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 2011[10], 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.

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;

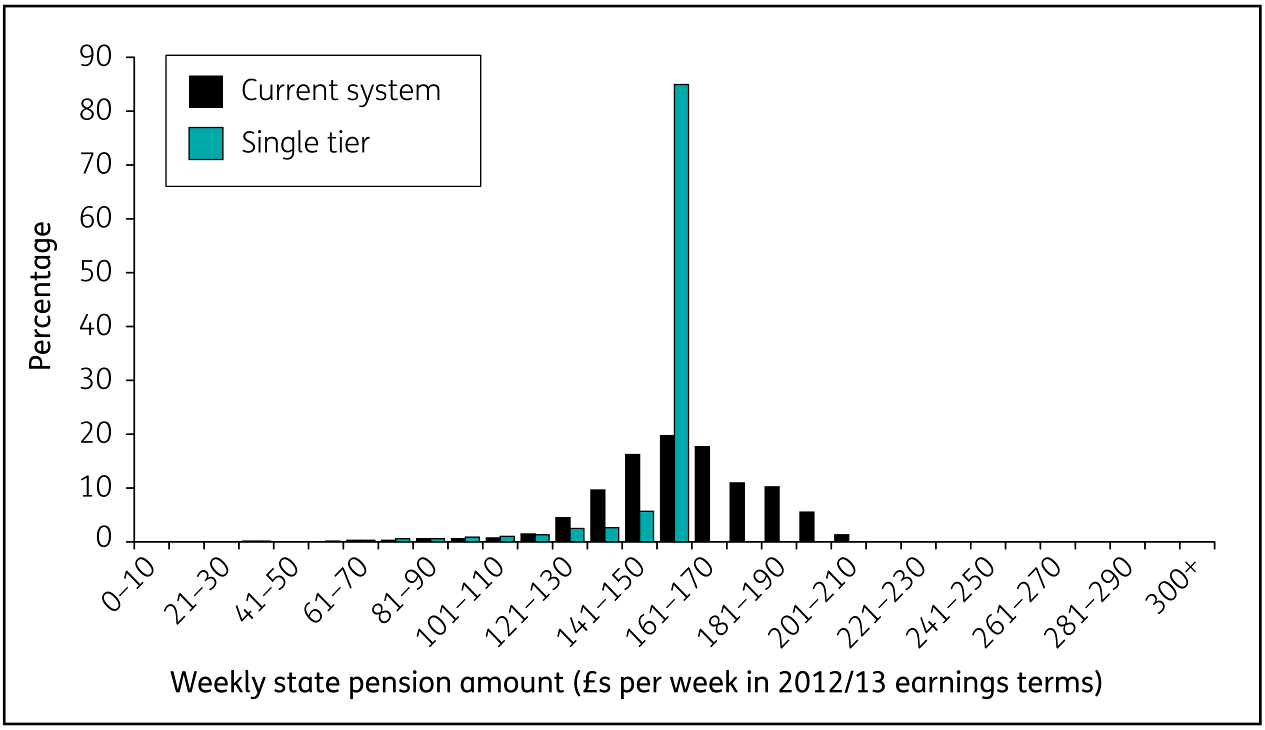
[14] MacLeod *et al.*, 2012, *Attitudes to Pensions: The 2012 survey*, Department for Work and Pensions Research Report No 813, Department for Work and Pensions.

[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 systems[16]



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 uprating it is expected that the single-tier pension value will grow slightly faster than average earnings over the long term.

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.

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.

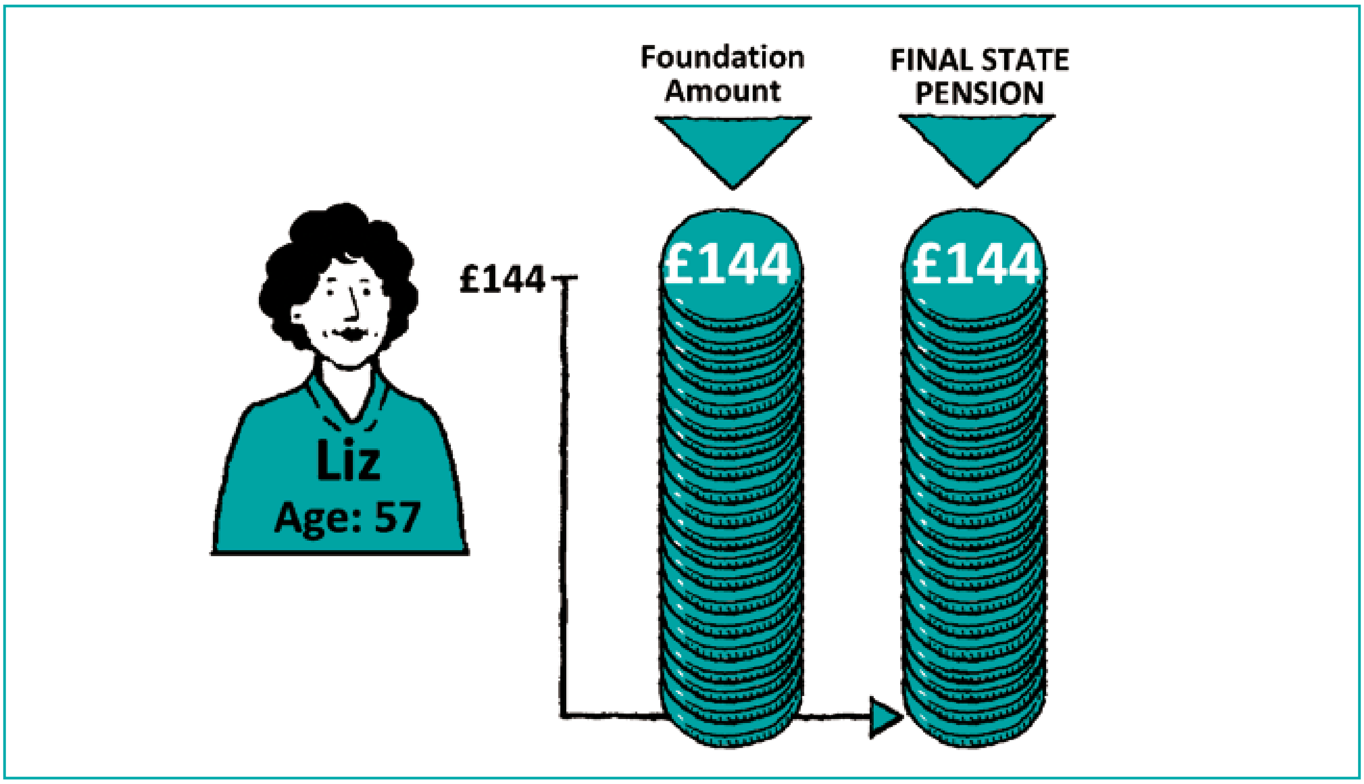
36. To this end, the Government will carry out a review of the State Pension age every five years, based around the principle that people should maintain a specific proportion of adult life receiving the state pension. This will be informed both by analysis of life expectancy projections by the Government 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.

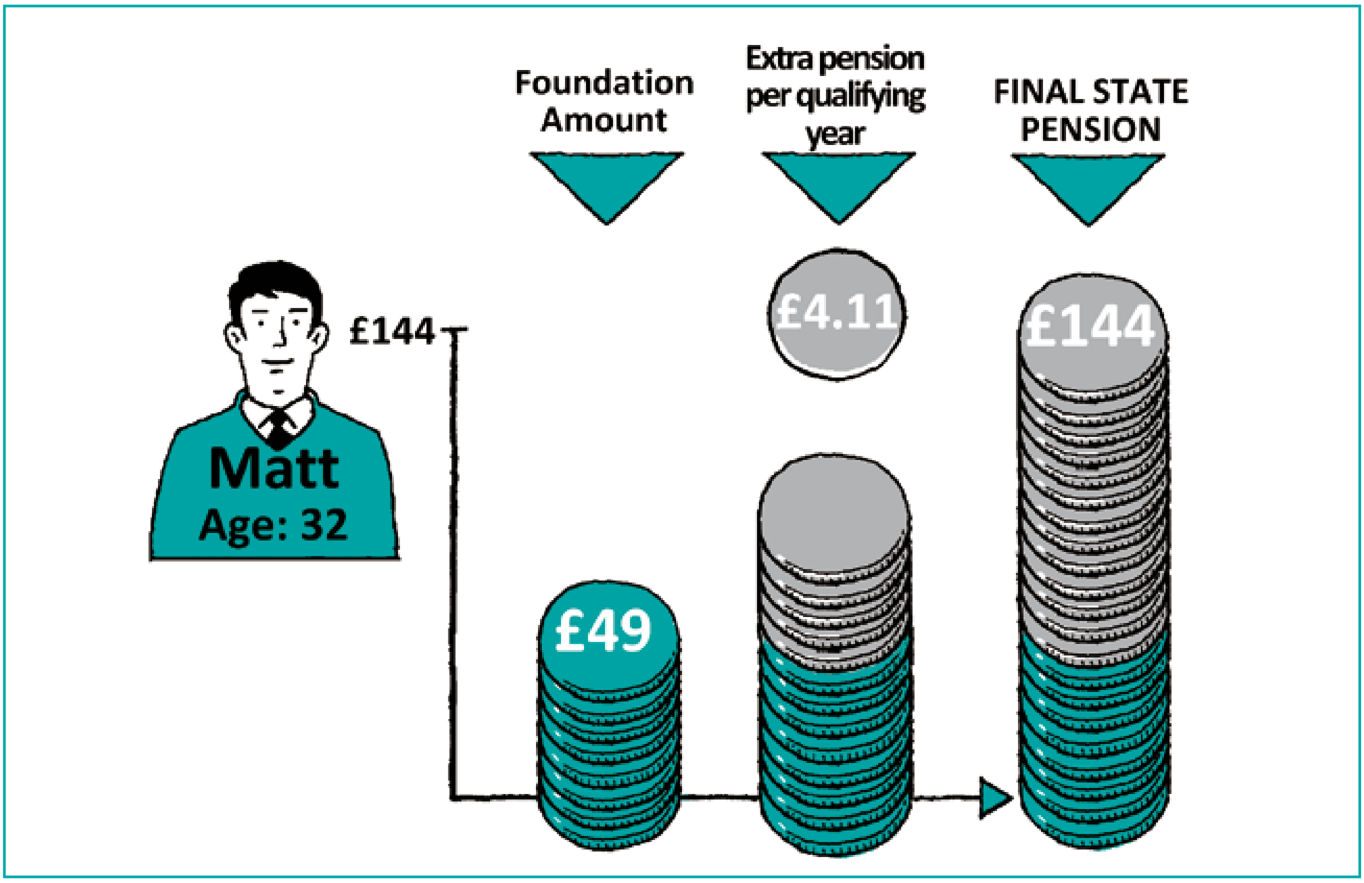
Case Study E1.1: Liz, at implementation aged 57, with a foundation amount which is equal to the full level of the single-tier pension



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.

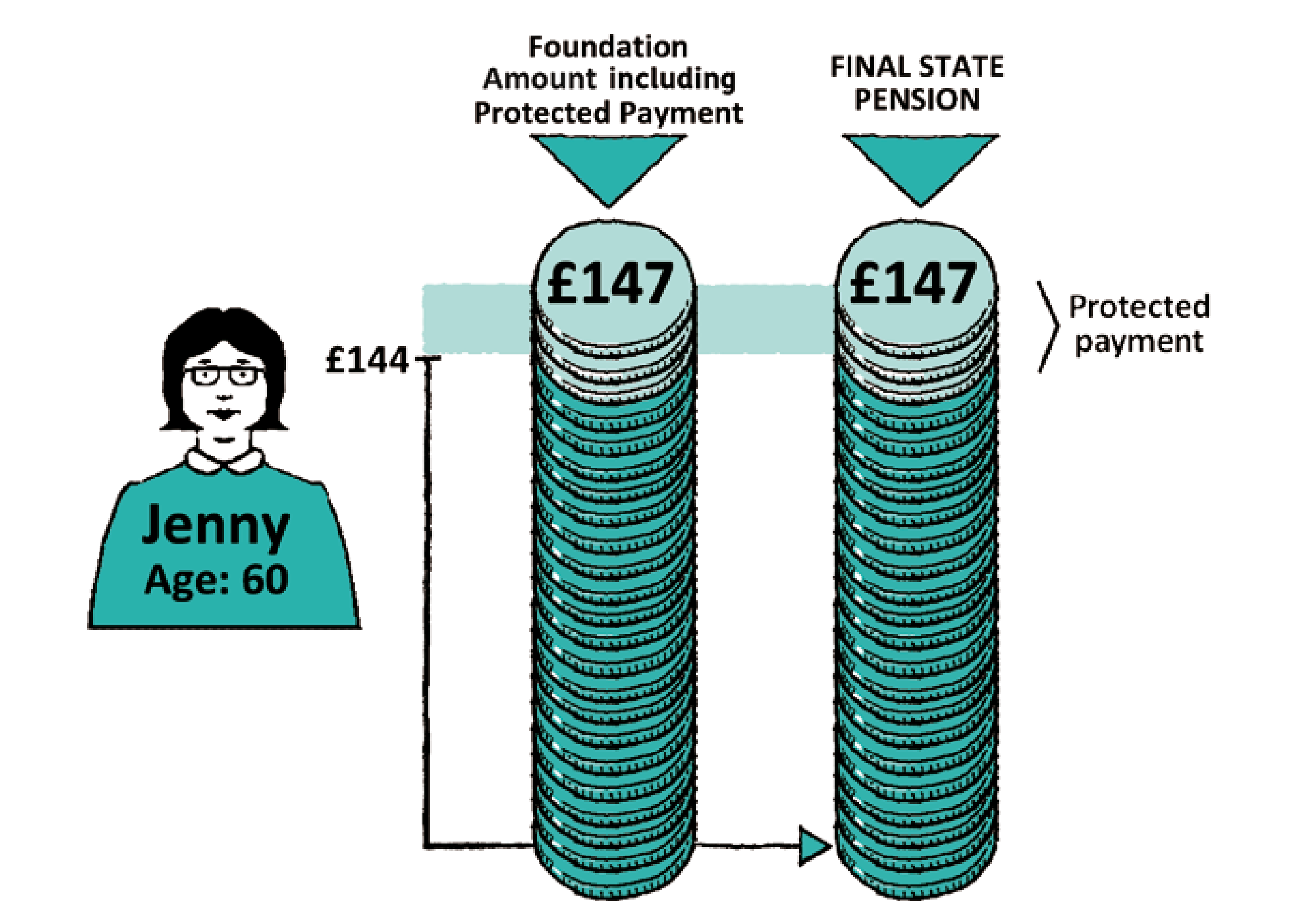
Case Study E1.2: Matt, at implementation aged 32, with a foundation amount less than the full level of the single-tier pension



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.

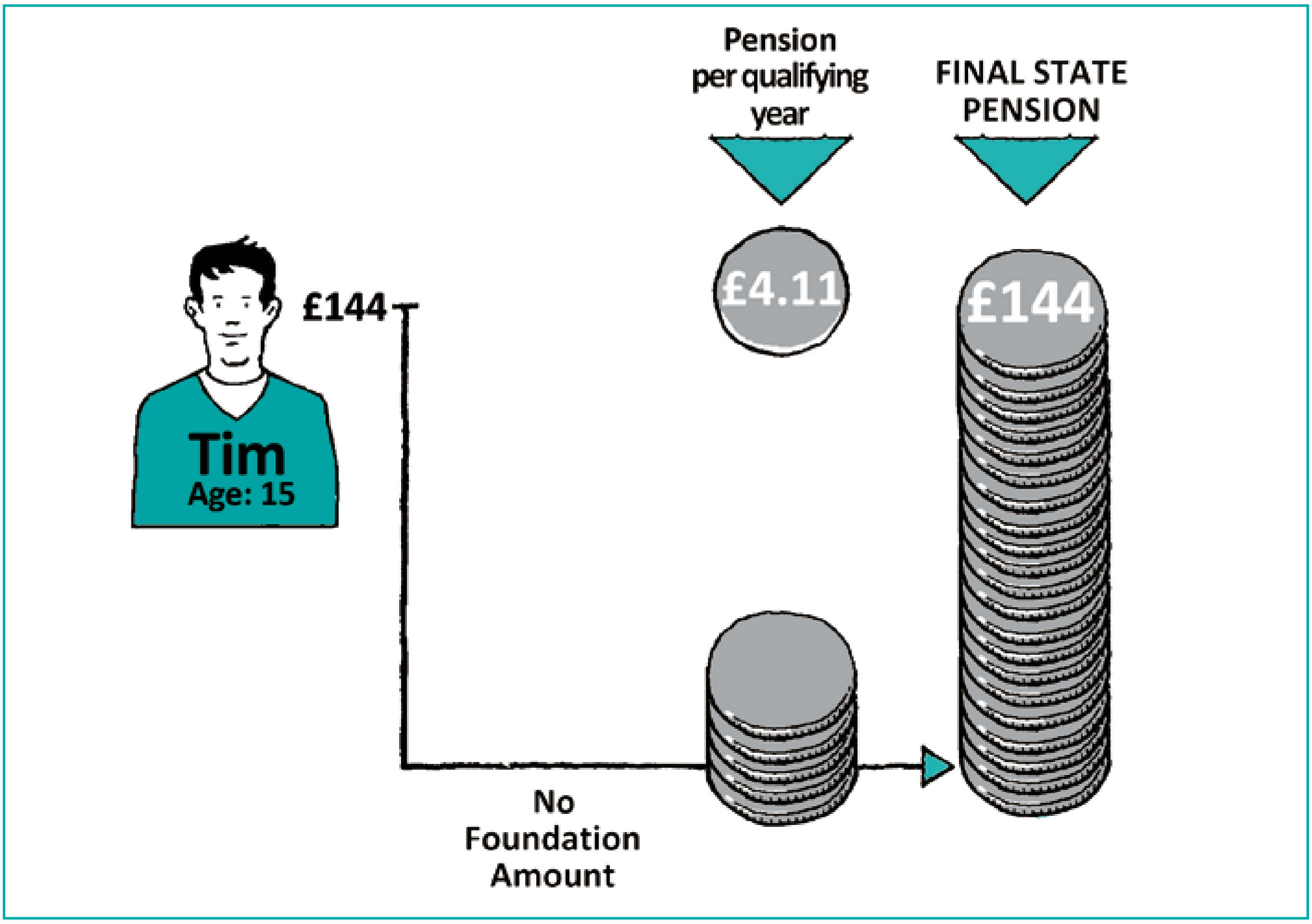
Case Study E1.3: Jenny, at implementation aged 60, with a foundation amount which is more than the full level of the single-tier pension



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.