GREEN PAPER: A STATE PENSION FOR THE 21ST CENTURY - SYNOPSIS

The Department for Work and Pensions issued a Green Paper setting out the Coalition Government's proposals for future pension reform on 4 April 2011.

The consultation paper was issued by the Department to stakeholders in Northern Ireland.

The consultation ends on 24 June 2011.

The Paper seeks views on:-

- options for reform of the State Pension that better support saving for retirement;
- the most appropriate mechanism for determining future changes to State Pension age; and
- whether a new safety net for the poorest pensioners needs to be considered.

The current state pension system

- There is substantial complexity and uncertainty in state pension outcomes as a result of the structure of the current system (basic state pension, state second pension, contracting out and state pension credit).

- Many are therefore unsure what their total state pension will be worth when they retire. This makes it more difficult for people to plan and save for their retirement.

- There is a question as to whether the extent of means testing in the current system strikes the right balance between protecting the poorest while ensuring people have clear incentives to save.

- Inequalities remain in the system – although the position is improving, groups such as women tend to have lower state pension outcomes.

- Affordability and sustainability are concerns in light of increasing life expectancies and an increasing older population.

- While people are living longer, not enough are saving for their retirement.

- To tackle undersaving automatic enrolment into workplace pensions and the establishment of the National Employment Savings Trust to encourage and enable more people to save for their retirement will be introduced from 2012.

Options for reform

The Green Paper seeks views on two broad options for reform to deliver a simple, flat-rate contributory state pension that lifts the majority of future pensioners above the current standard level of means-testing:

Option 1: acceleration of existing reforms so that the state pension evolves into a two-tier flat-rate structure by 2020 instead of the early 2030's. This would consist of an amount made up from basic State Pension and State Second Pension. A flat-rate State Second Pension would give a clearer idea of the state pension a person will receive in retirement.

Option 2: combining basic State Pension and State Second Pension into a single-tier flat-rate pension set above the level of the Pension Credit standard minimum guarantee. Future pensioners with at least 30 qualifying years would receive the same flat-rate pension currently estimated at £140 a week.

Means tested support

The consultation seeks views on means tested support which ensures it pays to save for retirement and which reduces complexity.

State Pension age mechanism

The State Pension age plays an important role in ensuring that the state pension remains sustainable and affordable.

It is recognised that the State Pension age must be kept under constant review and the Green Paper seeks views on two options which are:

- Increasing the State Pension age through a formula linked to life expectancy; or
- Increasing the State Pension age through a review.

COMMITTEE BRIEFING – GREEN PAPER: A STATE PENSION FOR THE 21ST CENTURY

On 4 April 2011 the Department for Work and Pensions issued a Green Paper setting out the Coalition Government's proposals for future pension reform. The consultation paper has been issued in Northern Ireland and has been made available on the Department's website.

The consultation period ends on 24 June 2011.

The Paper seeks views on:-

- options for reform of the State Pension that better support saving for retirement;
- the most appropriate mechanism for determining future changes to State Pension age; and
- whether a new safety net for the poorest pensioners needs to be considered.

Background – the context for reform

The Government is considering options for delivering a simpler and fairer State Pension which rewards those who save for their retirement but which is sustainable for future generations. It has four main guiding principles in relation to pension reform. These are:

- personal responsibility;
- fairness;
- simplicity; and
- affordability and sustainability

Personal Responsibility

- many people rely on Pension Credit to top up their income but means testing can deter people from saving;
- around a third of pensioners do not claim the Pension Credit they are entitled to;
- does means testing strike the right balance between protecting the poorest while ensuring people have clear incentives to save?

Simplicity

- the substantial complexity in the current state pension system and many are unsure what their state pension will be worth when they retire;
- this makes it more difficult for people to plan and save for retirement;

Fairness

- women, low paid and the self-employed tend to have lower state pensions;
- around two-thirds of Pension Credit claimants are women;
- women are also less likely to become entitled to a comparable level of additional State Pension because of periods spent outside the labour market caring for children;
- recent reforms aimed at reducing inequalities for women includes:
    - reducing to 30 the number of years needed to qualify for a full basic State Pension; and
    - introducing more generous credits for carers.
- self-employed are not entitled to the State Second Pension.

Affordability and sustainability

- life expectancy in the UK has reached its highest level on record for men and women;
- in 1981, an average 65-year-old man could expect to live for another 14 years, today it’s over 21 years;
- while people are living longer fewer are saving for their retirement – across the United Kingdom it is estimated that around seven million people are not saving enough for their retirement;
- to tackle under-saving National Employment Savings Trust established;
- employers will be required to automatically enrol eligible employees into a qualifying pension scheme and to make mandatory employer contributions on their behalf.

<u>Options for State Pension reform</u>

The Government believes it is necessary to reform the state pension for future pensioners so it provides a better foundation to save for retirement. It is also seeking to reduce complexity.

The Green Paper seeks views on two broad options for delivering a simple, flat-rate contributory state pension that lifts the majority of future pensioners above the current standard level of means-testing.

The options are:

1. **acceleration of existing reforms so that the state pension evolves into a two-tier flat-rate structure more quickly; or**

2. **more radical reform to a single-tier flat-rate pension set above the level of the Pension Credit standard minimum guarantee.**

Option 1

The basic State Pension is a flat-rate payment and the State Second Pension is partly flat-rate and partly linked to earnings. Current legislation removes the earnings-related component of the State Second Pension so that the State Pension will evolve into two separate flat-rate components by the 2030s.

This option would accelerate the pace of these reforms so the State Second Pension would become flat rate by 2020 instead of the early 2030's. A flat-rate State Second Pension would give people a clearer idea of the amount of State Pension they would get in retirement.

A person with 30 qualifying years would build up a state pension, currently estimated at around £145 a week through two tiers. People who contract out of the State Second Pension will, as now, receive part of that pension payment from their private pension rather than delivered through the state.

It would be possible to use the same uprating for the two elements when in payment. There may be scope to consolidate the calculations of the different pensions used to determine the additional State Pension. This has already been legislated for. Consolidating past calculations would give people a clearer idea of their future pension and provide a more transparent basis for a flat-rate pension going forward.

Under this option, the large majority of people could expect to receive a state pension that lifted them above the standard level of means-tested support only by around the middle of this century. However, the State Second Pension, which is one of the key causes of variability and uncertainty in state pensions, would be retained, meaning people may not have absolute clarity as to the amount of state pension they would receive when they retire.

Option 2

This option combines basic State Pension and State Second Pension into one single-tier state pension. Future pensioners with at least 30 qualifying years would receive the same flat-rate pension currently estimated at £140 a week which is higher than the basic level of support provided by Pension Credit.

People would qualify for the single-tier pension individually, irrespective of whether they were married, divorced or widowed, reflecting the fact that most people working today can expect to build up sufficient state pension in their own right. Rules around state pension entitlement would be simplified so that there would be no special rules for bereavement, marriage or divorce.

The self-employed, as well as employees, would be able to build up entitlement to the single-tier pension.

A person would need a minimum level of seven years of contributions or credits to qualify.

The State Second Pension would end as would contracting out for Defined Benefit schemes and the Savings Credit element of Pension Credit.

This option would deliver improved pensions for women, low-paid workers and the self-employed, providing the basis for a fairer system. Uprating will be by the triple guarantee (earnings, prices or 2.5 per cent whichever is the highest) so people could be confident their State Pension would maintain its value over time.

Transitional arrangements

The National Insurance contributions people have already made would have to be taken into account up to the point the new system is introduced. Recognising these contributions would inevitably mean that some of the complexity of the current system, particularly related to contracting out, would continue during the transition to the single-tier pension. Transitional provision would have to take into account two issues:

- **Recognising people's pension records under the existing system in a way that is fair, but facilitates transition to the new system as quickly as possible:** This could be achieved by calculating pension records under the existing system and then, during transition to the new system, recognising amounts in excess of the currently estimated single-tier pension of £140. This would mean people with higher amounts of additional State Pension before the introduction of single tier would receive correspondingly higher weekly payments than the current estimate of £140.

- **Calculating entitlement to the new pension taking account of periods spent contracted out of the State Second Pension in a way that is fair, but delivers simplicity and clarity as quickly as possible:** This would mean that during the transition many would receive their single-tier pension from a combination of their state and contracted out scheme, as happens now. This means they would receive less than the currently estimated £140 directly from their state pension.

Means tested support

It is recognised that there will always need to be a safety net benefit to help those pensioners who do not have sufficient resources to meet their basic needs in retirement.
Consideration needs to be given as to whether reforms are needed to the current system of means-tested support to ensure that this part of the system delivers on the principles for reform.

Pension Credit currently has two elements – the Guarantee Credit that ensures people have a minimum income and the Savings Credit which ensures those with small amounts of savings see some reward. Additional support is provided for those with a disability, carers and those with mortgages. Many people on Pension Credit may also get additional support through Housing Benefit.

The Savings Credit element was introduced to ensure that those who have made some modest provision for their retirement above the level of the basic State Pension are rewarded for saving. However, due to under-saving for retirement, Pension Credit has effectively evolved from being a safety net for the poorest pensioners to being a more general top up for basic retirement income for those who have had low and moderate incomes during their working lives.

The main concerns for many when considering their retirement provision are whether they will be subjected to means-testing when they retire and if they do have to rely on means-tested support the uncertainty about the extent of withdrawal of benefits for every pound of income.

Therefore the consultation seeks views on how means tested support can help ensure that it pays to save for retirement and reduce complexities in the current system.

State Pension age mechanism

State Pension age plays an important role in ensuring that the state pension remains sustainable and affordable – one of the key principles underpinning future pension reform. An ageing population will create significant pressures on future public finances. In reaction to recent growth in life expectancy, the Westminster Government has brought forward proposals to increase the State Pension age to 66 by April 2020.

Increases in longevity are projected to continue and the Westminster Government believes it is fair that those generations who will benefit from these increases should share in the costs.

It is recognised that the State Pension age must be kept under review. The Green Paper seeks views on how to build into a future state pensions system a more automatic mechanism for ensuring further revisions in life expectancy are taken into account in a way that is timely and transparent.

Two options are considered:

1. **Increasing the State Pension age through a formula linked to life expectancy.**

    - any increases in life expectancy would automatically adjust the State Pension age;
    - State Pension age would rise on a continual basis as soon as revised life expectancy projections were available;
    - there may be difficulties in maintaining the need to provide some period of notice for those affected by any increases.

2. **Increasing the State Pension age through a review.**

    - a review at pre-determined intervals would give greater certainty about when the State Pension age would be considered again in the future;
    - review-based approach would also enable wider factors to be taken into account by the Government in making any final decisions such as variations in life expectancy and the fiscal position;
    - a review mechanism could be more complex than a formula to determine what the State Pension age should be because of possibly conflicting evidence.

Consultation

Any responses received in Northern Ireland will, with Minister's agreement, be shared with the Department for Work and Pensions. We will also share these with the Committee if requested.

The Department for Work and Pensions has indicated that it aims to publish a summary of all responses received later in the summer.