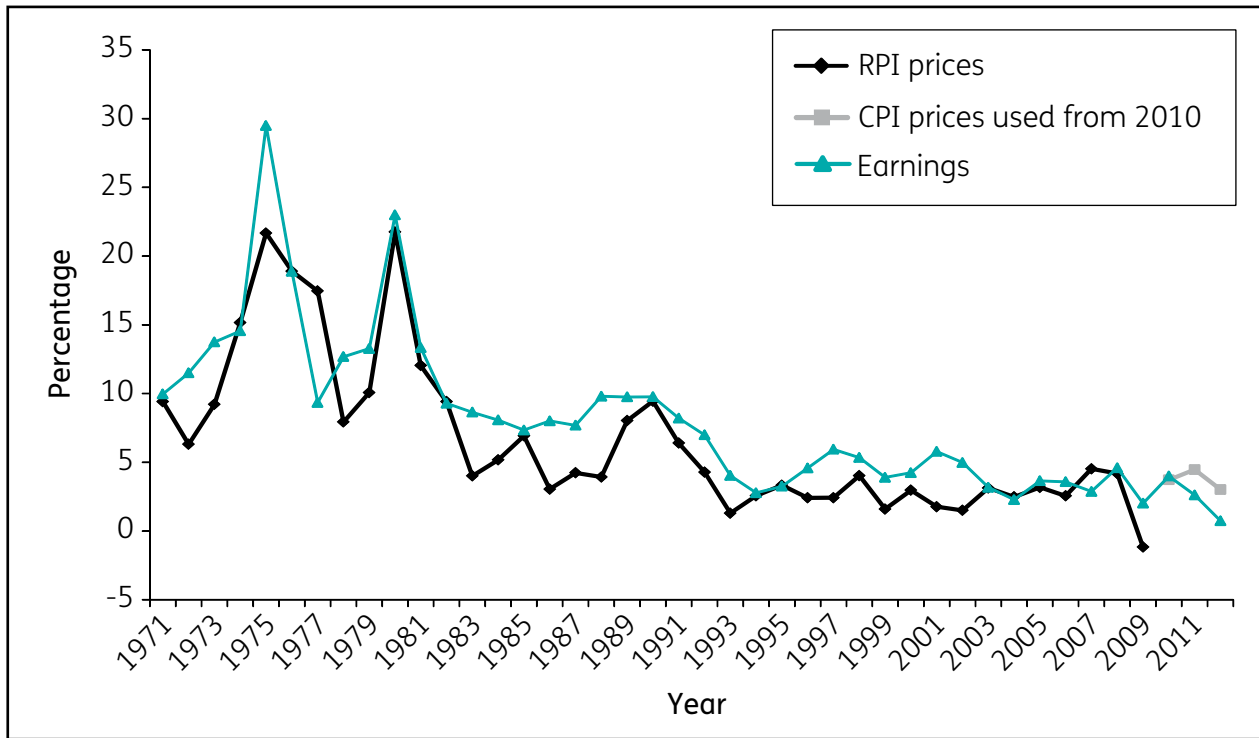
114. A key principle of single-tier design is that the weekly pension will be set above the basic level of means-tested support, the Pension Credit Standard Minimum Guarantee (£142.70 in 2012/13). For purely illustrative purposes, this document has used a starting level of £144 per week. However, depending on fiscal conditions around implementation, the final level of the single-tier pension at implementation could be closer to, though not below, the level of the Standard Minimum Guarantee.

Uprating

115. Uprating is the process by which benefits and pensions are reviewed against inflation. The method of uprating is not standardised, with different legislative requirements for different benefits, depending on the policy intent. This means that the uprating of certain benefits is linked to price inflation, while others have regard to increases in average earnings. For some benefits, the Secretary of State must uprate each year by at least the increase in prices or earnings, whereas for others, the Secretary of State has an element of discretion, taking into account the level of prices, the national economic situation, and other factors.
116. Broadly speaking, uprating pensions by earnings means that pensioners’ standard of living keeps pace with that of the working population. Uprating by prices means that the purchasing power of pensions is maintained. Whether pensioners benefit more from one or other uprating mechanism is therefore dependent on wider economic circumstances. However, historically, earnings growth has tended to be greater than the increase in prices, as Chart 5.1 shows.

⁶² The Pensions Commission, 2005, *A New Pension Settlement for the Twenty-First Century*, TSO.

Chart 5.1: Historical growth in prices and earnings⁶³



117. As the state pension system has evolved from the Beveridge flat-rate model into a two-component model (flat-rate plus earnings-related), a wide range of policy and economic factors have determined successive governments’ approaches to uprating the basic State Pension. The key challenge throughout has been to balance the need to provide stability of income for pensioners with the necessity of ensuring that state pension expenditure remains sustainable.

Pension uprating: a historical perspective

Summary of previous uprating decisions for the basic State Pension

1948 – 1974	Discretionary <i>ad hoc</i> increases in basic State Pension – increased four times in the period 1948 to 1959; generally every two years in the 1960s and annually from 1970 onwards.
Mid-1970s	Legislation introduced requiring annual uprating by the higher of growth in prices or growth in average earnings.
1980	Legal requirement for annual uprating restricted to minimum of prices only – at that time the only published measure of price inflation was the Retail Price Index.
2001	Introduction of a discretionary policy of uprating by a minimum of 2.5 per cent.
2010	Legislation to uprate annually by a minimum of earnings commenced. Benchmark for price inflation switched from Retail Price Index to Consumer Price Index. Government introduced discretionary policy of increasing basic State Pension by the triple lock (highest of growth in prices, average earnings or 2.5 per cent).

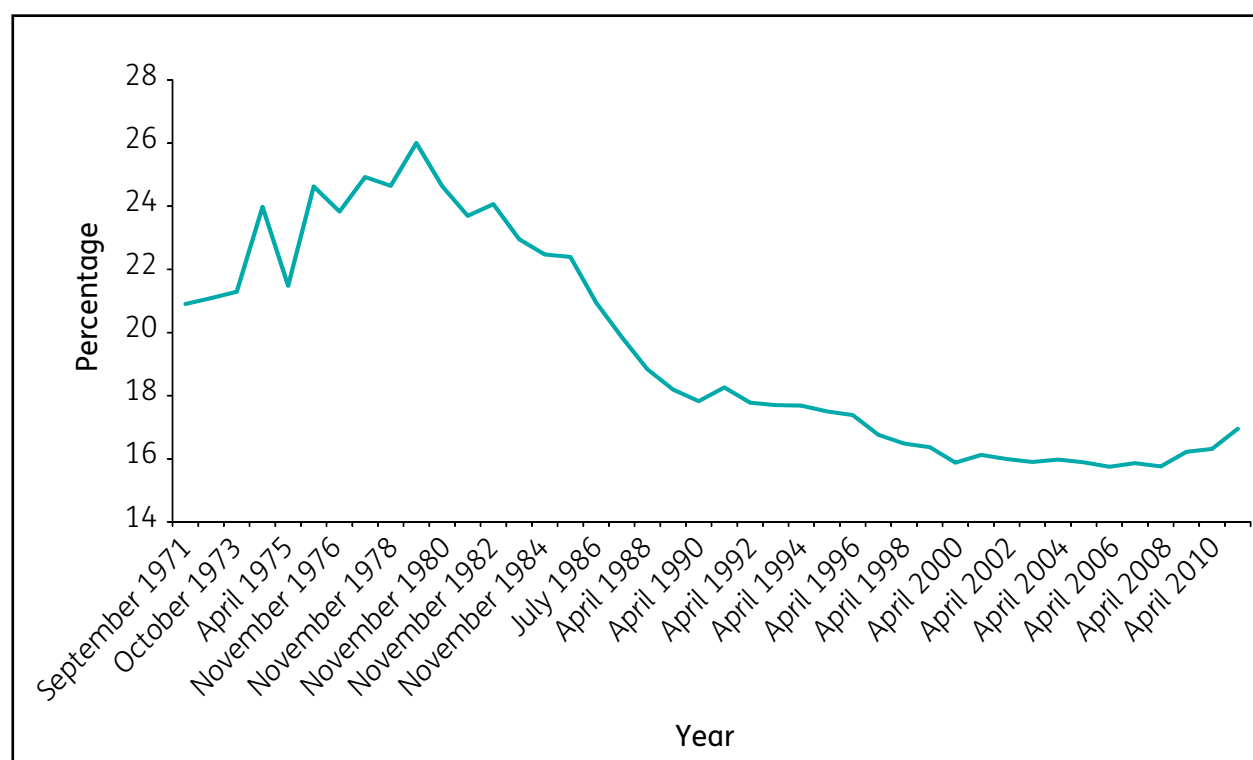
⁶³ Department for Work and Pensions, 2012, *The Annual Abstract of Statistics for Benefits, National Insurance Contributions, and Indices of Prices and Earnings 2011 Edition*, Department for Work and Pensions.

118. Up-rating policy for the additional State Pension has been less varied, having maintained its link to prices once a person starts to draw it at State Pension age.

Reintroducing an earnings link

119. As the Pensions Commission pointed out in 2005, the value of the State Pension reduced significantly in relation to earnings after the late 1970s.⁶⁴ At its peak in November 1979, the basic State Pension was equivalent to 26 per cent of average earnings (in April 2012 earnings terms that would have been equivalent to £157.85 per week, whereas the actual full rate of basic State Pension is £107.45). This devaluation of the basic State Pension has created a greater reliance on means-tested benefits within the state pension system, with around 40 per cent of current pensioners now eligible for Pension Credit.

Chart 5.2: Basic State Pension as a percentage of average earnings⁶⁵



120. The Pensions Commission recommended the earnings link be restored to the basic State Pension and the Coalition Government commenced legislation for this in 2010.

Impact of different uprating assumptions

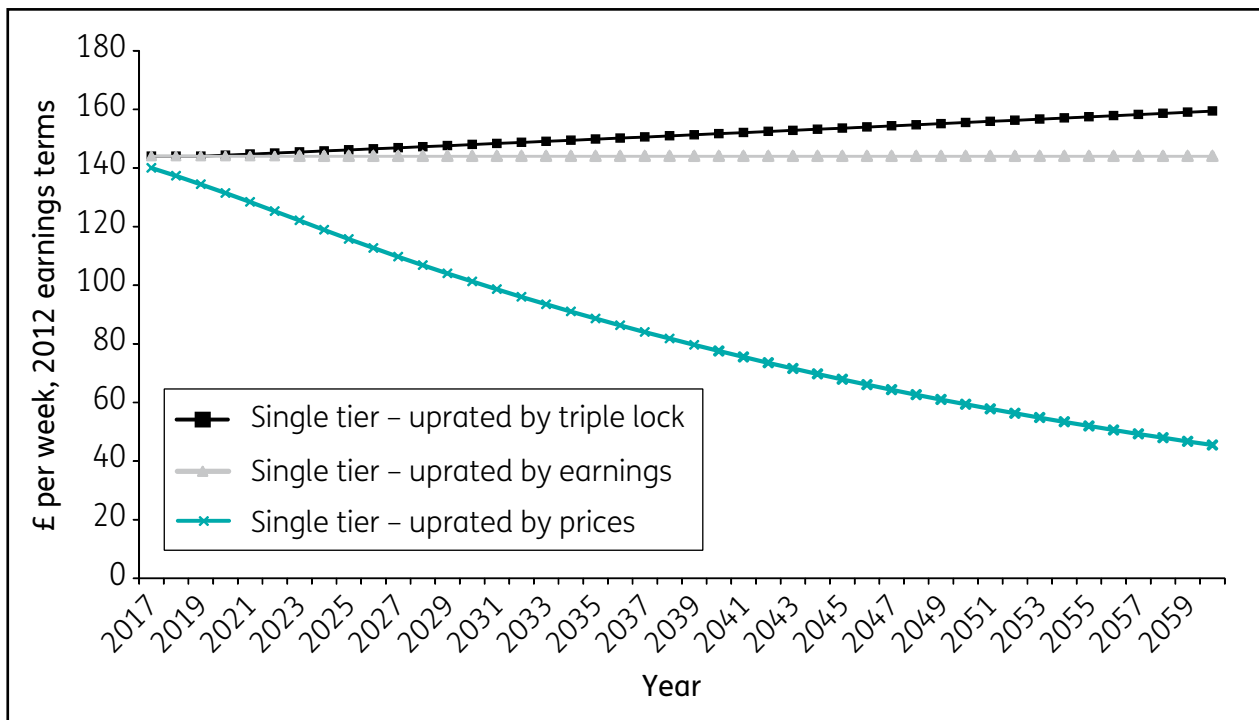
121. The illustrative costs set out in Chapter 2 for single-tier expenditure are based on an assumption that the Government's policy of a triple lock on uprating is extended to the single-tier pension and continues undisturbed until 2060. This assumption is also used by the Office for Budget Responsibility (OBR) to uprate basic State Pension costs in its long-term projections.

⁶⁴ The Pensions Commission, 2005, *A New Pension Settlement for the Twenty-First Century*, TSO.

⁶⁵ Data from September 1971 to April 2011 is taken from DWP abstracts of statistics (<http://research.dwp.gov.uk/asd/index.php?page=abstract>, table 2.1). For April 2012 the index is derived using the current (2012/13) basic State Pension rate (£107.45) and the Annual Survey of Hours and Earnings provisional weekly earnings figures in 2012 (£607.10).

- 122. While the triple lock insulates pensioners from periods where inflation is relatively high, compounding adds significantly to costs. The OBR’s methodology for estimating longer-term costs of uprating by the triple lock applies a 0.26 percentage point premium to the annual uprating of the basic State Pension, over and above projected growth in earnings. This reflects the likelihood of earnings growth either being surpassed by growth in prices or being below 2.5 per cent at some points during the period in question. The further into the future that the costs are modelled the more uncertain they become.
- 123. Earnings uprating would reduce these costs and ensure the value of pensioner benefits keeps pace with increases in wages, but could lead to falls in real incomes when prices rise faster than earnings. Such periods tend to be short-lived and the expectation is that they would be reversed when real wages rose again.
- 124. Chart 5.3 illustrates the impact of different uprating assumptions (triple lock, earnings and prices) on the value of the single-tier pension in earnings terms.

Chart 5.3: The future value of a £144 single-tier pension under different uprating mechanisms, 2012 earnings terms⁶⁶



⁶⁶ Notes: Projections of earnings and prices from Office for Budget Responsibility, 2012, *Fiscal sustainability report 2012*, TSO; triple lock assumption is earnings plus 0.26 percentage points from 2017.

Impact on overall expenditure

125. Projections suggest that uprating by the triple lock will not generate net costs compared to the current system overall, though this is highly dependent on projections of earnings growth and prices.⁶⁷ Changing from an assumption of uprating by the triple lock to uprating by earnings does not have a significant impact on costs in the short term. However, earnings uprating would further slow down the increase in pensioner expenditure (by 0.1 per cent of GDP in 2040), compared to uprating by the triple lock for a starting level of £144 per week. Similarly, uprating the single-tier pension by earnings could enable a slightly higher start value, whilst still meeting the Government's fiscal parameters for reform.

Chart 5.4: Pensioner benefit expenditure as a proportion of GDP for £144 single-tier pension under different uprating mechanisms⁶⁸

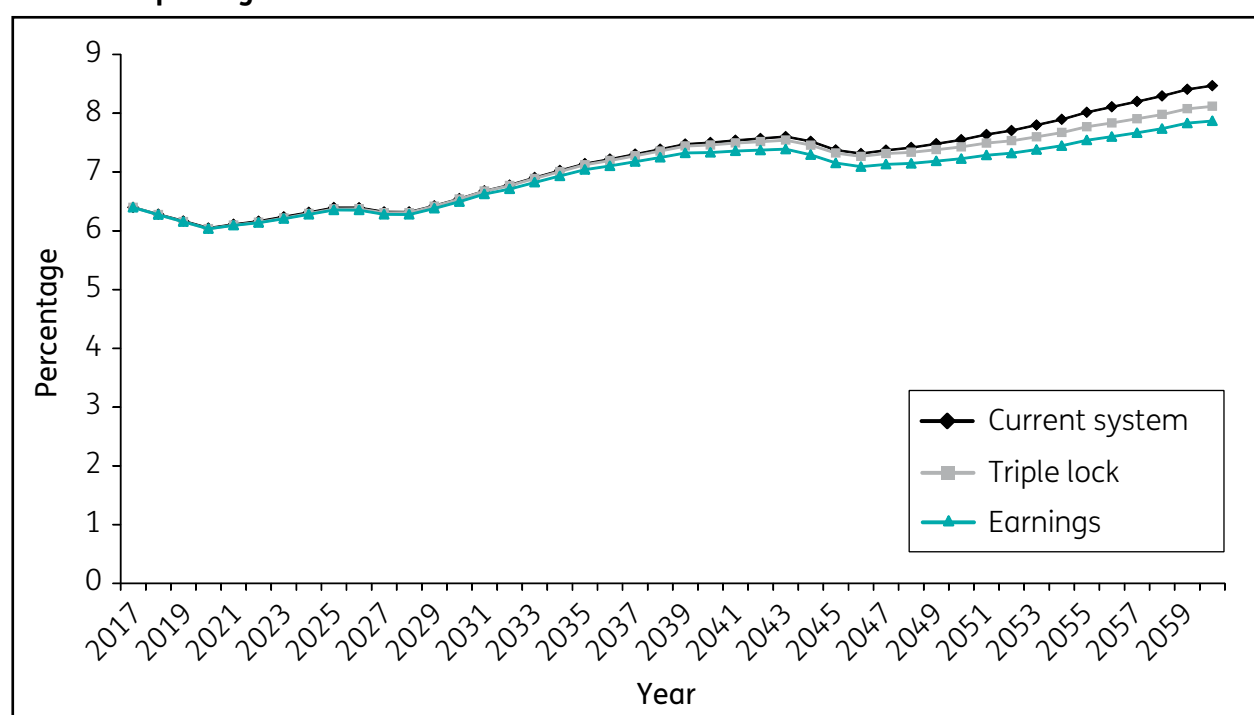


Table 5.1: Pensioner benefit expenditure as a proportion of GDP for the single-tier pension under different uprating mechanisms

Uprating	State Pension expenditure as a proportion of GDP (per cent)					
	2017	2020	2030	2040	2050	2060
Single tier with triple lock	6.4	6.0	6.5	7.5	7.4	8.1
Single tier uprated by earnings	6.4	6.0	6.5	7.3	7.2	7.9
Current system with triple lock	6.4	6.0	6.5	7.5	7.5	8.5

⁶⁷ This analysis compares single-tier expenditure against the current system, and assumes that the basic State Pension will continue to be uprated by the triple lock.

⁶⁸ Source: Departmental modelling using Pensim2. This excludes National Insurance contributions and includes the minimum qualifying period and deferrals policy. It has been calibrated; this constrains the expenditure figures estimated in Pensim2 to the Department's medium and long-term forecasts for expenditure on pensioner benefits in order to ensure consistency between the two estimates.

Longer-term sustainability: State Pension age

6

When it came to office, the Government took immediate action to increase the State Pension age to 66 by 2020 to ensure that the costs of the state pension system remain manageable in the light of rising life expectancy. However, longevity increases will not stop in 2020. This is why the Government has announced that State Pension age will increase to 67 between 2026 and 2028.

As life expectancy continues to increase, the Government believes there is a need for a more structured framework within which to consider changes to State Pension age in the future. Therefore:

- the Government will carry out a review of the State Pension age every five years, with the first review taking place in the next Parliament;
- these reviews will be based around the principle of maintaining a given proportion of adult life in receipt of state pension;
- the review will be informed by:
 - a. analysis from the Government Actuary's Department on the proportion of adult life individuals in the future can expect to spend in receipt of state pension;
 - b. an independently-led body, commissioned to produce a report on the wider factors that should be taken into account when setting State Pension age, such as variations in life expectancy.
- this review framework will seek to provide a minimum of ten years' notice for individuals affected by changes to State Pension age.

A more structured framework will help to ensure the costs of increasing longevity are shared fairly between the generations, and provide greater clarity around how State Pension age will change in future.

126. The Pensions Commission's report of 2005 described increases in State Pension age as "essential to keep the increase in public expenditure within limits which are fair between generations and sustainable over the long term".⁶⁹ It recommended that the State Pension age should be increased in line with future rises in life expectancy.

⁶⁹ The Pensions Commission, 2005, *A New Pension Settlement for the Twenty-First Century*, TSO.

127. As a result of the broad agreement that State Pension age should rise to reflect increases in life expectancy, the 2007 Pensions Act increased the age at which an individual could receive their state pension, with it eventually set to reach 68 by 2046. However, subsequent projections revised life expectancy upwards to such an extent that the timetable set by the 2007 Pensions Act no longer reflected forecast increases in longevity. Therefore, the Government accelerated the timetable with the 2011 Pensions Act, meaning that equalisation in State Pension age between men and women will now be achieved in November 2018, and that the rise to 66 will now be complete in October 2020.

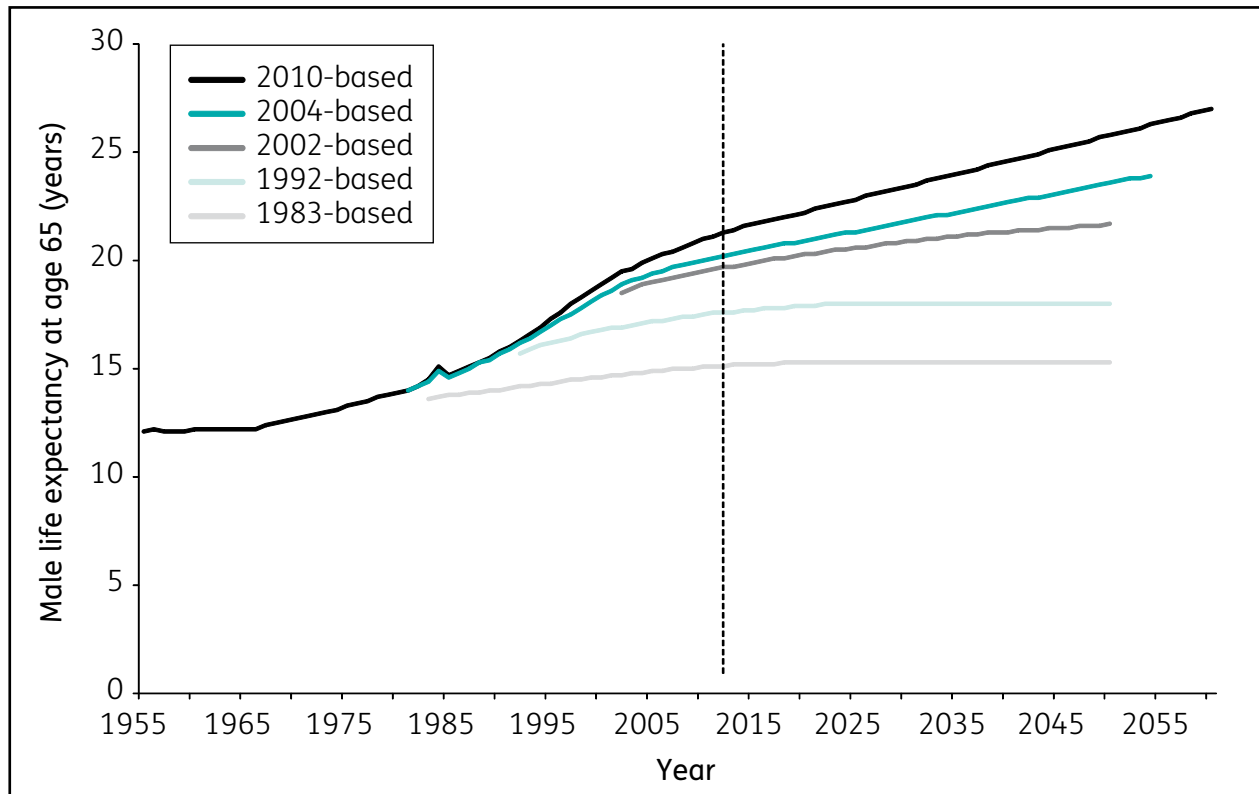
Increasing life expectancy

128. Data show that life expectancy at birth for men and women is at a record high and that increases in life expectancy are projected to continue into the future. When the first contributory state pension was introduced in 1926, even if infant and childhood mortality is excluded, only around half of men born in 1861 survived to the age of 65. A man who did reach 65 in 1926 could, on average, expect to spend 11.3 years in receipt of the state pension. In contrast, 93 per cent of men born in 2013 who survive past the age of 15 are projected to live to at least 65; with 32 per cent of men born in 2013 projected to live to at least 100. A man reaching the State Pension age of 65 today could expect to spend a decade longer in receipt of state pension than a man in 1926; an average of 21.4 years.⁷⁰
129. The rate at which life expectancy is increasing has also accelerated. It took 70 years, between 1920 and 1990, for life expectancy for both men and women at 65 to increase by around five years. The next five year increase took just 20 years, between 1990 and 2010.⁷¹ This increase in life expectancy is projected to continue, and each set of life expectancy projections has shown a greater increase than its predecessor (see Chart 6.1). Since the original timetable to increase State Pension age was agreed in 2007,⁷² according to the most recent forecasts, a man reaching State Pension age in 2013 can expect to spend more than an extra year in retirement.

⁷⁰ DWP analysis of various ONS cohort life expectancy tables. Figures for 1861 refer to England and Wales, those for 2013 to the UK, as data for the UK is not available for the 1800s. Unless otherwise stated, life expectancy figures refer to the mean cohort life expectancy for the UK, from the ONS principal projection. Throughout this chapter, the phrase 'in receipt of state pension' is used to refer to the period of life spent above the State Pension age, as the majority of people do not choose to defer payment of their state pension.

⁷¹ Data is for England and Wales only, as data for UK is not available for the 1920s.

⁷² The latest life expectancy data at that time was the Government Actuary's Department, Period and cohort expectation of life tables (2004-based).

Chart 6.1: Projected cohort life expectancy for men aged 65, 1955-2060⁷³

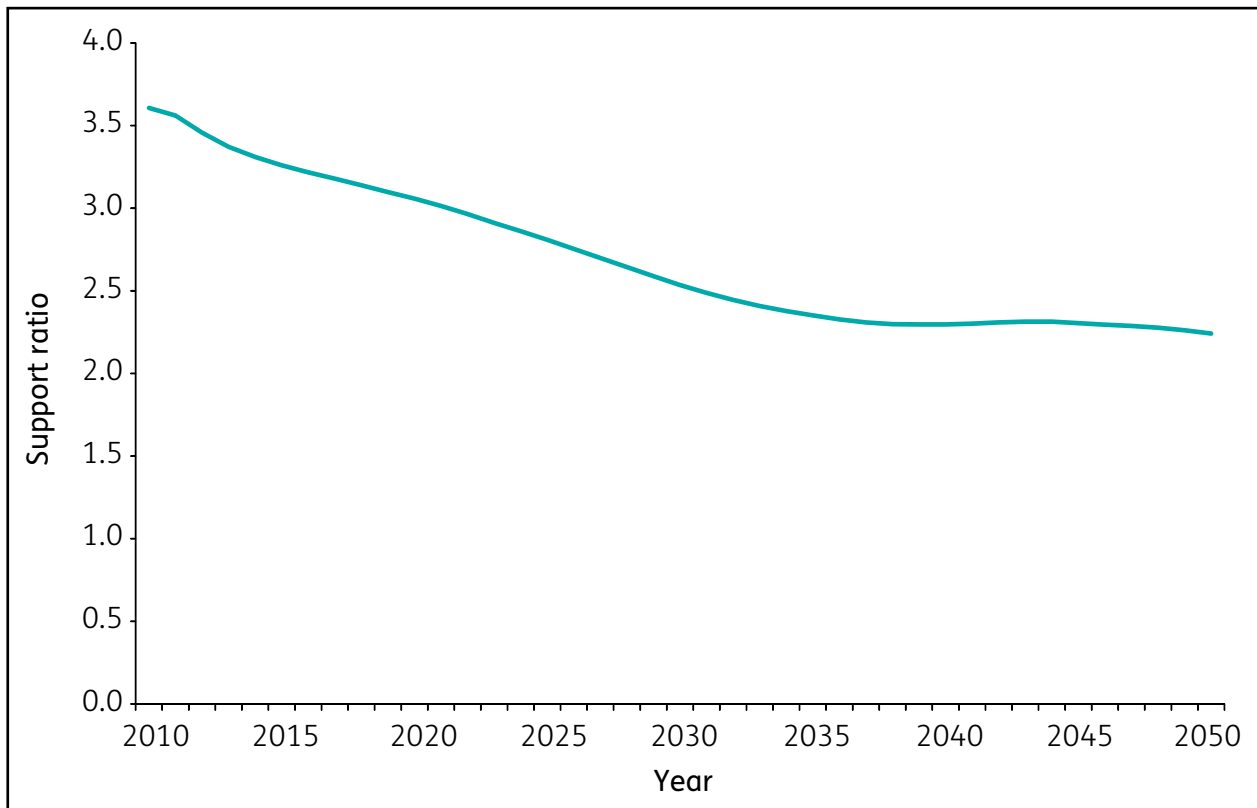
Demographic consequences

130. Even when the currently legislated changes to State Pension age are taken into account, the number of people in the UK over State Pension age is set to increase from 12.4 million in 2013 to 15.6 million by 2035 – a rise of 26 per cent. Over the same period, the size of the working age population is projected to grow by only 13 per cent (an increase from 39.5 million to 44.7 million). This increase in people above State Pension age partly reflects the higher number of people born as part of the ‘baby boom’ in the twenty years following the Second World War. However, data indicates that this trend will continue and that the number of people over State Pension age will have exceeded 18 million by 2060.
131. We can also expect to see large increases in the number of people reaching later old age. The number of people aged 90 and above is projected to almost triple by 2035 and, during the same period, the number of centenarians is projected to rise from 16,000 to 110,000; almost a sevenfold increase.⁷⁴
132. This trend will result in a declining support ratio – proportionately fewer people of working age supporting a growing pensioner population. Currently there are 3.4 people aged 20-64 for every person aged 65 and above. This will have fallen to 2.2 people in 2050 (see Chart 6.2).

⁷³ Office for National Statistics, Period and cohort expectation of life tables (various releases) and Government Actuary's Department, Period and cohort expectation of life tables (various releases).

⁷⁴ Office for National Statistics, 2011, *National Population Projections*, 2010-based projections, ONS.

Chart 6.2: Support ratio projections: 2010-2050 (population aged 20-64 vs population aged 65 and over)⁷⁵

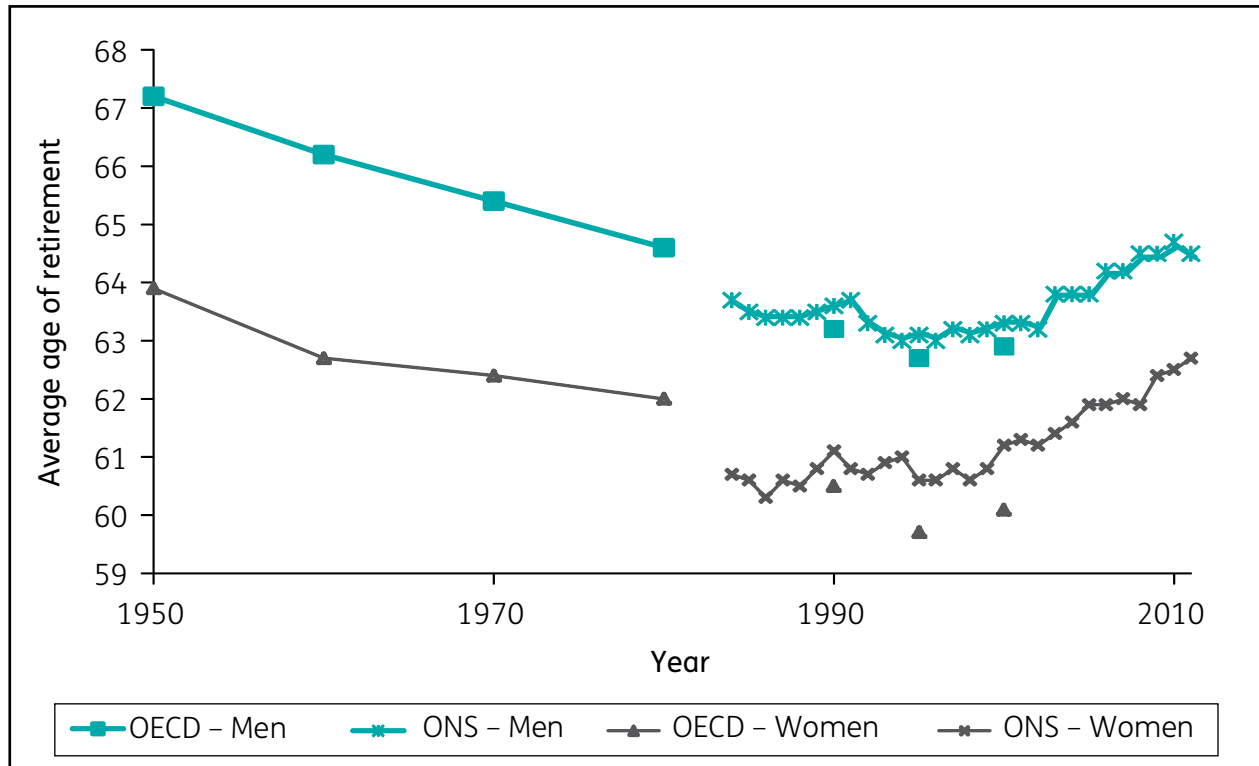


133. Despite increases in both life expectancy and healthy life expectancy, the age at which we retire has not shown the same rate of increase.⁷⁶ As Chart 6.3 shows, the average age at which men and women retired actually dropped from 1950 until the late 1980s. Between then and 2010 it began to increase again, rising by around two years, however, during that period there was a five year increase in life expectancy.
134. Since the 1990s the number of people above State Pension age in some form of work has been increasing: it almost doubled from 753,000 in 1993 to 1.4 million in 2011, with the employment rate for this group reaching 12 per cent.⁷⁷

⁷⁵ Office for National Statistics, 2011, *National Population Projections*, 2010-based projections, ONS.

⁷⁶ The Pensions Commission, 2004, *Pensions: Challenges and Choices The First Report of the Pensions Commission*, TSO.

⁷⁷ Office for National Statistics, 2012, *Older Workers in the Labour Market*, ONS.

Chart 6.3: Average age of retirement: 1950 to 2010⁷⁸

135. Evidence shows that enabling people to work longer has both economic and social benefits. The National Institute of Economic and Social Research has estimated that extending working life by one year would increase GDP by around one per cent.⁷⁹ Working longer also helps individuals to boost their income in retirement. Working two years beyond State Pension age and continuing to make private pension contributions could boost private pension income for an average earner by one fifth.⁸⁰
136. In addition, research shows that around 60 per cent of over 50s would like to continue working after they reach State Pension age, many on a part-time basis.⁸¹
137. To ensure that individuals who wish to continue to work beyond State Pension age are able to do so, the Government has removed the Default Retirement Age, which means that most people can now retire when the time is right for them. Through the Sector Initiative, the Department for Work and Pensions has been working in partnership with employer-lead organisations across nine of the largest sectors to help employers manage this change.
138. The Government's Age Positive Initiative provides guidance and case studies to employers and business organisations on employing older workers and the business benefits of adopting flexible approaches to work and retirement.

⁷⁸ Office for National Statistics, 2012, *Pension Trends Chapter 4: The labour market and retirement*, ONS; and Organisation for Economic Co-operation and Development, 1999, *The retirement decision in OECD countries*, OECD. All figures are for the UK. Note: OECD is the Organisation for Economic Co-operation and Development. ONS is the Office for National Statistics.

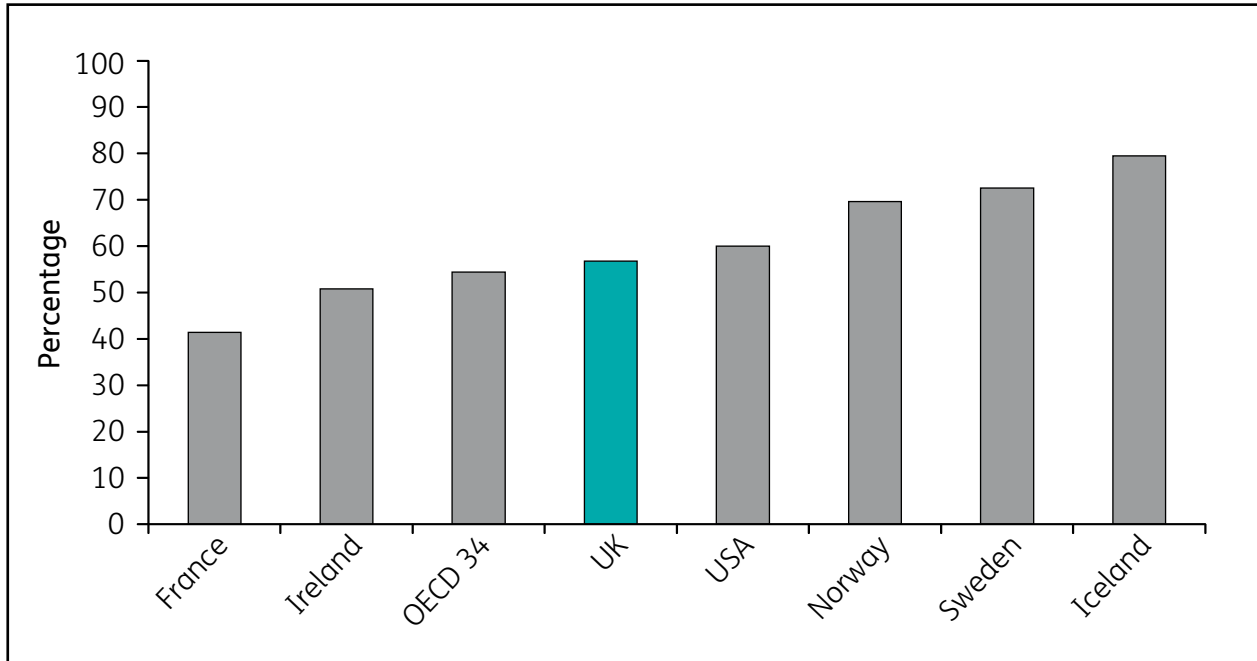
⁷⁹ Barrell R, Kirby S and Orazgani A, 2011, *The macroeconomic impact from extending working lives*, DWP.

⁸⁰ The Pensions Policy Institute, 2012, *Closing the gap: the choices and factors that can affect private pension income in retirement*, PPI.

⁸¹ The Equality and Human Rights Commission, 2010, *Working Better: The over 50s, the new work generation*, EHRC.

139. While the UK has a higher employment rate for older workers than the Organisation for Economic Co-operation and Development (OECD) average (see Chart 6.4), it is lower than countries such as Sweden and Norway, even though life expectancy at age 65 in those two countries is similar to the UK's.⁸²

Chart 6.4: Percentage employment rate of 55-64 year olds, 2011⁸³



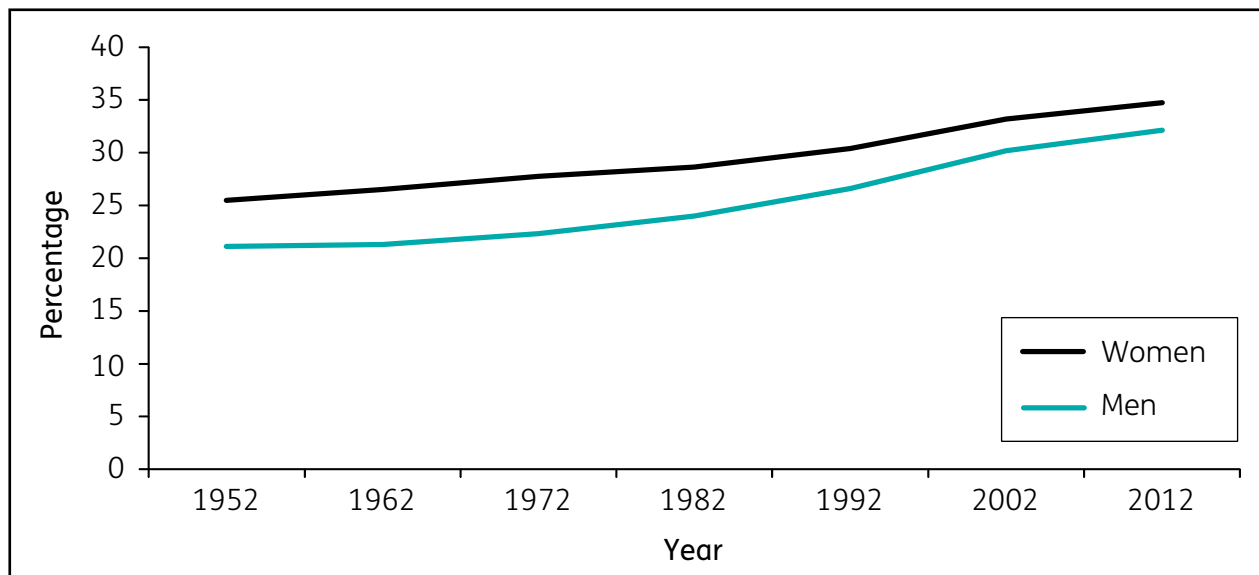
⁸² Organisation for Economic Co-operation and Development, 2012, *Health: Key Tables: Life expectancy at age 65, males and females*, OECD.

⁸³ Organisation for Economic Co-operation and Development, 2012, *Employment and Labour Market Statistics: Employment rate of older workers*, OECD.

Proportion of adult life spent over the age of 65

140. Women's State Pension age will have risen to equalise with men's at 65 by November 2018. The proportion of adult life spent over the age of 65 has increased substantially over the past few decades, as shown in Chart 6.5.

Chart 6.5: Years spent over the age of 65 as a proportion of adult life: 1952-2012⁸⁴



The need to bring forward the increase in State Pension age to 66 and 67

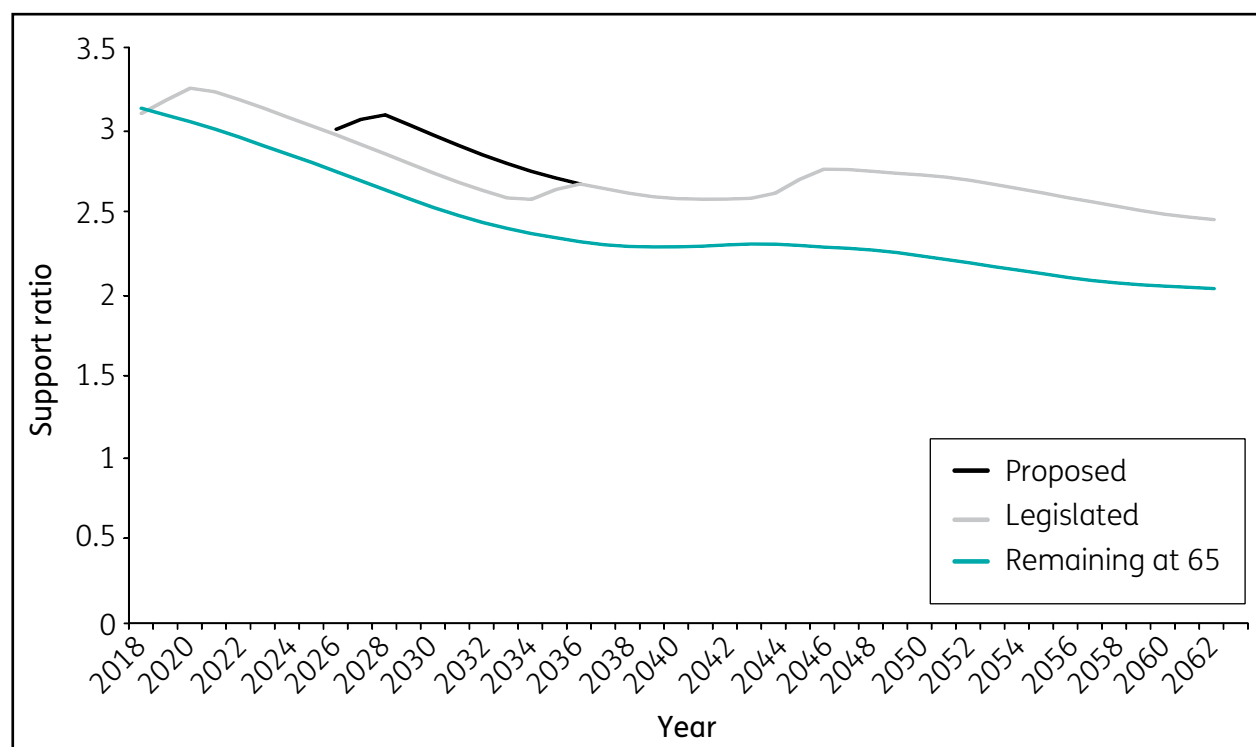
141. As a consequence of the trends outlined above, the Government took immediate action to bring forward to 2020 the increase in the State Pension age to 66. This will put the state pension system on a more sustainable footing.
142. The Government has also announced that the date on which the State Pension age rises to 67 will come forward by eight years from 2036 to 2028. Taking this action now avoids a future Government having once more to take emergency action to ensure that the state pension system remains affordable. It also provides as much notice as possible of the change in State Pension age for those affected.
143. The rise to 67 will be phased in between 2026 and 2028 and legislation to this effect will be introduced in this Parliament. Starting the transition in 2026 means that those whose State Pension age was affected by the timetable to increase State Pension age to 66 will not find their State Pension age changing again. The proposed timetable for the rise in State Pension age to 67 is shown in Annex 5.
144. Even with these changes, a man reaching State Pension age at 67 in 2028 can still expect to draw his state pension for roughly as long as a man reaching State Pension age at 65 today.⁸⁵

⁸⁴ This chart is based on data from: Office for National Statistics, 2012, *Historic and Projected Mortality Rates (qx) from the 2010-based UK Life Tables: Principal Projection, 1951-2060*, Office for National Statistics and Office for National Statistics, 2012, *Historic and Projected Numbers Surviving at Exact Age (lx) from the 2010-based UK Life Tables: Principal Projection, 1951-2060*, Office for National Statistics. For the purposes of this chart, adult life is defined as starting at age 20.

⁸⁵ This is 21.4 years in both cases.

145. Chart 6.6 shows how increases in the State Pension age have helped to put the state pension system on a more sustainable footing in terms of support ratios. Increasing the State Pension age to 66 by 2020 and 67 by 2028 will keep a ratio of around three people of working age to each person above State Pension age into the early 2030s. Nevertheless, even with these changes, the support ratio will continue to decline in the future. This implies that further action will need to be taken to bring forward increases in the State Pension age in the future, in order to ensure the state pension system remains sustainable in the long term.

Chart 6.6: Support ratio projections: 2018-2062 (population aged 20 to State Pension age vs population over varying State Pension ages)⁸⁶



146. The UK is not alone in having to face up to the challenges of demographic change. Most other developed countries have taken, or are considering taking, action to increase their State Pension age to reflect changes in longevity (See Table 6.1). Around half of the Organisation for Economic Co-operation and Development (OECD) countries now do this through linking their pension benefits in some way to life expectancy. Denmark will do this through linking pension age and life expectancy from 2027, which is the point their pension age will complete its increase from 65 to 67. Italy and Greece will link pension age to life expectancy from 2013 and 2021 respectively.⁸⁷ Some countries, however, have chosen to respond to life expectancy changes through a link to benefit levels or qualifying conditions. For example, in France, the number of qualifying years required to receive a full state pension changes in line with life expectancy.

⁸⁶ Office for National Statistics, 2011, *National Population Projections, 2010-based projections*, ONS.

⁸⁷ Organisation for Economic Co-operation and Development, 2012, *Pensions Outlook 2012*, OECD.

Table 6.1 State Pension age changes in a number of OECD countries⁸⁸

Country	State Pension age in:				
	2010	2020	2030	2040	2050
Australia	65 (64)	66	67	67	67
Czech Republic	61 (58.7)	62.2 (60.7)	63.5 (63.3)	66.7	68.2
Denmark ¹	65	65	67	67.9	68.8
Germany	65	66.1	67	67	67
Iceland	67	67	67	67	67
Ireland ²	66	66	68	68	68
Israel	67 (62)	67 (64)	67 (64)	67 (64)	67 (64)
Italy ¹	59	61	67.3	68	68.7
Netherlands	65	66	67	67	67
Norway	67	67	67	67	67
Poland	65 (60)	67 (62)	67 (64.5)	67	67
Spain	65	66	67	67	67
UK	65 (60)	66	67	67	68
USA	66	66	67	67	67

Notes:

Figures in brackets indicate women's State Pension age, where different from men's.

¹ Pension age based on increases in life expectancy: these are OECD estimates based on mortality rates.

² This is the State Pension (Contributory) age, as opposed to the State Pension (Transition) age.

A new approach to setting the State Pension age

147. As longevity continues to increase, the Government believes that there is a strong case for considering changes to State Pension age in a more structured way.

⁸⁸ Organisation for Economic Co-operation and Development, 2012, *Pensions Outlook 2012*, OECD. Data for Poland is from World Bank, 2012, *Poland Partnership Program Snapshot – October 2012*, World Bank. Data for Ireland is from Analytical Support on the Socio-Economic Impact of Social Protection Reforms, 2012, *Annual National Report 2012, Ireland*, ASISP.

148. In its 2011 consultation document on state pension reform, the Government sought views on a more systematic framework to consider future increases to State Pension age. In general, there was a high level of support for a mechanism to manage State Pension age changes, with the majority of respondents who addressed the issue favouring some form of review process which would allow changes to the State Pension age to be considered in light of expert advice based upon the most recent data. In the 2012 Budget, the Chancellor confirmed that the State Pension age will reflect future increases in longevity.⁸⁹
149. A regular review of State Pension age will:
- **help to ensure inter-generational fairness** by ensuring that the costs of increasing longevity are shared fairly between the generations;
 - **avoid governments having to take emergency action** to increase State Pension age. Considering State Pension age regularly means that it can be addressed with a view to the long term;
 - **provide individuals with greater clarity** on how and when State Pension age will change, allowing them to plan better for their retirement; and
 - **help to ensure the pension system remains sustainable in the longer term.**
150. The next section of this chapter provides further detail on how a more systematic framework for considering future changes to State Pension age will operate.

Frequency of review – every five years

151. There is a balance to be struck in the regularity of reviews. More frequent reviews would allow the Government to respond quickly to changes in life expectancy projections, but would mean clarity for individuals would be reduced. In contrast, less frequent reviews could result in the need for large adjustments to State Pension age. The Government believes that a review every five years strikes the best balance between providing clarity for individuals while also allowing State Pension age to take account of changes in life expectancy in a timely manner. Moreover, a review every five years would mean that State Pension age would be considered in every Parliament.
152. In light of the changes to State Pension age legislated for or announced since 2010, the Government proposes that the first review to consider subsequent changes to State Pension age should take place in the next Parliament. The report of the outcome of that review will be published by 7 May 2017, which allows the Government to consider State Pension age using two further sets of life expectancy projections after those used to set the timetable for the rise to 67. Subsequent reviews will take place every five years with each report published no later than six years after its predecessor.

A ten-year notice period for individuals

153. The Green Paper asked how the Government could best strike a balance between responding to the frequent revisions in projected life expectancy while giving people enough time to prepare for a change in State Pension age. While there is no definitive evidence of what the most appropriate level of notice is, there was broad consensus that a ten year notice period strikes a good balance.⁹⁰

⁸⁹ The Rt Hon George Osborne MP, 2012, *Budget 2012 statement by the Chancellor of the Exchequer*, Her Majesty's Treasury.

⁹⁰ Department for Work and Pensions, 2011, *A state pension for the 21st century: A summary of responses to the public consultation*, Cm 8131, TSO.

NAPF research shows that, generally, lifestyle funds tend to start adjusting investment strategies between 3 to 15 years before retirement. We therefore recommend that the notice period for changes in SPA be set to reflect this trend in private sector pensions and therefore recommend that the notice period be set around ten years.

The National Association of Pension Funds⁹¹

Any changes resulting from the review need to ensure people are given time to plan and continue to provide people with a degree of certainty. We suggest ten years as a minimum period for future reviews.

The Association of British Insurers⁹²

154. Should a future Government decide to raise the State Pension age following a review, this Government believes that a ten year notice period will be sufficient notice for individuals affected to prepare for the change.

A core principle based upon proportion of adult life in receipt of state pension

155. There is a strong case for having an underlying guiding principle that sets the parameters for how increases in longevity should be taken into account when considering future changes to State Pension age.
156. The Government proposes that future changes to the State Pension age be made with reference to maintaining a proportion of adult life spent in receipt of state pension. This approach, favoured by the Pensions Commission, would mean that each generation could expect to spend broadly the same proportion of their lives contributing to, and receiving, the state pension.

Over the long run, fairness between generations suggests that average pension ages should tend to rise proportionately in line with life expectancy, with each generation facing the same proportion of adult life contributing to and receiving a state pension.

The Pensions Commission (2005) *A New Pension Settlement for the Twenty-First Century*

157. At the time of the reviews, the Secretary of State will commission the Government Actuary's Department to provide analysis as to whether or not individuals reaching their State Pension age in the future will spend a specified proportion of their adult life in receipt of state pension. GAD will then report on what measures, if any, might be taken to achieve that proportion.
158. The Secretary of State will use this report, alongside the one from the independently-led review body, discussed below, to decide whether or not to bring forward proposals to increase the State Pension age.

⁹¹ Department for Work and Pensions, 2011, *A state pension for the 21st century: A summary of responses to the public consultation*, Cm 8131, TSO.

⁹² Department for Work and Pensions, 2011, *A state pension for the 21st century: A summary of responses to the public consultation*, Cm 8131, TSO.

Review of wider factors

159. Maintaining a given proportion of adult life in receipt of state pension creates a link between increases in life expectancy and changes in State Pension age. However, the Government recognises that in addition to longevity increases there is a range of other factors that should be considered when arriving at a decision on whether to change State Pension age.

The question of what the State Pension age should be has many levels of complexity, raising questions about the way the labour market operates, justice between generations and between different socio-economic groups. We believe these complexities do not lend themselves to a formula-driven approach.

Engineering Employers Federation⁹³

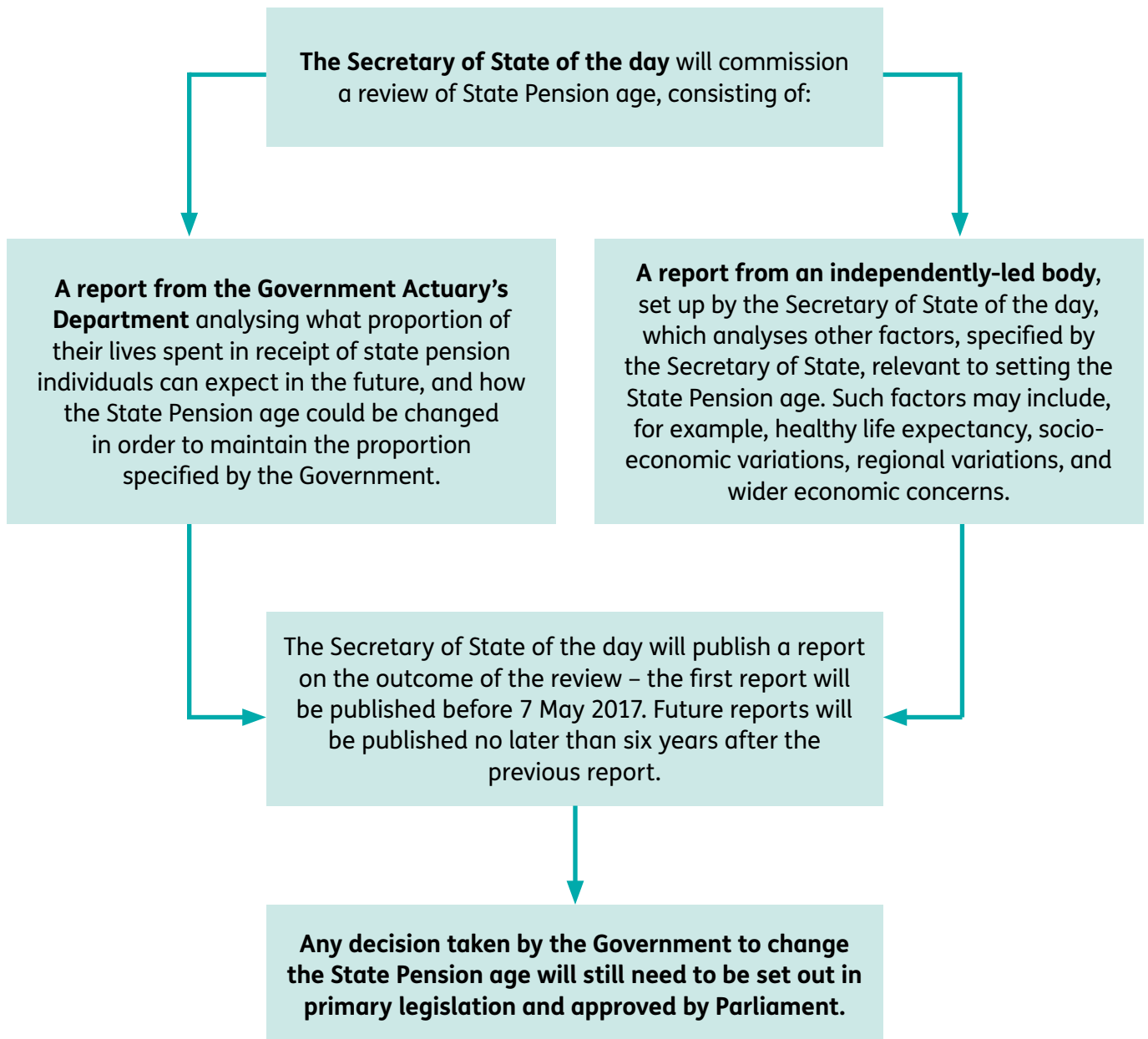
160. While GAD will provide analysis on the proportion of life spent in receipt of State Pension, the Government believes that the complex factors relevant to setting State Pension age should be considered by an independently-led review body. This body will have the necessary expertise to report to the Government and consider the full range of issues concerning future increases in State Pension age and the means by which the state pension costs of rising life expectancy can best be shared fairly among the generations. It will be expected to consult widely to ensure that it has considered the appropriate evidence and the range of views of interested parties.
161. The remit of the body will be specified by the Government commissioning the review. Prior to this, the Government would want to seek the views of organisations and individuals on factors to be taken into account. Based upon the 2011 consultation, the following factors are expected to be considered:
- **evidence of variations in life expectancy.** Life expectancy projections, by their very nature, look at the average experience for the population as a whole. While they do take account of the full range of mortality outcomes, there will be people and groups who may experience lower than average life expectancy outcomes. The independently-led body would analyse these variations, such as life expectancy by socio-economic class and geographical region, when conducting their review;
 - **trends in healthy life expectancy.** Using increases in life expectancy to consider changes to State Pension age does not take account of the length of time someone spends in good health. The Government therefore proposes that the independently-led body would be asked to analyse trends in healthy life expectancy;
 - **alternative ways of measuring life expectancy.** These could include the period projections of life expectancy, the high and low life expectancy variants (which set out what may happen to life expectancy if it increases at a faster or slower rate than that predicted in the principal projections) and the use of mean and median life expectancy outcomes when considering proportion of adult life in receipt of state pension; and
 - **impact on the labour market.** This would include an assessment of labour market capacity to increase the pool of older workers. Consideration of the labour market impacts would enable the macro-economic benefits, such as the impacts on GDP and the additional numbers in the labour market, to be accurately assessed. It would also help to determine the extent to which previous increases in State Pension age have been accompanied by longer working.

⁹³ Department for Work and Pensions, 2011, *A state pension for the 21st century: A summary of responses to the public consultation*, Cm 8131, TSO.

Taking a decision to change the State Pension age

- 162. Any Government’s decision on the necessity and timeframe for changing State Pension age will be informed by both the report by GAD on maintaining a given proportion of adult life in receipt of State Pension and the report produced by the independently-led body on the varying factors that may affect when State Pension age should change. This framework will not remove the need to set State Pension age in legislation. This means that any proposal to change State Pension age will continue to be subject to full scrutiny by Parliament and an Impact Assessment will be published alongside any future proposals to change State Pension age.
- 163. An overview of how the State Pension age review mechanism will work is provided in the flowchart below:

Figure 6.1: Overview of the State Pension age review mechanism



Awareness of the State Pension age

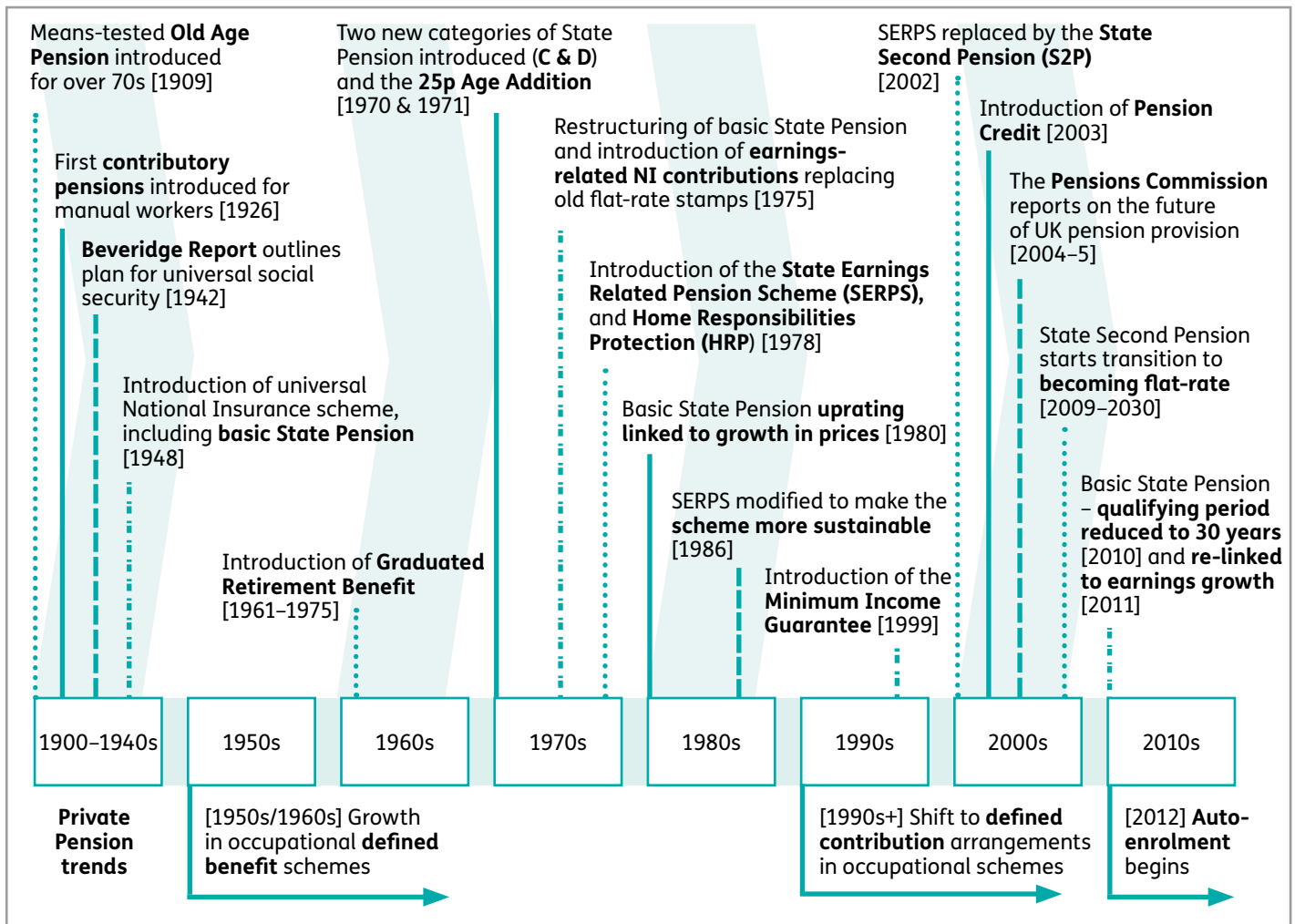
164. The recent Attitudes to Pensions survey indicated a low level of understanding of pensions among respondents. The report found that the proportion of men and women who could correctly identify their State Pension age was just 25 per cent and 11 per cent respectively.⁹⁴ While these proportions increased among respondents who were within ten years of their State Pension age, it is clear that much remains to be done to increase people's awareness of when they can expect to receive a pension from the state in order to allow them to better prepare for their retirement.
165. The mechanism for reviewing the State Pension age, described in detail above, introduces a systematic and regular means for considering how the State Pension age should change to ensure that the pension system remains fair, sustainable, and provides individuals with greater clarity. The nature of the review means that individuals will be regularly exposed to the concept of a State Pension age which responds to projected increases in life expectancy. They will be frequently signposted to the resources where they can find the State Pension age which applies to them, such as the GOV.UK website, which was introduced in October 2012 to replace Directgov.
166. The GOV.UK website hosts a State Pension age calculator and timetables for legislated increases in the State Pension age. These tools are also available on the websites of a number of governmental and non-governmental bodies, including The Pensions Advisory Service and The Pension Service, which will also continue to provide this information over the phone and in writing.

⁹⁴ MacLeod *et al.*, 2012, *Attitudes to Pensions: The 2012 survey*, Department for Work and Pensions Research Report No 813, Department for Work and Pensions.

Annex 1

A brief history of the state pension

Figure A1.1: Evolution of the State Pension



1. The UK's state pension system is a product of over 70 years of expansion, reform and adjustment. The system as originally introduced in 1948 was a flat-rate state pension designed to prevent absolute poverty and provide a "national minimum [leaving] room and encouragement for voluntary action by each individual to provide more than that minimum for himself and his family".⁹⁵
2. Over time, however, the simplicity of Beveridge's original vision of a flat-rate pension has become increasingly blurred, largely due to the complexity of means-tested support and the state becoming directly involved in the provision of earnings-related pension.

The first departure from a basic State Pension

3. The first move away from providing a simple flat-rate basic State Pension was the introduction of the Graduated Retirement Benefit in 1961. Under this scheme, earnings-related National Insurance contributions were paid and in return an individual would receive extra units of pension. The value of these units remained static, so the value of Graduated Retirement Benefit declined significantly over time. The scheme was closed in 1975.
4. Other changes were made to the state pension in the 1970s. What became Category C pensions were introduced in 1970 for those who did not qualify under the post-war system as they had already reached pensionable age in 1948. What became Category D pensions were introduced the following year to ensure those aged 80 or over (who had limited opportunity to build up entitlement under the post-war scheme) had a minimum amount of state pension worth around 60 per cent of the basic State Pension. In addition, to provide extra support in response to high inflation at the time, a 25p 'Age Addition' was introduced for all pensioners over the age of 80 and continues to the present day.

The additional State Pension

5. In 1978 the Government introduced the State Earnings Related Pension Scheme (SERPS) to replace Graduated Retirement Benefit. The previous administration had planned to replace Graduated Retirement Benefit with the 'State Reserve Scheme', which was to have been a separately funded Government-run Defined Contribution scheme, as a fall-back for employees who were not covered by an occupational pension scheme. SERPS represented the most significant departure from the original model set out by Beveridge because the State was effectively stepping in to provide an alternative to occupational pension provision for those without access.
6. SERPS provided an extra pension to an individual on top of the basic State Pension, linked to how long they worked and how much they earned up to an upper ceiling. The original design provided a pension representing 25 per cent of average earnings. From 1999 earnings were to be averaged over the 'best' 20 years of the individual's working life to provide a boost for those whose earnings fluctuated or who took time out of the labour market due to caring responsibilities. With the introduction of the additional State Pension it became possible to contract out of parts of the state pension. Further detail on contracting out is provided in Chapter 3.

⁹⁵ Beveridge W, 1942, *Social Insurance and Allied Services*, Cmd. 6404, HMSO.

Recognising carers' contributions

7. The first attempt at recognising caring in the state pension system was the introduction of Home Responsibilities Protection in 1978. This was awarded to those caring for children or someone with a long-term disability. For every year it was awarded, it reduced the number of qualifying years needed to get the full basic State Pension by a year. However, the number of qualifying years needed could not be reduced below 20 and it did not provide any access to the additional State Pension. As such, Home Responsibilities Protection provided only partial cover for people who took time out of the labour market to care for others. It was replaced by National Insurance Credits in April 2010.

Affordability and reform of the additional State Pension

8. It became clear within less than a decade that the generosity of SERPS and the state pension system more broadly were not sustainable in the long term within the pay as you go framework of National Insurance.⁹⁶ During the 1980s a number of modifications were made to the state pension to ensure its sustainability including:
 - from 1980 the basic State Pension increased in line with prices rather than earnings; and
 - the basis of the SERPS calculation for those reaching pension age from 1999 onwards was altered – the ‘best 20 years’ feature was not implemented and the accrual rate for years from 1988 onwards was reduced from 25 per cent to 20 per cent. There were also changes to the amount that could be inherited.
9. In 2002 SERPS was replaced by the State Second Pension (S2P). Historically, because SERPS was directly linked to earnings, it was of little or no benefit to low earners and those who took time out of the labour market due to caring responsibilities. The State Second Pension was designed to be more generous to low and median earners and new carers' credits were introduced so that groups historically excluded from the additional State Pension, such as women caring for young children, were covered.
10. Separate arrangements have been required over the years to ensure that people are not disadvantaged from being contracted out of the additional State Pension. There have been fundamental shifts in the nature of the safeguards deployed to ensure that contracted-out private pensions are revalued up to retirement and uprated during retirement in a fair way. There are also arrangements in place to ensure that contracted-out low earners can still benefit from the boost in State Second Pension. This layering of a complex system of safeguards on top of an already complicated additional State Pension system has made this aspect of state pension provision particularly difficult to understand.
11. A final element of complexity comes from the rules allowing a surviving spouse or civil partner to inherit a proportion of their deceased partner's additional State Pension. These rules have evolved with reforms of the additional State Pension and are very complex. Annex 3 provides an overview of the circumstances in which inherited additional State Pension may be payable and what a survivor may inherit.

⁹⁶ Beveridge had envisaged a funded system, where the new contributory pensions would only be paid in full after a 20 year phasing in period while National Insurance contributions built up. The Government rejected this principle and chose to start paying pensions in full immediately, with the result that the 1948 scheme ran on a pay as you go basis from the very beginning.

Means testing

12. The first Old Age Pension was introduced in 1909 and was available to those with income below a specified amount as an alternative to local Poor Law relief. Unemployment assistance benefit, introduced in 1935, was extended to pensioners in 1940. National assistance was introduced in 1948. The basic level of means-tested support it provided was lower than the flat-rate retirement pension, though higher support was available if a pensioner had rent of more than a certain amount to pay. The basic level of the means test increased over time and has now been consistently higher than the level of the basic State Pension for around a quarter of a century.
13. In 2003 the Government reformed the income support available for pensioners with the introduction of Pension Credit. This was designed to help tackle pensioner poverty by boosting pensioners' incomes to the level of a minimum income guarantee to help cover basic needs. But the advent of Pension Credit also introduced a new element through the Savings Credit. This was designed to provide those who had saved, and had an income above the level of the basic State Pension, with a modest 'reward' for saving and addressed the fact that the basic State Pension did not take people clear of the basic means test. Savings Credit brought more pensioners into the scope of means testing, as it became available to pensioners higher up the income distribution, and added to the complexity of the means-tested part of the pensions system.

The Pensions Commission: a consensus for reform

14. In 2004 and 2005 the Independent Pensions Commission, which was tasked in 2002 with looking at the challenges facing the pensions system, published two reports. The second report made a series of recommendations for reform⁹⁷, which led to changes taken forward in the Pensions Acts of 2007 and 2008, including:
 - committing to reintroduce the earnings link to basic State Pension so that it would hold its value better over time and reduce reliance on means-testing in the longer term;
 - reducing the number of qualifying years required for the full basic State Pension to 30 years for both men and women, and other changes in qualifying conditions that would improve coverage;
 - gradually removing earnings relation from the State Second Pension, to produce a two-tier flat-rate pension by the late 2030s, making the state pension more sustainable and simpler in the longer term;
 - refocusing the state pension on providing a simpler foundation to support saving. It would be the individual's responsibility to ensure they build up private pension savings themselves through a workplace pension scheme;
 - introducing automatic enrolment into workplace pension schemes, removing contracting out from Defined Contribution schemes (from April 2012) and creating a low-cost pension scheme (now known as the National Employment Savings Trust, or NEST) open to all employers and the self-employed to ensure that workers have the opportunity to save for retirement and to encourage greater private saving; and
 - providing for a staged rise in State Pension age in line with increases in life expectancy to ensure sustainability.

⁹⁷ The Pensions Commission, 2005, *A New Pension Settlement for the Twenty-First Century*, TSO.

Annex 2

Faster flat rating – assessment against principles for reform

1. In the Green Paper '*A state pension for the 21st century*' the Government outlined two alternative options for state pension reform to deliver a simple flat-rate contributory state pension above the basic level of the means test. Option one was to accelerate the move already underway towards a two-tier flat-rate pension – 'faster flat rating'. Option two was the single-tier pension.
2. This annex provides an assessment of the faster flat rating option against the Government's principles for reform, to accompany the assessment made for the single-tier pension in Chapter 2. The box below provides a summary of the faster flat rating option.

Faster flat rating – summary

- The two-part system of basic and additional State Pension (State Second Pension) to be retained.
- Earnings-related element of State Second Pension to be phased out by 2018 instead of by the 2030s so people receive a set amount of pension for each qualifying year.
- A small increase in the value of the flat-rated element in 2018 compared to the current system.
- 30 qualifying years for full entitlement to the basic State Pension. People can contribute towards the additional State Pension from age 16 to State Pension age.
- A seven-year minimum qualifying period would be introduced for the basic State Pension.⁹⁸
- Basic State Pension uprated by the triple lock, State Second Pension revalued by earnings until State Pension age and uprated by the Consumer Price Index (CPI) in payment (as now).
- Some differences in qualification criteria between the two elements would remain, and it would remain possible to contract out of the State Second Pension.

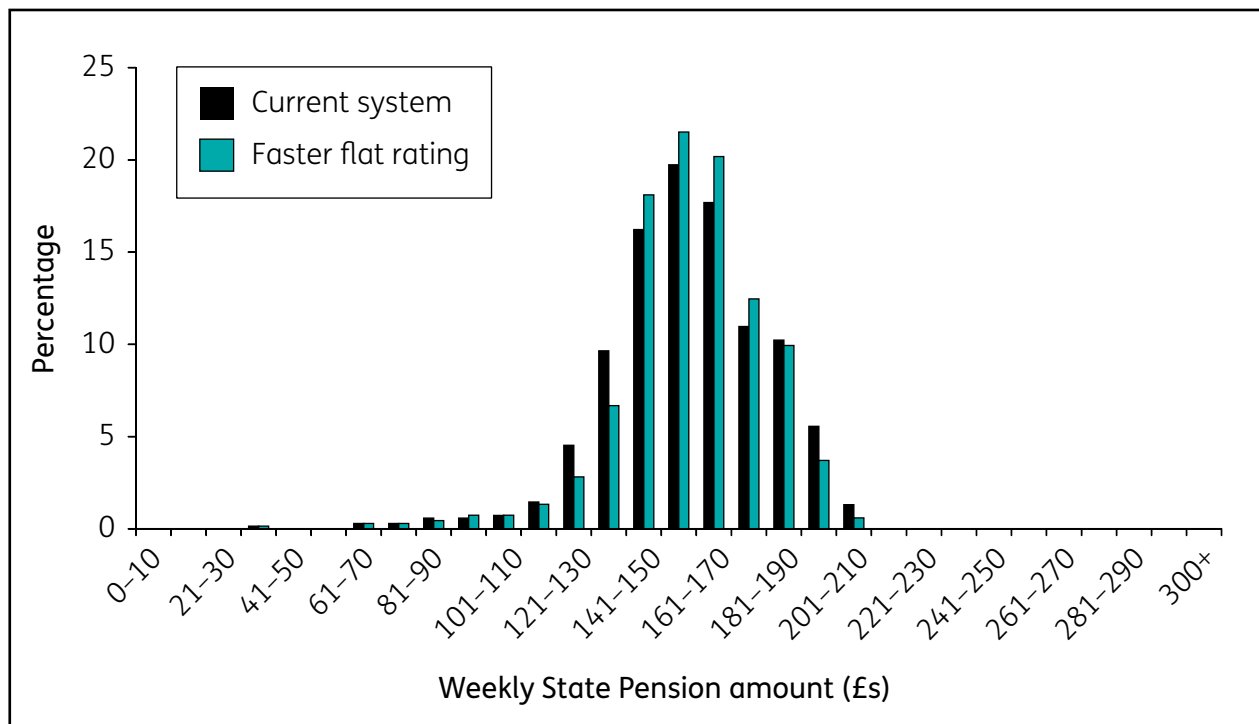
⁹⁸ This was not specified in the consultation document (although a seven year minimum condition was part of the basic structure of the single-tier model in that Green Paper).

- The Government does not believe that faster flat rating would provide the clear foundation that is needed to support current generations in taking greater personal responsibility for saving for their retirement. Most significantly, there would be much greater variation in outcomes under faster flat rating compared to under the single-tier pension, and much of the complex architecture of the current system would remain.

A. Clarity of outcome

- Under faster flat rating, from 2018, people could become entitled to a set amount of pension for each qualifying year. This would give people greater clarity and certainty over what their state pension will be worth when they retire. However, it would not be until the late 2060s that the first person would retire with a completely flat-rate state pension. As Chart A2.1 shows, by 2040 there would still be significant variation in state pension outcomes across the population because the amount of additional State Pension an individual has would continue to vary.

Chart A2.1: Projected distribution of net state pension income for those reaching State Pension age in 2040 in the current system and under faster flat rating



- This variation in amounts of additional State Pension would persist because the qualification criteria for the two tiers would remain different (National Insurance contributions paid by the self-employed, for example, would not give rise to additional State Pension entitlement). Variation would also persist because a person could continue to contribute to the additional State Pension over the entirety of their working life. As a result, those with longer working lives could continue to be entitled to higher amounts of state pension. Conversely those with broken work histories would be entitled to comparatively less state pension.
- Under faster flat rating, much of the current system’s complex architecture would remain, such as the Savings Credit element of Pension Credit and contracting out. This raises further questions about whether it would achieve the level of simplification that is required.

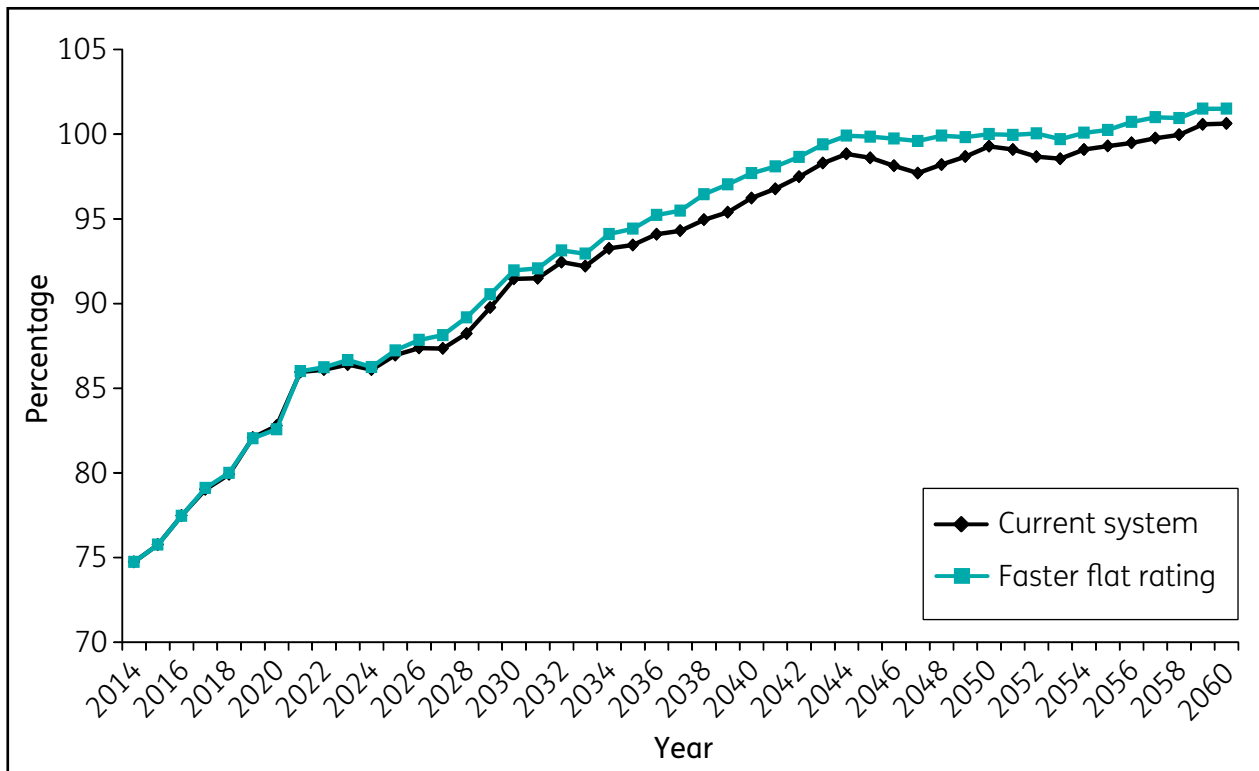
B. A reduction in means-testing

7. Faster flat rating would have a minimal impact on levels of eligibility for Pension Credit. In addition to those who would still qualify for Pension Credit at State Pension age, others would remain at risk of falling within scope of Pension Credit during their retirement, just as they do under the current system. As outlined in Chapter 2, this would be particularly those who, for example, have periods of broken employment and retire with a state pension just above the basic level of means-tested support. This is because, while the full basic State Pension (£107.45 in 2012/13) would be uprated by the triple lock (highest of earnings, prices and 2.5 per cent), their additional State Pension would be increased by prices (as defined by the Consumer Price Index). Assuming the standard minimum guarantee in Pension Credit (£142.70 in 2012/13) continues to be uprated in line with the growth in earnings, their state pension entitlement would hold its value less well over time relative to the level of the basic means test.

C. Equalisation of state pension outcomes between men and women

8. Chart A2.2 shows that faster flat rating brings forward the equalisation of state pension outcomes between men and women by over a decade. This is mainly because under the current system it is men who tend to benefit from large additional State Pension payments.

Chart A2.2: Median female gross state pension as a proportion of median male gross state pension, for those reaching State Pension age in a particular year, under current system and faster flat rating



D. Affordability and sustainability

9. Expenditure on faster flat rating as a proportion of GDP is virtually indistinguishable from expenditure on the current system rolled forward. Larger savings could be generated by adjusting the level of the flat-rate element, but not without significantly increasing the number of people who would lose out under the reform.
10. Table A2.1 summarises how faster flat rating and the single-tier pension fare against the Government's principles for reform.

Conclusion

11. Faster flat rating would go some way towards simplifying the system by more clearly defining what each qualifying year of state pension would be worth from 2018. The continuation of additional State Pension would mean every year that contributions are paid or credited would be recognised in the state pension system.
12. However, it would also mean that people would not have clarity or certainty over what their state pension will be worth when they retire, which would continue to make retirement planning difficult. As a result the role of the individual and the State in providing an income in retirement would not be clear cut. Much of the architecture of the existing system including complex elements such as Savings Credit would remain, meaning a significant amount of complexity would persist. It would also do little to address inequalities in the system for groups such as the self-employed. Under faster flat rating around 30 per cent of pensioners would remain eligible for Pension Credit in 2060, the same proportion as under the current system.
13. In contrast, a single-tier pension would be a substantial simplification of the system. Complex elements of the current system such as Savings Credit and contracting out would be abolished for those reaching State Pension age under the new system. A single flat-rate state pension would give people much greater certainty and clarity over what their state pension will be worth when they retire, providing a much firmer foundation on which to base decisions around saving for retirement.
14. In line with the comments of a majority of respondents to the Green Paper, the Government agrees that faster flat rating does not meet the principles for reform and that the single-tier pension is the only option that would meet those principles and provide the foundation that is needed to support current generations of workers in saving for their retirement.

Table A2.1 Assessment of faster flat rating and single tier against the principles of reform used in the 2011 Green Paper

	Option one (faster flat rating)	Option two (single-tier pension)
Clarity of outcome	<ul style="list-style-type: none"> • Would deliver a simpler two-tier flat-rate pension, but not until the 2060s that the first person would retire with a completely flat-rate pension. • Retention of current two-tier structure means people would still not have clarity or certainty over what they will get. • Many of the most complex elements of current system (e.g. savings credit, contracting out) remain. 	<ul style="list-style-type: none"> • Flat rate amount over the basic level of means-tested support gives people clarity and certainty over what they would get when they retire. • One clear flat rate payment increased by at least earnings provides transparency. • Complex elements such as Savings Credit and contracting out would end for new pensioners. • Some complexity linked to the current system would persist during transition – around a decade until the large majority retire on the full single-tier amount due to the need to take account of contributions made to the current system.
A reduction in means testing	<ul style="list-style-type: none"> • Does little to reduce means testing compared to the current system. • Some groups at risk of falling onto means-testing during retirement because State Pension does not hold its value as well during retirement. 	<ul style="list-style-type: none"> • Halves the number of new pensioners in the scope of Pension Credit. Reduces the number of pensioners qualifying for any means-tested benefits by around 400,000 pensioner benefit units (3 percentage points) by 2040. • Full amount of state pension uprated at least in line with earnings, ensuring that people stay above the means test throughout retirement.
Fairness/ improving outcomes for women	<ul style="list-style-type: none"> • Women reach parity with men in the state system around a decade earlier than under the current system. • Additional State Pension can be built up every year of a working life. 	<ul style="list-style-type: none"> • Women reach parity with men in the state system over a decade earlier than under the current system. State Pension entitlement cannot be increased with more than 35 qualifying years (although specific arrangements would apply during transition) – those on higher incomes and with longer working lives get less than under the current system.
Sustainability	<ul style="list-style-type: none"> • Broadly cost neutral compared to existing system – expenditure rises over time from around 6.9 per cent of GDP in 2012/13, to 8.5 per cent by 2060. However this would depend on the level of the flat-rated element. 	<ul style="list-style-type: none"> • Costs no more than the current system overall – costs also rise over time, but by less – forecast expenditure in 2060 is 8.1 per cent of GDP, helping to contribute to sustainability in the longer term.

Annex 3

Features of the single-tier pension and specific transitional arrangements

1. This Annex provides further detail to accompany the summary description of the single-tier pension in Chapter 2, including how it compares to the current system, and the transitional arrangements that will be put into place. Those who reach State Pension age before the reforms are implemented will continue to receive the state pension in line with current rules.
2. The chapter is structured as follows:
 - A. Level of the full rate, including:
 - setting the level of the single-tier pension;
 - uprating;
 - relationship to means-tested and other pensioner support.
 - B. Eligibility conditions for the full rate, including:
 - number of qualifying years;
 - National Insurance credits for certain activities;
 - treatment of contributions paid by the self-employed;
 - treatment of voluntary contributions.
 - C. Minimum qualifying period for single-tier entitlement.
 - D. Designing the single-tier pension for individuals, including:
 - transitional arrangements for women who have paid Reduced Rate Elections;
 - inheritance of additional State Pension and protected payments;
 - pension sharing;
 - a summary of other outdated features abolished as part of the single-tier reforms.
 - E. State Pension deferral.

A. Level of the full rate

Setting the level of the single-tier pension

3. The single-tier pension will be a simple, flat rate amount set above the basic level of means-tested support (the Pension Credit Standard Minimum Guarantee, £142.70 per week in 2012/13). The precise starting value will be a matter for the Government to decide shortly prior to implementation taking account of the fiscal context at the time.
4. It will replace the basic State Pension, additional State Pension, Graduated Retirement Benefit and the Savings Credit, providing a clearer foundation to support saving.

Uprating the single-tier pension

5. The basic State Pension must be increased at least in line with the average growth in earnings. This same legislative requirement will also apply to the single-tier pension. For the purposes of illustration, in this document it is assumed that the single-tier pension will be uprated by the triple lock (the highest of earnings, prices or 2.5 per cent), as per Government policy for the basic State Pension. Single-tier uprating policy will also be set shortly prior to implementation, taking account of the fiscal context at the time. Further decisions on uprating will be made by future governments on a yearly basis, as part of the annual uprating process.

State Pension payments outside of the UK

6. Currently, individuals are able to draw their state pension even if they live outside the UK. State pension paid outside the UK is not normally uprated each year, unless it is paid in the European Economic Area (EEA), Switzerland, the Channel Islands or in a country with a bilateral social security agreement with the UK which covers uprating.
7. This arrangement will be maintained under the single-tier pension. Both current pensioners and those reaching State Pension age after the implementation of the single-tier pension will continue to be able to draw their state pension abroad. Their state pension will be uprated in the European Economic Area (EEA), Switzerland, the Channel Islands and in countries with appropriate bilateral agreements with the UK. For those pensioners living outside the EEA in countries with which the UK does not have an appropriate bilateral agreement, the single-tier pension will not be uprated. Changing this long-standing policy would have a significant impact on other spending priorities.

The single tier and means-tested support

8. The Government recognises the importance of providing a basic safety net to prevent pensioners falling into poverty under the single-tier system, as well as for existing pensioners and this will continue after reforms are implemented.
9. Additional means-tested support is currently available through housing benefit and Council Tax Benefit. Similar support will exist after the single-tier pension is implemented, though in revised form in accordance with measures set out in the Welfare Reform Act 2012. For a transitional period of five years from the implementation of single tier, support will be retained for those people who may have received more help with certain housing costs by virtue of the availability of the Savings Credit under the current system.

Other payments to pensioners

10. Other provisions for pensioners, such as the Winter Fuel Payment, free bus passes, and the Christmas Bonus, are unaffected by the single-tier reforms.

B. Eligibility for the full rate of the single-tier pension

How the contributory principle will be implemented under single tier

11. The new single-tier pension retains the contributory principle, so that the amount of single-tier pension an individual receives will be based on their National Insurance record of paid or credited contributions.
12. Those whose National Insurance record under the current system would have a value at the point of implementation of more than the full single-tier pension will receive both a full single-tier pension and a 'protected payment' (an additional payment protected against price inflation) to recognise their higher entitlement.
13. Under the current system, 30 qualifying years of paid or credited National Insurance contributions are required for a full basic State Pension. Additional State Pension entitlement is based on National Insurance contributions paid or credited over the full course of working life. Entitlement is calculated using extremely complex rules reflecting the evolution of the system, changes in an individual's employment status over their lifetime, and the interaction between the two. Key factors include the level of earnings; a system of credits for years from 2012 onwards which is more restrictive than that for the basic State Pension, and whether an individual has ever belonged to an occupational or private pension scheme which was contracted out of the additional State Pension. More detail is provided in Annex 1.
14. Entitlement to the full amount of the single-tier pension will be based on a simple test of 35 qualifying years of National Insurance contributions or credits.⁹⁹ It is estimated that around 85 per cent of people reaching State Pension age in 2020 will have at least 35 qualifying years. Setting the number of qualifying years at 35 ensures that the large majority of people will be able to receive the full single-tier amount at State Pension age, including those who historically have poorer state pension outcomes, such as women and carers.
15. The trade-off for the simplicity and clarity of a flat rate single-tier pension is that the amount of pension that people can get will be capped at 35 qualifying years of contributions or credits. In practice this means that higher earners and those with longer working lives would be entitled to less state pension under the single tier than they will have been entitled to under the current system.
16. Qualifying years under the single-tier pension will be generated in the same way as qualifying years for the current basic State Pension. A qualifying year will be defined as a tax year during an individual's working life in which they paid, or were treated as having paid, National Insurance contributions or were credited with National Insurance contributions on earnings of 52 times the 'Lower Earnings Limit' (LEL). The LEL is the point at which a person is treated as having paid National Insurance contributions – for the 2012/13 tax year this is £107 per week (£5,564 per year).

⁹⁹ In some circumstances, an individual may need more than 35 qualifying years to get the full amount of the single-tier pension: for example, some individuals may have a deduction applied to their single-tier foundation amount, so that it is less than the full rate of the single-tier pension, despite having 35 or more qualifying years.

National Insurance credits

17. In the current system, an individual reaching State Pension age can be awarded National Insurance credits to recognise a range of activities including caring or looking for work. Credits help people to maintain their National Insurance record and so protect their state pension. All credits count towards the basic State Pension, and they may also count towards the additional State Pension depending on the 'class' of credit. The complexity of both tiers of the existing state pension scheme is deeply embedded in the recording and operating systems of both DWP and HMRC. Separately, HMRC and DWP operate a system of National Insurance credits which apply to over 21 different circumstances from being a carer to serving as a member of a jury.
18. Crediting arrangements will be brought forward to protect the single-tier pension position of those who cannot work, with the implementation of the single-tier pension potentially providing an opportunity to simplify recording and operating systems.

Contributions paid during periods of self-employment

19. Under the current system, National Insurance contributions paid by the self-employed do not count towards the additional State Pension. This places at a disadvantage those who work on their own account – a group that plays an increasingly important role in the economy.
20. As part of making the state pension system simpler and fairer through single-tier reforms, all forms of National Insurance contributions will be treated equally in the calculation of the single-tier pension. Rates and levels of National Insurance are reviewed annually by HMT.

Voluntary National Insurance contributions

21. Under the current system, those who have gaps in their National Insurance records, for example, as a result of time spent in full-time education, are able to 'top up' their records by paying voluntary National Insurance contributions. These do not count towards the additional State Pension.
22. The Government intends to retain voluntary National Insurance contributions. As is currently the case, the cost of those contributions will be kept under review.

C. Minimum qualifying period

23. People reaching State Pension age after the implementation of the single-tier pension will need to have a minimum number of qualifying years to become eligible for a pro rata amount of state pension. This will be set at between seven and ten years – the equivalent of around 15 - 20 per cent of normal working life. This ensures state pension expenditure is targeted at those who make a significant economic or social contribution to this country during their working lives. The final decision on the length of the minimum qualifying period will be made closer to implementation, but for illustrative purposes, modelling in this document has assumed a ten-year minimum qualifying period.

D. Designing a state pension for individuals

A single-tier pension for a 21st century society

24. In the current system, it is possible to obtain a pension based on the contributions of a spouse or civil partner. 'Derived rights' to basic State Pension may apply where that spouse or civil partner is still alive or where a marriage or civil partnership ends in divorce/dissolution or bereavement. In some cases, women paid reduced rates of National Insurance on the assumption that they would receive such a derived pension. In the case of bereavement, there is also an extensive system of rules determining the eligibility of the surviving partner to inherit some or all of the deceased's additional State Pension (see below). Additional State Pension entitlement may also be shared as part of a divorce settlement.
25. In addition to adding to the complexity of the current system, these arrangements often mean that women have had low entitlement to state pension for much of their retirement, but then gain significantly after the death of their partner, which of course cannot be predicted.
26. The single-tier pension has been designed to ensure the large majority of individuals will be able to get the full rate in their own right. In steady state, there will be no rationale for allowing people to inherit or derive state pension income based on the National Insurance record of their spouse or civil partner.
27. However, there will be transitional protection to cover a variety of circumstances where the Government believes it is right to recognise contributions made prior to the implementation of the single-tier pension.

Derived rights

28. A person who is, or who has been, married or in a civil partnership may be able to qualify for a basic State Pension or an increase to their own basic State Pension based on the National Insurance record of their spouse or civil partner. This can provide a basic State Pension of up to £64.40 for a married person or civil partner and up to £107.45 for a widow, widower or surviving civil partner or a person who is divorced or whose civil partnership has been dissolved (2012/13 amounts).
29. These provisions go back to the establishment of the state pension system in the post-war period, and were originally designed to ensure a pension would be paid to a dependent wife when her husband retired or she was widowed or divorced, on the assumption that she would have little or no state pension in her own right.
30. Consequently, they apply only where the person's own National Insurance record does not provide a basic State Pension of equivalent value and are now mainly used to top up a person's basic State Pension to that level. For example, a widow who had 25 qualifying years in her own right could have her own basic State Pension of £89.54 increased by £17.91 using her late husband's record to provide the full basic State Pension of £107.45.
31. People who retire under the current system will continue to be able to use these provisions even if their spouse or civil partner is in the single-tier system. However, contributions a person pays or is credited with into the new system will only count towards their own state pension. This means that the Government will only use the National Insurance records of an individual's spouse or civil partner up to and including the tax year before the implementation of single tier to calculate any derived entitlement.

Women with a reduced-rate election under single tier

32. From 1948 to 1977 married women (and certain widows) who were employed could opt to pay lower National Insurance contributions in exchange for relying on their husband's contributions for state pension entitlement. Self-employed women could opt not to pay the flat-rate self-employed stamp. This option was known as a Reduced Rate Election. Most elections in force when the option to make such an election was ended in 1977 have since lapsed but a very small number of women are still paying the 'married woman's stamp' and they will be able to continue to do so after single tier is implemented.
33. Fully removing the potential to derive basic State Pension from a spouse under the single-tier pension would disadvantage women who elected to pay reduced rate National Insurance contributions. They may have few or no qualifying years as a result of their election, which would leave them with potentially no state pension under single-tier rules despite a long history of paying National Insurance contributions and engaging with the system.
34. The Government therefore intends to make provision for married women and widows who paid these reduced rate contributions. Where a valid election existed at any point in the 35 years before State Pension age, they will be able to access a single-tier pension based on their own contributions to the point at which the single-tier pension is implemented. This will include an amount equivalent to the full rate of the 'married woman's' lower-rate basic pension or, if widowed or divorced, the full rate of the basic State Pension. If they would also qualify for a single-tier pension based just on their own contributions, they will receive the higher of the two.
35. Text Box A3.1 provides an example of how derived rights to the basic State Pension will be protected in these circumstances. It does not cover all possible permutations.

Text Box A3.1: Protected derived rights to basic State Pension for certain women who have held reduced rate elections: calculation example

Iris reaches State Pension age in November 2020. She paid reduced rate National Insurance contributions between her marriage in 1974 and divorce in 2005, so qualifies for the transitional protection arrangements. She paid full rate National Insurance contributions for a total of 15 years in the periods before and after she was married. She does not re-marry or form a new civil partnership prior to her State Pension age.

- 1) In 2020 we first work out a single-tier pension based only on her contributions:
- Iris had a foundation amount of £63.73. This was based on 15 qualifying years for basic State Pension and £10 of State Second Pension. After implementation she gained three more qualifying years, each giving rise to an extra £4.11 a week. This would be valued at:

Foundation Amount:

Calculation by current rules	£63.73
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Calculation by single-tier rules (15/35ths of £144)	£61.71
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The current rule valuation is higher, and so this becomes Iris' foundation amount.

Plus:

Three post-implementation qualifying years	£12.33
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Total	£76.06
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- 2) This would then be compared with a state pension valuation based only on her pre single-tier contributions but including an increase to represent the derived basic State Pension she could have got as a divorcee if the current system had continued:
- To do this, the basic State Pension amount in her pre single-tier valuation would be increased to the full rate (£107.45). Qualifying years under the single-tier system would not be added to this amount.

Alternative single-tier pension:

'Boosted' basic State Pension	£107.45
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State Second Pension	£10.00
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Total	£117.45
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Post-implementation qualifying years are not added

Iris would receive the higher of the two rates: £117.45. This would be paid as a single-tier pension of that value.

Inheritance of additional State Pension

36. Widows, widowers and surviving civil partners may inherit additional State Pension in the following circumstances:
- The bereaved is over State Pension age and the deceased died over State Pension age;
 - The bereaved is over State Pension age and reached State Pension age after 5 April 2010 or is a widow who reached State Pension age at any time¹⁰⁰ and the deceased died under State Pension age;
 - The bereaved is under State Pension age after 8 April 2001 and the survivor was entitled to bereavement allowance or widowed parent's allowance;
 - The bereaved is under State Pension age before 9 April 2001 and the survivor is a widow entitled to widow's pension or a widower who qualified for widowed parent's allowance under special rules or who reached State Pension age after 5 April 2010 who would have qualified for widow's pension if he had been a widow.
37. Where bereavement is under State Pension age, a survivor cannot inherit if they remarry or form a new civil partnership before State Pension age.
38. A survivor may inherit the following amounts:
- 50 per cent of the deceased's Graduated Retirement Benefit;
 - up to 100 per cent of SERPS (additional State Pension entitlement based on a National Insurance record built up between 1978 and 2002) where the survivor was widowed before 6 October 2002 or the deceased reached, or would have reached, State Pension age before that date;
 - up to between 60 per cent and 90 per cent of SERPS where the deceased reached, or would have reached, State Pension age between 6 October 2002 and 5 October 2010;
 - up to 50 per cent of SERPS where the deceased reached, or would have reached, State Pension age after 5 October 2010;
 - up to 50 per cent of State Second Pension (additional State Pension entitlement based on National Insurance record built up since 2002);
 - a reduced amount of State Second Pension if they are under age 55 when bereaved or when they cease to receive Child Benefit for their only or youngest child.
39. Where the deceased was contracted out of SERPS before 1997, a deduction is made to reflect the survivor benefit the contracted-out scheme is required to pay as a condition of contracting out.
40. Where the total amount of the survivor's own plus their inherited additional State Pension exceeds a specified limit, the excess is not payable.
41. There will be **no change** to the current rules on inheriting state pension where both members of a couple reach, or would have reached, State Pension age before single tier is implemented.

¹⁰⁰ Following the proposed introduction of same-sex marriage, the "at any time" rule for widows will continue to apply only to widows of men. Surviving same-sex spouses will qualify under the same rules as apply to civil partners – see the Home Office website for further information on Equal Marriage.

42. Transitional arrangements will allow inheritance of additional State Pension entitlement (determined under current rules) to continue under the circumstances set out below, where either the survivor or the deceased is in the single tier:

A – Where the survivor reached State Pension age in the current system and the deceased died under State Pension age before the implementation of single tier

Current rules will apply as the survivor is in the current system and the deceased could only have made contributions prior to the implementation of the single-tier pension.

B – Where the survivor reached State Pension age in the current system and the deceased reached State Pension age under single tier, or died under State Pension age after the implementation of single tier

Current rules will apply as the survivor is in the current system, but the inheritable amount will be based only on contributions made by the deceased prior to the implementation of the single-tier pension. The maximum amount of additional State Pension the survivor will be able to inherit will be 50 per cent because the deceased's State Pension age will be after 5 October 2010.

C – Where the survivor reached State Pension age under single tier, and the deceased reached State Pension age under the current system or died under State Pension age before the implementation of single tier

As the deceased could only have made contributions prior to the implementation of the single-tier pension, the survivor will be able to inherit an amount equal to the additional State Pension entitlement they could have inherited under current rules, with the additional condition that the marriage or civil partnership must have begun before the implementation of single tier.

If the survivor is bereaved under State Pension age and after the new bereavement support payment is introduced, their inherited additional State Pension will not be reduced based on their age when bereaved or when their youngest child ceases to be dependent. The inherited amount will be paid in addition to the survivor's single-tier pension.

43. In all cases, as now, a person who is under State Pension age when bereaved will not be able to inherit state pension from the deceased spouse or civil partner if he or she re-marries or forms a new civil partnership before State Pension age.

Inheritance of protected payments

44. Even where neither partner reaches State Pension age before single tier is implemented, inheritance will be possible in relation to the protected payment, a feature designed as part of the single-tier transition and explained in Chapter 4. A protected payment applies where the value of an individual's contributions at the point of implementation exceeds the full level of the single-tier pension. The excess amount is price protected and paid alongside the full single-tier amount at State Pension age.

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45. The survivor will inherit 50 per cent of any protected payment to which the deceased was entitled, or would have been entitled to, had they not died under State Pension age. The marriage or civil partnership must have been in existence immediately prior to single-tier implementation, and remained so until the point of bereavement. The inherited amount will be paid in addition to the survivor's single-tier pension.

Shared additional State Pension

46. Since December 2000 divorcing couples have been able to share the value of the additional State Pension which they may be entitled to as part of any financial settlement. Pension sharing applies equally to both men and women, however, the current distribution of additional State Pension entitlement has meant that the main beneficiaries have been women.
47. Pension sharing can be applied to the additional State Pension entitlement based on either spouse's own National Insurance record or the shared additional pension they gained from a previous divorce. Where a pension sharing order is made, part or the entire additional State Pension of one spouse is shared with the other. The court will determine the percentage split. The beneficiary will gain a shared additional State Pension which is payable on top of any additional State Pension entitlement they have in their own right. The additional State Pension of the former spouse will be reduced by a corresponding amount.
48. Pension sharing will not be applied to the single-tier pension. However, existing share orders will be honoured and the rules will allow for sharing of protected payments where these are awarded.

Other outdated features replaced under single tier

Category D pension

49. The Category D pension is a non-contributory pension paid at around 60 per cent of full basic State Pension to eligible pensioners over the age of 80. It was introduced in 1971 to provide age-related support to particular groups who did not have enough qualifying years to be entitled to a basic State Pension.
50. Under single tier the majority of pensioners in the future will be eligible for a state pension above the basic level of means-tested support based on their own National Insurance records. Category D pension will therefore be withdrawn for people reaching State Pension age under single tier.

Age Addition

51. The Age Addition is an additional payment on top of the basic State Pension for individuals aged 80 and above. When it was introduced in 1971 it was set at 25p per week, at a time when the full basic State Pension was £6 per week, and it has remained at this level ever since. It will be removed under the reforms with the savings recycled into the single-tier system. The Age Addition will be withdrawn for people reaching State Pension age after the implementation of the single-tier pension.

E. State Pension Deferral

Options to defer state pension

52. Under the current system, individuals can increase their state pension by deferring drawing it at State Pension age. A person who defers their state pension for at least a minimum period of five weeks can receive a higher weekly pension in return. Their state pension will increase by one per cent for every five weeks (10.4 per cent a year) they delay drawing it. If a person defers for at least 12 months consecutively they may choose to receive either a higher weekly state pension or a lump-sum payment in return. The lump-sum payment is based on the amount of state pension deferred, with weekly compound interest at two per cent above the Bank of England base rate.
53. The Government believes individuals should have the flexibility of choice in terms of drawing their pension if they decide to stay economically active and to continue working after State Pension age. Under the single-tier pension the ability to defer will therefore be retained. However, the deferral award will change under single tier. In order to simplify the scheme and ensure people have an increase to their income throughout their retirement it will no longer be possible to receive deferred state pension as a lump-sum payment.
54. For modelling purposes, the Department for Work and Pensions has assumed a deferral rate of one per cent for every ten weeks' deferral. This rate will be finalised closer to the planned implementation date, taking into account the value of the income foregone by the delay in drawing a single-tier pension and the fit with the Government's agenda for supporting people who wish to work for longer.

Inheritance of deferral rewards

55. Currently, it is possible to inherit a deferral reward from a deceased spouse or civil partner. It will not be possible to inherit a deferral reward on a single-tier pension. There is more information on changes to state pension based on another person's National Insurance record, including inherited state pension, earlier in this Annex.
56. Individuals who reach State Pension age before the implementation of the single-tier pension will continue to be able to defer their state pension in line with current rules. This will include the provisions that permit their surviving spouse or civil partner to inherit a deferral reward from them, whether that surviving spouse is covered by the current or single-tier system.

Claiming a deferred current system pension under single tier

57. It will not be possible for a person who reaches State Pension age before single tier is implemented to qualify for the single-tier pension by deferring their state pension. The single-tier rules will only apply to those who reach State Pension age on or after the implementation of the single-tier pension.

Annex 4 Example State Pension statement

1. An example State Pension statement is provided here for the illustrative case study 4.2 used in Chapter 4. This would be supported by a leaflet providing more detailed information. The Government will work with customers to develop the format of these documents ahead of the implementation of single tier.

Your State Pension statement¹⁰¹

This statement gives you an estimate of your single-tier state pension based on your National Insurance (NI) record up to the tax year ending 5 April 2017.

It is based on the law as it currently stands. Any changes in the law, your circumstances or your NI record may affect the information provided.

The figures shown are in 2017-2018 values.¹⁰² The value of the state pension is usually increased each year to take account of inflation.

Single-tier state pension estimate

We estimate that your single-tier state pension is **£49 a week**.

The amount shown will increase by 1/35th of the full single-tier state pension amount – £4.11 a week – for each qualifying year added to your NI record between now and when you reach your State Pension age, until it reaches the full single-tier state pension of £144 a week.

If twenty four more qualifying years are added to your NI record before you reach your State Pension age, you would get the full single-tier state pension of £144 a week.

State Pension age

You reach your ***State Pension age*** on 14 March 2053.

This is the earliest date you will be able to get your single-tier state pension.

You do not have to claim your state pension when you reach your State Pension age. You may be able to get more state pension by putting off your claim. This means either delaying when you start to get your state pension or stopping claiming your state pension for a period of time. This is called ***deferring*** your state pension.

More information

You will find more detailed information about your single-tier state pension estimate in the leaflet '*Your State Pension statement explained*.'

¹⁰¹ When users hover over text shown in ***bold italics*** they will be able to read an explanation of what the terms mean.

¹⁰² This is used illustratively. Figures in this example State Pension statement are in 2012/13 terms.

Annex 5

Proposed timetable for implementing the increase in State Pension age to 67

Period within which birth date falls	Age at which State Pension age will be reached
6 April 1960 – 5 May 1960	66 years and 1 month
6 May 1960 – 5 June 1960	66 years and 2 months
6 June 1960 – 5 July 1960	66 years and 3 months
6 July 1960 – 5 August 1960	66 years and 4 months ¹
6 August 1960 – 5 September 1960	66 years and 5 months
6 September 1960 – 5 October 1960	66 years and 6 months
6 October 1960 – 5 November 1960	66 years and 7 months
6 November 1960 – 5 December 1960	66 years and 8 months
6 December 1960 – 5 January 1961	66 years and 9 months ²
6 January 1961 – 5 February 1961	66 years and 10 months ³
6 February 1961 – 5 March 1961	66 years and 11 months
6 March 1961 – 5 April 1977	67

Notes:

For the purposes of determining the age at which State Pension age will be reached, the following applies:

¹ A person born on 31st July 1960 is considered to reach the age of 66 years and 4 months on 30th November 2026.

² A person born on 31st December 1960 is considered to reach the age of 66 years and 9 months on 30th September 2027.

³ A person born on 31st January 1961 is considered to reach the age of 66 years and 10 months on 30th November 2027.

Glossary of terms

Additional State Pension	This term is used to refer to the different variants of state earnings-related pensions that have existed since 1978 e.g. SERPS between 1978-2002 and State Second Pension from 2002.
Age Addition	An extra 25 pence a week in pension is paid to people over 80.
Automatic Enrolment	The requirement for employers to enrol eligible employees into a qualifying workplace pension from October 2012.
Basic State Pension	A regular payment from the Government upon reaching State Pension age given to those who have built up a sufficient National Insurance record.
Benefit Unit	This is a single adult or a married or cohabiting couple and any dependent children; since January 2006 same-sex partners (civil partners and cohabittees) have been included in the same benefit unit.
Category D Pension	This is for those individuals who are 80 or over and have not paid enough National Insurance contributions. Can be a top up of the basic State Pension they are entitled to. For those who have lived in the UK for at least ten years since they were 60.
Consumer Price Index (CPI)	This measures changes in the price level of consumer goods and services purchased by households. It is published by the Office for National Statistics. Used to uprate most state benefits from April 2011.
Contracting Out	When individuals leave the additional State Pension and join a contracted-out Defined Benefit occupational pension instead. They receive a rebate of NICs. Between 1988 and 2012, people could also contract out from a Defined Contribution pension scheme.

Contracted-out rebate	'Rebate' has been used as a collective term to describe two forms of paying a lower amount of NICs: first an individual in an occupational pension scheme will have paid reduced NICs. Second, for those contracted out via a personal pension, HMRC will have paid a rebate directly into the scheme. The rebate's value is set to enable the pension provider or scheme to fund a pension benefit broadly equivalent to the additional State Pension the individual would have received if they had remained contracted in.
Foundation amount	The single-tier start level that an individual's pre-implementation contribution record will give them on reaching State Pension age calculated as at implementation.
Guarantee Credit	This is an element of Pension Credit and tops up an individual's weekly income to a 'standard minimum guarantee'.
Guaranteed Minimum Pensions (GMPs)	The minimum pension which an occupational pension scheme has to provide for those employees who were contracted out of SERPS between 6 April 1978 and 5 April 1997.
Minimum qualifying period	An individual will need at least seven to ten qualifying years of National Insurance contributions or credits in order to qualify for any single-tier state pension.
National Employment Savings Trust (NEST)	A low-cost pension scheme that is open to all employers who wish to use it. The scheme is intended to provide a suitable savings vehicle for those moderate-to-low earners to whom the existing private pension industry does not offer a suitable product.
National Insurance credits	Credits of earnings awarded by the Government in certain circumstances (for instance, when someone has caring responsibilities or is registered unemployed). They cover periods when a person is not paying National Insurance contributions.
National Insurance record	An individual's history of National Insurance contributions and credits.
Reduced Rate Election	Until 1977 married women and widows could 'elect' (choose) to pay a reduced rate of Class 1 National Insurance contributions. These women can get some benefits based on their (late) husbands' contributions.
Pension Credit	An income related benefit for pensioners living in Great Britain which supplements weekly income after the qualifying age is reached. The amount payable varies by age and income and it is made up of two parts – Guarantee Credit and Savings Credit.
Personal pension	A private pension arrangement between an individual and a pension provider. In some cases the employer also makes a contribution to the pension, but not in all cases.
Private pension	Any non-state pension including employer, public-sector pensions and personal and stakeholder pensions.

Protected Payment	Where an individual's starting valuation amounts to more than the full rate of single tier, this additional amount will be recognised for future payment as a 'protected payment'. It will be protected against price inflation.
Qualifying Year	A tax year during an individual's working life in which they paid, were treated as having paid or were credited with National Insurance contributions on earnings of 52 times the weekly 'lower earnings limit'.
Retail Price index (RPI)	This measures the change in the cost of a basket of retail goods and services. It is a measure of inflation published monthly by the Office for National Statistics.
Savings Credit	This is an element of Pension Credit and provides an extra payment for people who have income/savings above the level of the Savings Credit threshold.
State Earnings-Related Pension Scheme (SERPS)	Between April 1978 until April 2002 this was the earnings related part of the state pension.
State Graduated Pension (Grad)	Introduced in April 1961 and also known as the Graduated Benefit or Graduated Retirement Benefit. This was a state scheme related to an individual's National Insurance contributions which were in turn related to earnings.
State Pension age (SPa)	The age at which a person can claim their State Pension as laid down by legislation.
State Second Pension (S2P)	Introduced on 6 April 2002, to replace SERPS. It improved benefits for low and moderate earners and extended access to include certain carers and people with long-term illness or disability.
Triple lock	The current policy by which the value of the basic State Pension is increased each year by the highest of price inflation, increase in earnings or 2.5 per cent.
Uprating	The annual increase in a benefit or pension.
Workplace pension	A pension scheme offered by an employer. This is a type of private pension.

Abbreviations

AHC	After Housing Costs
BHC	Before Housing Costs
BSP	Basic State Pension
CPI	Consumer Price Index
DB	Defined Benefit
DC	Defined Contribution
DWP	Department for Work and Pensions
EEA	European Economic Area
EEF	Engineering Employers Federation
EU	European Union
GAD	Government Actuary's Department
GB	Great Britain
GDP	Gross Domestic Product
GMP	Guaranteed Minimum Pension
HMRC	Her Majesty's Revenue and Customs
HMT	Her Majesty's Treasury
LEL	Lower Earnings Limit
ISAs	Individual Savings Accounts

NAPF	National Association of Pension Funds
NEST	National Employment Savings Trust
NICs	National Insurance contributions
OBR	Office for Budget Responsibility
OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics
PAYE	Pay As You Earn
RPI	Retail Price index
S2P	State Second Pension
SERPS	State Earnings-Related Pension Scheme
SPa	State Pension age
UAP	Upper Accrual Point
UK	United Kingdom



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