Department for Work & Pensions

Government Response to the Fifth Report of the House of Commons Work and Pensions Select Committee, Session 2012-13, into Part 1 of the draft Pensions Bill

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

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Introduction

The Government welcomes the Fifth Report of the Work and Pensions Select Committee (Session 2012-13), published on 4 April 2013, and the contributions from stakeholders and individuals in written and oral evidence.[1] The Government is grateful to the Committee for agreeing to undertake pre-legislative scrutiny of Part 1 of the draft Pensions Bill in a highly compressed timescale, which has allowed time for the Report to be considered and the Bill amended before introduction into Parliament. The Government recognises that this process was further complicated by its announcement towards the end of the Committee's scrutiny that the implementation date had been brought forward.

Pre-legislative scrutiny has raised a number of important issues and resulted in two changes to the Pensions Bill: to specify the start date of the single-tier pension and to put an upper limit on the Minimum Qualifying Period (MQP) in primary legislation. The Pensions Bill has been introduced into the House of Commons and a summary of the changes made to Part 1 of the Bill since it was published in draft is at Annex A.

Part 1 of the Pensions Bill introduces the single-tier pension, which will replace the basic and additional State Pensions for those reaching State Pension age after its implementation in April 2016. The Government welcomes the Committee's broad support for these reforms, which will deliver four key outcomes: clarity; a reduction in means testing; a fairer system, appropriate to the lives and employment patterns of today's working-age population; and improved sustainability.

The single tier will achieve greater clarity of outcomes by replacing the basic and additional State Pensions, as well as a range of outdated additions, with a simple, flat-rate pension, set above the level of the basic means test. This will reduce the scope of means testing in the State Pension system, clarify incentives to save and support automatic enrolment into workplace pensions. These reforms will also bring forward the equalisation of male and female State Pension outcomes by over a decade, with over 80 per cent of people becoming entitled to a full single-tier pension in their own right by the mid-2030s, rather than depending on the National Insurance (NI) record of a spouse or civil partner.[2]

1 House of Commons Work and Pensions Committee, April 2013, Fifth Report of Session 2012-13, *The Single-tier State Pension: Part 1 of the draft Pensions Bill*, HC 1000, TSO.
2 Department for Work and Pensions, January 2013, *The single-tier pension: a simple foundation for saving*, Cm 8528, TSO.

The single tier will help to ensure the sustainability of the State Pension in the longer term by slowing down the rate at which State Pension expenditure is increasing; by 2060, pension expenditure under single tier is around 8.1 per cent of Gross Domestic Product (GDP), compared to 8.5 per cent if the current system were rolled forward.[3]

This report sets out the full Government response to each of the Committee's recommendations and addresses a number of the conclusions. Alongside this report and the Pensions Bill, we have also published an updated impact assessment for the Bill.

[3] Department for Work and Pensions, May 2013, *Pensions Bill Impact assessment: The single-tier pension: a simple foundation for saving*, Department for Work and Pensions.

Response to recommendations and conclusions

The recommendations and responses have been grouped according to the chapter titles and sub-titles used in the Committee's Report, with the exception of recommendation 8, which has been considered in conjunction with recommendation 6 as both concern the Government's communications strategy.

1. Introduction
Our approach to this report

Recommendation 1

It has not been possible for us [the WPSC] to take further evidence on the implications of the earlier implementation date for the STP [single-tier pension] because the Government announced it after we had completed the evidence-taking for our inquiry. The change is particularly significant for the pensions industry and employers because of the adjustments which they will need to make to workplace pensions schemes to take account of the ending of contracting-out, but it clearly also has implications for many groups of individuals. We [the WPSC] consider it imperative, therefore, that the Government carries out a further Impact Assessment of the Single-tier Pension proposals. This should take particular account of the impact of the changed timetable on the pensions industry and employers. The revised Impact Assessment should be published at the same time as the finalised Bill is introduced in May 2013, together with the other additional analyses of impacts and costing of options by DWP which we have indicated are required.

The Government recognises that the decision to bring forward the implementation date by a year to April 2016 at this stage in the process had an impact on the Committee's scrutiny of the draft Pensions Bill. The decision to return to the original timetable was taken in order to deliver the new system as soon as possible, to support the roll-out of automatic enrolment and provide certainty concerning the changes for both individuals and their pension schemes at the earliest opportunity. The new implementation date will mean that around 400,000 more people will reach State Pension age under single tier, including every woman affected by the acceleration of the State Pension age equalisation process in the Pensions Act 2011.

The new implementation date will have implications for employers and the pensions industry due to the end of contracting out. Since the publication of the Committee's Report, we have consulted further with stakeholders and industry representatives to understand this impact. We will continue to work with these groups as we move towards implementation.

The Government has also published an updated Pensions Bill impact assessment[4] which takes account of the new implementation date and includes additional material, including more information on the impacts on individuals. In particular it provides more analysis of the impact of the end of the contracting-out rebate on individuals, more information on derived entitlement and the MQP, as well as a number of case studies that will help stakeholders and the general public to better understand how the policy affects outcomes.

2. Overall impacts of the reform
Pension Credit and reliance on means-tested benefits

Recommendation 2

Pensioners on low incomes who are entitled to Pension Credit are often also entitled to other means-tested support, particularly Housing Benefit and Council Tax support, as well as other passported benefits. The Government has indicated that there will be transitional protection for people who would have been entitled to both Savings Credit and Housing Benefit under the current system. However, the details of how this will work in practice are not clear. We [the WPSC] recommend that the Government develops and publishes a clear explanation of how means-tested support, including passported benefits, will operate under the Single-tier, and of the transitional protection that will be put in place, in time for consideration of the final legislative proposals later this year.

The Government accepts the need to make public further detail on the changes to means-tested benefits and will do so during the passage of the Pensions Bill. We have already announced that the Savings Credit will be removed for those reaching State Pension age after the introduction of the single-tier pension. The Government is considering the detail of the provisions for mixed-age couples (where one member reaches State Pension age after the introduction of single tier) and the intention is that transitional protection will apply to those mixed-age couples already in receipt of Savings Credit, provided entitlement remains. The Government will provide further information on how we expect this to operate during the passage of the Bill.

The White Paper, *The single-tier pension: a simple foundation for saving*, set out that the removal of the Savings Credit will entail linked reductions in additional support for housing costs and signalled an intention to provide protection for those reaching State Pension age in the first five years after single tier is introduced. The Government is currently considering the question of housing support for pensioners following the introduction of Universal Credit and will consider this issue in that context.

[4] Department for Work and Pensions, May 2013, *Pensions Bill Impact assessment: The single-tier pension: a simple foundation for saving*, Department for Work and Pensions.

As the Committee notes, Pension Credit acts as a passport to other benefits and schemes, the majority of which use receipt of the Guarantee Credit element (with or without the Savings Credit) as the main criterion for entitlement. Decisions on passporting rest with the relevant payment or service provider but, for those benefits administered by the Department for Work and Pensions (DWP), the arrangements are reviewed annually in order to target expenditure on those in greatest need.

The Guarantee Credit will remain as a safety net for the poorest pensioners and the carer's premium and extra amount for severe disability will continue to recognise higher levels of need.

Incentives to save

Conclusion 4

We [the WPSC] welcome the Single-tier Pension (STP) as a necessary complement to automatic enrolment in workplace pensions. We [the WPSC] believe that the STP will give people more clarity about the amount they can expect the State to provide for them in retirement so that they are better placed to make decisions about whether and how much to save in a workplace pension or other private pension. The STP is not, however, in itself a "silver bullet" solution to the problem of low saving levels for retirement. Further measures to encourage private pension saving and to increase consumer confidence in the pensions industry, including through improved governance of pension schemes, are also required, particularly in the context of people being automatically enrolled into workplace pensions. Earlier education about planning one's retirement income is also needed and should start in schools, as part of a financial education curriculum. We [the WPSC] will address these issues in our forthcoming report on governance and best practice in workplace pension schemes.

There has been a significant decline in retirement saving over several decades; the number of people saving into an occupational pension scheme has fallen from a peak of just over 12 million active members in 1967 to 8.2 million in 2011[5] and the Government now estimates that almost 11 million people of working age face an inadequate income in retirement[6]. The Government is introducing a number of policies to reverse this trend, including single tier, automatic transfers of small pension pots and automatic enrolment into workplace pensions.

The single-tier pension will clarify incentives to save by lifting most people above the basic level of means-tested support: the proportion of single-tier pensioners entitled to Guarantee Credit is projected to be below 10 per cent at implementation and to fall below 5 per cent over the long term.[7] Moreover, following the introduction of single tier and Universal Credit, we expect nearly 80 per cent of people to have a marginal deduction rate of 20 per cent or less in 2040, rising to nearly 90 per cent of people in 2060, compared to 66 per cent under the current system in 2020. Those with full State Pension entitlement who are enrolled in a private pension are likely to see the lowest marginal deduction rates and benefit more from every pound saved.[8]

[5] Office for National Statistics, 2011, *Occupational Pension Schemes Survey*, ONS.
[6] Department for Work and Pensions, 2012, *Estimates of the number of people facing inadequate retirement incomes*, Department for Work and Pensions.
[7] Department for Work and Pensions, May 2013, *Pensions Bill Impact assessment: The single-tier pension: a simple foundation for saving*, Department for Work and Pensions.
[8] Department for Work and Pensions, 2013, *Enabling and encouraging saving: the evidence around pension reform and saving*, Department for Work and Pensions.

The Government will continue to encourage private pension saving and work to increase people's trust and confidence in, and engagement with, pension saving as set out in the recent strategy, *Reinvigorating workplace pensions*.[9] We have received the detailed recommendations relating to these issues in the Committee's Report on governance and best practice in workplace pension schemes and will respond in due course.

The Pensions Bill contains a number of measures designed to promote saving and restore confidence in the pensions industry. The Bill establishes the legal framework for automatic transfers of small pension pots, which will make it easier for individuals to consolidate their pension savings and see how much they have saved. It will also help them to keep track of small pension pots and reduce difficulties when buying a pension income at retirement, while also helping to ensure that they do not incur higher charges on pots to which they are no longer contributing.[10]

We are also working with industry to eliminate bad practices in the area of incentivised transfers, particularly the payment of cash sums. We have delivered a voluntary Code of Practice which defines principles to be followed by scheme sponsors and advisers when implementing such schemes and the Pensions Bill will allow Government to ban this practice if the voluntary approach does not work.

Winners and losers

Recommendation 3

The introduction of the STP, the roll-out of automatic enrolment and further increases in the State Pension Age will all significantly affect retirement planning and income, in different ways for different groups over the long period of transition. We [the WPSC] recommend that the Government carries out and publishes an assessment of the cumulative impacts of these policies on different population groups, including at a range of income levels, separately for men and women, at 10-year intervals over the period to 2060.

The Government agrees that single tier and automatic enrolment, as well as changes to State Pension age, are significant reforms affecting the entire working-age population. The forthcoming Strategy for Future Pension Saving will set out the key pension challenges faced by the Government, provide an assessment of the combined impact of existing measures and discuss the challenges for future pension policy.

The Pensions Bill impact assessment covers the measures for which we are legislating. This includes an impact assessment of bringing forward the increase in the State Pension age to 67 against a baseline of the current State Pension system and State Pension age timetable. It also contains an impact assessment for the single-tier pension against a baseline of the current State Pension system and the accelerated State Pension age timetable which will be legislated for in the current Pensions Bill. This sequential approach will demonstrate both the individual and cumulative impacts of these two changes and is consistent with the approach used when we published the draft Pensions Bill.

[9] Department for Work and Pensions, December 2012, *Reinvigorating workplace pensions*, Cm 8478, TSO.
[10] The Government outlined its plans in *Automatic transfers: consolidating pension savings* (Department for Work and Pensions, April 2013, Cm 8605, TSO).

3. Issues on which clarity is needed now
Balance between detail set out in primary and secondary legislation

Conclusion 7

Much of the detail of the Single-tier Pension proposals will be set out in Regulations rather than being contained in the primary legislation. We [the WPSC] understand the need for flexibility in this respect and the risk involved in Parliament agreeing primary legislation which is too prescriptive and which then has to be amended by further primary legislation. However, a proper assessment of the reforms, by Parliament and stakeholders, will not be possible until the detailed arrangements are finalised and published. The Government's announcement on 18 March that the implementation date for the STP is to be brought forward by a year makes it even more urgent that the draft Regulations are published as soon as possible, particularly those on the detailed arrangements for ending contracting-out which have major implications for pension schemes and employers.

The Government recognises the need to place sufficient detail in primary legislation to ensure that Parliament is able to effectively scrutinise these reforms and to provide clarity to those affected. The central features of the single-tier pension are therefore set out in the Pensions Bill, including the calculation of the foundation amount and deferral arrangements. The Bill also establishes transitional provisions for a range of circumstances and groups including: inheritance of additional pension; women who elected to pay a reduced rate of NI contributions before 1977; and pension sharing on dissolution of a marriage or civil partnership. In response to the Committee's recommendations, both the upper value of the MQP and implementation date for single tier are now also stipulated in the Pensions Bill.

The majority of powers in secondary legislation reflect the position of similar provisions in existing legislation. This applies to the uprating and revaluation measures, the limit on inheritable additional old State Pension and the detailed provisions in relation to deferral. A Delegated Powers Memorandum for the draft Pensions Bill was published in February 2013.[11] It explains the purpose of the powers to be set in regulations, the reasons why they are left to delegated legislation, the Parliamentary procedure selected for the exercise of these powers and why that procedure has been chosen. We have published a revised Delegated Powers Memorandum for the Pensions Bill introduced into the House of Commons.

While industry representatives emphasised the need to retain sufficient flexibility to amend legislation during the implementation process in evidence to the Committee, the Government recognises the need to enable employers to consult with their workforce and move forward with any changes to their pension schemes. We will therefore be publishing draft regulations relating to the end of contracting out as soon as practicable.

[11] Department for Work and Pensions, February 2013, *Draft Pensions Bill – Delegated Powers Memorandum*, Department for Work and Pensions.

Implementation date

Recommendation 4

In his oral evidence to us on 11 March 2013, the Minister [Minister of State for Pensions, Steve Webb MP] gave a very clear indication that the April 2017 implementation date for the STP was fixed. He agreed then that it was very important for stakeholders, particularly pension schemes, to have certainty about the start date. We [the WPSC] were therefore very surprised when, a week later, he announced that implementation was to be brought forward by a year to April 2016. We [the WPSC] had already decided that the implementation date was one of the key features of the reforms which needed to be set out on the face of the Bill. The Government's decision to make this major change, which has significant implications, at this very late stage of the scrutiny process, makes the case for this even stronger. We [the WPSC] therefore recommend that the new implementation date of April 2016 is set out on the face of the Bill, to give the public, the pensions industry and employers the certainty they need about when this major change affecting so many people will happen. Given the likelihood that any delay in implementation, no matter how small, would cause a significant impact on retirement income for the groups which face a cliff edge, including the implementation date in the primary legislation would provide greater assurance that the planned start date will be met.

It is unusual to set the start date for such a major reform programme in primary legislation; the implementation dates for Universal Credit, Personal Independence Payment, automatic enrolment, Pension Credit and Jobseeker's Allowance were all set by commencement order. However, the Government agrees that it is important to give clarity and certainty as regards the implementation date for single tier and, in response to the Committee's recommendation, has specified this date in the Pensions Bill introduced into the House of Commons.

Minimum number of qualifying years

Recommendation 5

We [the WPSC] believe that it is appropriate for a minimum qualifying threshold to be set for the Single-tier Pension. The draft Bill does not specify the minimum number of years required for eligibility, although the White Paper indicates that this will be set between 7 and 10 years. We [the WPSC] understand the need for flexibility in setting the minimum number of qualifying years. However, there is nothing in the draft Bill as it stands to prevent the Government of the day deciding to set the requirement at more than 10 years. We [the WPSC] recommend that the Bill specifies that the minimum number of qualifying years will be "not more than 10 years".

The Government accepts this recommendation and has included provision in the Pensions Bill to limit the MQP to a maximum of ten years. This will apply equally to those with just pre-implementation, or both pre- and post-implementation qualifying years, and to those with only a post-implementation NI record and is therefore set out in both Clauses 2 and 4.

A final decision on the value of the MQP will be made during the passage of the Bill and this will be set in regulations, consistent with the legislative approach for the pre-2010 de minimis. The MQP will target State Pension expenditure at those who make a significant economic or social contribution during their working lives. A wide range of activities attract a qualifying year, in addition to payment of Class 1, 2 and 3 NI contributions, for instance, where an individual is credited for caring responsibilities or seeking employment. This means that there is a strong likelihood that anyone who spends a significant period of their working life in the United Kingdom (UK) will satisfy the MQP.

Pension Credit will continue to be available to provide a safety net for individuals who live in Great Britain (GB) and individuals can also purchase Class 3 voluntary NI contributions to meet the MQP.

Communications strategy

Recommendation 6

We [the WPSC] recommend that publication of the Pensions Bill containing the State Pension reform proposals at the start of the next parliamentary session is accompanied by the publication of the high-level DWP communications strategy for informing the public about the reforms. The urgency of ensuring an effective strategy is in place has been increased by the Government's decision to bring forward the implementation date by a year. We [the WPSC] recognise that some of the detail will come later, but believe that this high-level strategy should set out the timing for each stage of the communications process, and the broad approaches to be adopted for different groups of individuals. The strategy should also include targeted material to alert people who may lose out under the new system and provide clear advice on any action they can take to avoid this – for example by making voluntary National Insurance Contributions.

Recommendation 8

We [the WPSC] welcome HM Revenue & Customs' acknowledgement that people will require additional time to assess their need to make voluntary National Insurance Contributions (VNICs) around the time of the introduction of the STP, particularly as the implementation date has now been brought forward by a year. The usual six-year period during which it is normally possible to make voluntary NICs has been extended so that VNICs for the years 2006-07 to 2015-16 can be made at any time up to April 2023. We [the WPSC] regard this as a very sensible measure which will be of considerable assistance to many people. However, people will need help to understand the implications of the transition to the STP, and many may not immediately appreciate the need to build up more years in their NI record under the new system and in their own right. We [the WPSC] therefore recommend that the DWP communications strategy for the STP includes specific provision for a joint campaign with HMRC to publicise this extended opportunity to build up a full NI record.

The Government agrees that effective communications are crucial to the success of these reforms and is committed to making timely information available to all those affected. We have already consulted with interested parties, including industry bodies, employer representatives, Trades Unions, the adviser community and members of the public who will be affected by these changes. We will continue to work with these groups to develop a customer-focused communications strategy. This will help to ensure that single tier and the wider pension reforms are explained clearly, with a focus on the key groups of people who will need to take action.

The DWP is monitoring areas of public interest through correspondence queries, media coverage, Parliamentary Questions and Freedom of Information requests. We are also looking at common misconceptions, for instance, that the new system will be more generous than the one it replaces, and ways of addressing these through our public messaging. To this end, we have published a number of information products for different audiences on GOV.UK, including a fact sheet with frequently asked questions[12] and technical papers on derived entitlement and inheritance arrangements[13], the impact of single tier on the self-employed[14] and the transition calculation[15].

In response to the Committee's recommendation, we have also made a high-level strategy on planned communications activity available.[16] We are continuing to develop this strategy, which will grow as we gain further insight into target groups and, as a consequence, the most effective communications channels. We will publish a more in-depth strategy during the passage of the Bill.

We agree with the Committee's comments that individuals need to understand the implications of the transition to single tier and the new qualifying conditions, including the option to purchase voluntary National Insurance contributions (VNICs). Accordingly, in advance of implementation, the DWP will provide State Pension statements with an estimate of an individual's State Pension to date, based on the rules of the current system. These will be accompanied by a leaflet with simple information and case studies that will help people to understand how they will be affected by the single-tier changes and how the foundation amount will be calculated. When the single tier is introduced and all pre-implementation contribution years are recorded on an individual's NI record, we will be able to provide State Pension statements with a single-tier foundation amount valuation and explain how future qualifying years may build on this. People who want to find out more about their specific calculation will be able to contact the DWP.

It is important that individuals can know their foundation amount before purchasing VNICs and therefore Her Majesty's Revenue and Customs (HMRC) laid regulations which came into force on 6 April 2013 for those reaching State Pension age on or after 6 April 2017 to extend the time limits for paying VNICs until 2023 for years 2006/07 to 2015/16 inclusive. This instrument also made changes to the higher rate provisions that apply to the late payment of VNICs so that the 2012/13 rate will be payable until 6 April 2019 in respect of the 2006/07 to 2009/10 tax years for Class 3 (and 2006/07 to 2010/11 for voluntary Class 2). For the remaining tax years up to and including 2015/16, no higher rate provisions will be applied until 6 April 2019. Following the announcement that the single-tier pension will be introduced from 6 April 2016, HMRC have laid further regulations which came into force on 18 April 2013 to apply these changes to those who reach State Pension age on or after 6 April 2016. We welcome the Committee's positive response to this work.

[12] Department for Work and Pensions, 2013, *Single-Tier State Pension Fact sheet*, Department for Work and Pensions.

[13] Department for Work and Pensions, 2013, *State pension entitlements derived from a current or former spouse's or civil partner's national insurance contributions*, Department for Work and Pensions.

[14] Department for Work and Pensions, 2013, *The single-tier pension and people who have spent time in self-employment*, Department for Work and Pensions.

[15] Department for Work and Pensions, 2013, *Single-tier transition – technical note*, Department for Work and Pensions.

[16] This is a DWP strategy document for internal use. A copy has been placed in the House of Commons library.

4. Ending of contracting-out
Impact on Defined Benefit (DB) pension schemes

Conclusion 10

The Government's decision to bring forward the implementation date for the Single-tier Pension after we [the WPSC] had finished taking oral evidence and within a week of the deadline for us completing the scrutiny process meant that it was not possible for us [the WPSC] to seek the views of employers and the pensions industry about the implications for them of this major policy change. However, it is self-evident that having one year less to prepare for the ending of contracting-out will impose a significant burden on both groups of stakeholders. Having previously appeared to listen and respond to the concerns of pension schemes and employers about the impact of the STP, the Government has now sprung this earlier implementation date on them. We [the WPSC] believe it is therefore the government's clear responsibility to work with these key stakeholders to ensure that the transition to the ending of contracting-out is as smooth as possible and that already beleaguered Defined Benefit private sector occupational schemes do not suffer further adverse consequences.

The Government has engaged extensively with industry representatives to understand the impact of the end of contracting out and has had further contact with these bodies following the announcement that the single tier will be introduced in 2016 to discuss the implications of this change.

Several stakeholders indicated that they did not have significant concerns regarding the new implementation date and delivering the end of contracting out in a shortened timescale. However, there was some suggestion that the reduced timescale would increase the number of scheme valuations needing to be performed outside of the normal valuation cycles, with a subsequent increase in demand for actuarial resource. Another issue raised was the importance of giving certainty around the implementation date, which we have now addressed by specifying this in the Bill. Some stakeholders also indicated that employers may not want to consider any changes to their schemes before the Bill has received Royal Assent. This, combined with the earlier implementation date, will reduce the time available to negotiate with trustees and Trades Unions on potential changes and could therefore increase use of the statutory override that the Government is providing.

We also received comments around the need for Government communications activity to support these changes, and are currently putting together a communications strategy to cover this point. Further comments concerned the necessity for early consultation on the draft secondary legislation. We are therefore intending to assist the industry in preparing for these reforms by publishing draft regulations relating to the end of contracting out and the statutory override as soon as possible and will continue to work with the industry to ensure these changes are delivered as smoothly as possible.

The Government welcomes evidence presented to the Committee by bodies such as the National Association of Pension Funds (NAPF), Confederation of British Industry (CBI) and Association of British Insurers (ABI) that these reforms will not cause the closure of defined benefit (DB) schemes. Employers who offer DB schemes already have the ability to close them, regardless of the end of contracting out, and they continue to offer them because they are valuable tools for the recruitment and retention of staff. In order to minimise the impact of the abolition of contracting out on the pensions industry, the Government is introducing a statutory override which will grant DB scheme sponsors a means of alleviating additional costs by allowing them to modify their scheme benefit structures where scheme rules prevent them from doing so.

We recognise the concerns of the Trades Union Congress regarding the need for a statutory override, but expect that employers will consult with their trustees before implementing any changes and, in many cases, will negotiate an agreement without use of the override. The current requirement to consult with employees and their representatives over changes to pension schemes will still apply when using the override. Moreover, Malcolm Small of the Institute of Directors (IoD) suggested, in evidence to the Committee, that two-thirds of IoD members may not seek to recoup the cost. Where employers do make scheme changes, an actuary will need to certify that these do not exceed the value of the additional employer NI contributions.

The Government has made provision in the Bill for multiple uses of the override. This will not allow employers to recover more than the loss of the NI rebate, but will enable them to recoup less than this amount, if they wish, in the knowledge that they retain the ability to make subsequent use of the override. This measure will therefore allow employers greater flexibility in their use of the override and could help to mitigate the impact on employees as well.

The Government carried out a public consultation on the issue of whether or not the employer override should apply to scheme members covered by the Protected Persons regulations.[17] The consultation ended on 14 March 2013 and the Government response will be published in due course.

While the Government does not believe that the end of contracting out will undermine the ongoing viability of DB pension schemes, we welcome the suggestion from the NAPF to the Committee that this provides an opportunity for developing a regulatory framework for Defined Ambition. We intend to publish a paper in the summer to set out further consideration of potential pension models which share the longevity, inflation and investment risks between employers, individuals and industry, and also the scope of potential future legislative changes.

Impact on employees

Recommendation 7

We [the WPSC] accept that, on average, employees who were previously contracted-out will not lose out in the longer term from having to pay increased National Insurance and pension scheme contributions, because most will gain enough in increased State Pension to compensate for this. However, within this average, some individual employees could lose out and some may face difficulties in the shorter term, especially if current wage restraints continue. We [the WPSC] recommend that the Government undertakes more analysis of which employees might fall into this category, so that Parliament can properly consider what measures, if any, might be put in place to limit losses.

We accept that these changes will impact on employees who are members of contracted-out schemes at the point single tier is introduced. They will pay the standard rate of NI in line with all other employees, which will mean an increase in the rate of contributions that they pay, equivalent to 1.4 per cent of their earnings (between the Lower Earnings Limit (LEL) and the Upper Accrual Point (UAP)[18]), and their scheme contributions may also increase, or accruals decrease. However, 90 per cent of scheme members reaching State Pension age in the first two decades after the implementation of single tier will receive enough extra State Pension to offset both the increased NI contributions and any

[17] Department for Work and Pensions, January 2013, *Abolition of contracting out – consultation on a statutory override for Protected Persons Regulations*, Department for Work and Pensions.
[18] The LEL is £5,668, the UAP is £40,040 (2013/14 annualised figures). Whilst NI liability does not begin until earnings reach the primary threshold, the contracted-out rebate is actually calculated from the LEL.

potential adjustment to their pension scheme.[19] The ten per cent who do not recoup all of the additional contributions will not necessarily be concentrated in particular industries, sectors, cohorts or pay bands; those who may not fully recover the contributions will tend to be people who have not always been contracted out, those who do not remain in a DB scheme for the rest of their career and those who die relatively young.

The Government has published a revised impact assessment and, in response to the Committee's recommendation, we have included more analysis on notional gainers and losers from the reform. This includes additional information on those individuals who may experience a notionally lower outcome as a result of the ending of contracting out.

5. Further improvements which need to be built into the new system

National Insurance issues

Conclusion 11

It is important that people are given the opportunity to build up a full entitlement to a State Pension, given that the number of qualifying years required for this will increase from 30 to 35. We [the WPSC] welcome the Government's willingness to look at how the system of National Insurance credits might be improved, by providing more prompts to people who have incomplete records to take up credits if they are carers or are in other circumstances which give them a crediting entitlement. However, any system which relies on individuals being aware of this facility is likely to exclude many of the people it is intended to help. We [the WPSC] are pleased that the Government plans to use the introduction of Universal Credit to widen the scope of the NI crediting system for people claiming benefits and to more fully automate it.

Conclusion 12

People in multiple low-paid jobs which all fall below the Lower Earnings Limit do not currently build up a National Insurance record. We [the WPSC] accept the Minister's [Minister of State for Pensions, Steve Webb MP] assurance that many of these people, mainly women, often receive NI credits because they meet the relevant criteria. However, DWP estimates that around 20,000 people in this situation do not receive NI credits or make NI contributions. We [the WPSC] support the Government's changes under Universal Credit which will mean that many multi-job low-earners are brought within the scope of NI credits, including through the new facility for both partners to receive credits on the basis of a household entitlement to Universal Credit. This is particularly important as the facility to derive State Pension entitlement through a spouse or partner's NI contributions will no longer exist under the STP.

We appreciate the Committee's comments regarding NI credits and recognise that there is more work to be done to communicate their availability and increase take-up. This issue will form part of the DWP's detailed communications strategy to be published during the passage of the Pensions Bill.

[19] Department for Work and Pensions, May 2013, *Pensions Bill Impact assessment: The single-tier pension: a simple foundation for saving*, Department for Work and Pensions.

We also note the Committee's support for the changes in this area as a result of Universal Credit, which will widen access to the State Pension system by extending crediting arrangements to around 0.8 million households who are not already credited under legacy benefits.[20] These changes will mean that some people on low incomes with multiple jobs and their partners will become eligible for NI credits. Some claimants earning below the Lower Earnings Limit, for example Housing Benefit claimants and Child Tax Credit claimants with a child over 12 years old[21], will now receive a credit. Income Support claimants who are not currently entitled to credits from other benefits, or who have to apply to HMRC to get credits, will also receive an automatic NI credit towards the single-tier pension.

Self-employed

Conclusion 13

Self-employed people are one of the key groups to benefit from the introduction of the Single-tier Pension, as they will be brought fully into the State Pension system. We [the WPSC] recognise the principle that this might mean they should pay the equivalent in National Insurance Contributions that employed people will pay. However, we [the WPSC] believe that this change should be considered as part of a wider review of how National Insurance could now be simplified.

The Government recognises the Committee's conclusion that, in view of the increased value of a qualifying year gained through Class 2 contributions under single tier compared to the current system, there may be cause to consider increasing the rate to equalise with Class 1 contributions. However, many people who are self-employed pay both Class 2 and 4 NI contributions; this means that some people paying self-employed NI contributions may in fact pay a higher rate than an employee with a similar income. By way of an example, in 2012/13 a self-employed person with an income of £10,000 could pay £353 per annum in NI, whereas an employed person earning the same amount would pay Class 1 contributions of £289 per annum.[22]

People who have spent time self-employed are one of the key groups who benefit from these reforms. They constitute a significant element of the labour market (the number of self-employed people is increasing, reaching 4.2 million by the end of 2012, which equates to 14.2 per cent of total employment[23]) and make an important contribution to the economy.

Treating Class 1, 2 and 3 NI contributions (as well as credits) equally for the first time in around 40 years gives the self-employed access to the same State Pension as employees.[24] This is consistent with the objective of giving people certainty about their State Pension income in an increasingly diverse labour market and realigns the State Pension system with the vision set out in the Beveridge Report.[25]

Improving State Pension provision for those who have spent time self-employed is particularly important in light of emerging trends in private pension provision amongst this group: only 21 per cent of self-employed people are contributing to a private pension scheme, compared to 50 per cent of all employees.[26] The self-employed are also out of scope for automatic enrolment into an occupational pension with a statutory employer contribution, although they can make voluntary contributions to the National Employment Savings Trust.

20 Source: DWP Policy Simulation Model, (based on Family Resources Survey 2010/11), 2014/15.
21 Where someone is eligible for Child Benefit in respect of a child under 12 years-old, they will receive an NI credit automatically, irrespective of Universal Credit.
22 This is based on the relevant 2012/13 bands of earnings: http://www.hmrc.gov.uk/rates/nic.htm
23 Office for National Statistics, April 2013, *Labour Market Statistics*, ONS.
24 Since the end of Graduated Retirement Benefit in 1975.
25 Beveridge, W., 1942, *Social Insurance and Allied Services*, Cmd. 6404, HMSO.
26 Department for Work and Pensions, June 2012, *Family Resources Survey 2010/11*, Department for Work and Pensions.

NI rates are set out by the Chancellor at fiscal events and Budget 2013 did not announce any significant changes to the rates of self-employed contributions.

Setting and maintaining the differential between STP and Pension Credit

Recommendation 9

One of the key elements of the Single-tier Pension is that it will be set above the rate for means-tested support, to ensure that incentives to save into a private pension are clear and to complement the aims of automatic enrolment. We [the WPSC] believe that the requirement for the level of the STP to be higher than the Pension Credit Guarantee rate is a fundamental principle of the reform. We [the WPSC] therefore recommend that this principle is set out on the face of the Bill.

The Government agrees that a central principle of the single-tier pension is that it will be set above the basic level of means-tested support in order to provide a firm foundation for retirement saving. This objective will be achieved without being stated in legislation, provided the starting rate is higher than the standard minimum guarantee (SMG), because both will be uprated by at least the growth in average earnings and therefore the single tier will maintain its value relative to the SMG. The Government has clearly stated that the starting rate will be higher than the SMG and Parliament will be able to debate this as the regulations will be subject to the affirmative resolution procedure.

Recommendation 10

There is no certainty about how long the triple lock will be in place and we believe that it is important that there is as much clear water as possible between the rate of the STP and that of Pension Credit. There appears to be scope for a bigger differential (either at the outset or over time) given the increased National Insurance revenue that the Government will derive from the ending of contracting-out and the overall long-term savings which will be made on State Pension expenditure as a result of the introduction of the STP. We [the WPSC] therefore recommend that, when the Bill is before Parliament in the summer, the Government publishes an analysis of (a) the cost of setting the STP rate at a range of higher levels; and (b) the level at which the STP could be funded if the additional NI revenue was used for this purpose.

Following the Committee's recommendation, we have published further analysis of the cost of setting the single-tier starting rate at a higher level in the sensitivity analysis section of the impact assessment.[27]

The Government notes the Committee's suggestion that it publish analysis on the starting rate at which the single tier could be funded using the additional NI revenue. However, a key objective of the single-tier pension is to help ensure the sustainability of the State Pension system for the longer term; the reforms will cost no more than the current system overall, and will not be more generous to future pensioners. The additional NI revenue will not be recycled within the State Pension system, but will contribute to other reforms such as the cap on social care costs and the Employment Allowance, as announced in the Budget 2013.

[27] The impact assessment for *The single-tier pension: a simple foundation for saving* (Department for Work and Pensions, January 2013) showed £143.50 and £144.50 variants of the start level and the *Pensions Bill Impact assessment: The single-tier pension: a simple foundation for saving* (Department for Work and Pensions, May 2013) shows the impact of a £145 start level. Both impact assessments are available at: www.gov.uk

Budget 2013 took account of the NI revenue in the public finances and confirmed that none of the additional employee and private sector employer NI contributions will be used for net revenue raising. Overall, Budget 2013 constituted a net reduction in taxation for non-wealthy households, and a net reduction in NI contributions for private sector employers.

6. Smoothing the transition to the new system Calculation of the foundation amount for the STP

Recommendation 11

The foundation amount calculated for each individual will be a key factor in determining how much Single-tier Pension they receive and whether this is more or less than the standard STP rate. For people who have had periods contracted-out of the State Second Pension (and/or SERPS), and who have therefore paid a reduced amount of National Insurance, the DWP will have to calculate how much this rebate is worth (the Rebate Derived Amount). It is important that this amount is calculated in a transparent way that everyone accepts is fair. We [the WPSC] recommend that the Government sets out in simple language the basis on which the Rebate Derived Amount will be calculated, so that Parliament can assess the fairness of the approach. We [the WPSC] also recommend that a report from the Government Actuary is laid, giving an assessment of the actuarial fairness of the proposed approach.

The Government agrees that it is important that the Rebate Derived Amount (RDA) and foundation amount are calculated in a fair and transparent way which takes into account NI contributions in the current system towards the basic and additional State Pensions. We originally published a technical paper[28] on the RDA on 24 January 2013 and, following the Committee's Report, we will be publishing a further paper which uses simpler language where possible, clarifies areas which are commonly misunderstood and adds further examples to aid the reader.

In the transition calculation, an individual's NI record will be valued according to both the single-tier and current system rules, and the higher valuation will form their foundation amount. In both cases, a deduction will be made where an individual has been a member of a contracted-out occupational pension scheme to take account of the fact that they will have paid a reduced rate of NI and their employer will have received a rebate to fund their workplace pension. The current scheme rules valuation will therefore use the same information as if the person had reached State Pension age in 2016, and the calculations will be based on existing legislation, therefore a question of actuarial fairness does not arise.

The Government would also like to address the point made to the Committee that individuals contracted out in defined contribution (DC) pension schemes are disadvantaged by the calculation of the RDA. This calculation treats all periods of contracting out up to 2016 the same for those retiring before and after 2016. We recognise that annuity rates are currently low, but many factors affect DC pension outcomes and individuals chose to enter into a contracted-out scheme in this knowledge. Prior to 2007, rebate rates were set based on the Government Actuary's best estimate of the cost of substituting foregone additional State Pension. Adjusting single-tier amounts to reflect worse than expected rebate outcomes would amount to the taxpayer underwriting the costs of an individual's decision to bear the investment and longevity risk associated with taking the rebate. It is important to recognise also that the majority of those retiring under the single-tier system who have been contracted out will have the opportunity to increase their foundation amount after 2016, thereby reducing the effect of any RDA.

[28] Department for Work and Pensions, 2013, *Single-tier transition – technical note*, Department for Work and Pensions.

Derived rights

Recommendation 12

We [the WPSC] welcome the Government's sensible transitional solution to the potential adverse impact on employed women who chose to pay reduced NI contributions under the Reduced Rate Election (or "married woman's stamp") arrangement, on the understanding that they would be able to derive a pension based on their husband's contributions. We [the WPSC] believe that it should also be possible to find a solution for another small group of women: those who did not build up their own NI record because they had a legitimate expectation that they would be able to rely on their husband's contributions to give them entitlement to a Basic State Pension. One option might be that women in this position who are within 15 years of State Pension Age should be able to retain this right. We [the WPSC] recommend that the Government assesses and publishes the cost of providing this option for the relatively small number of women affected. We [the WPSC] believe that, for those further from retirement, there is sufficient time for them to plan on the basis of the new rules.

As the Committee notes, the Government will put in place transitional arrangements for those women who have paid the Reduced Rate Election at any point in the 35 years prior to their State Pension age. This is to ensure that this group, who entered an active agreement with the Government to receive a pension based on their spouse or former spouse's NI record, is not disadvantaged by the decision to pay reduced rate NI contributions.

However, single tier will be a modern, individualised pension and the provision for derived entitlement based on the contributions of a spouse or civil partner will therefore end. While the Government recognises that this will affect a small number of individuals, crediting arrangements are in place to ensure that an individual's NI record does not suffer due to caring responsibilities or periods spent in receipt of disability or unemployment benefits. Under the new system, the majority of individuals will therefore be able to become entitled to a full single-tier pension in their own right (over 80 per cent by the mid-2030s).[29] People also have the facility to purchase VNICs.

The provision for derived entitlement dates back to the 1940s, when men worked and women stayed at home. This has not resembled the structure of our society for many decades and there is no longer a substantial need for these provisions: by 2020, fewer than 30,000 women in GB will receive a notionally lower State Pension outcome because of the removal of derived entitlement.[30] The Pension Credit Guarantee Credit will remain in place as a safety net for those living in GB.

Additionally, the derived entitlement arrangements have evolved over time so that they now result in outcomes not intended under the original policy, as envisaged in the 1940s, to support dependent spouses. Provided a person has at least one qualifying year of UK NI contributions or credits, a State Pension (including any derivable entitlement) is payable anywhere in the world, enabling the dependents of UK contributors to benefit, even if they have never been to the UK. The factors resulting in the decline in the domestic demand for derived entitlement do not apply in overseas cases, as demonstrated by the fact that among married men (who have been able to qualify for the married person's pension only since 2010), 70 per cent of the caseload with derived entitlement resides overseas.[31]

[29] Department for Work and Pensions, May 2013, *Pensions Bill Impact assessment: The single-tier pension: a simple foundation for saving*, Department for Work and Pensions.

[30] Department for Work and Pensions, May 2013, *Pensions Bill Impact assessment: The single-tier pension: a simple foundation for saving*, Department for Work and Pensions.

[31] From *DWP Information, Governance and Security, Work and Pensions Longitudinal Study* (http://83.244.183.180/100pc/tabtool.html) for numbers of men receiving Category B(L) and AB(L).

Furthermore, where both parties in a couple have a State Pension entitlement lower than the full married person's threshold of £66, which may be the case if they have not lived in the UK for a significant proportion of their working lives, each party can use the other's NI record to top up their own State Pension entitlement to this level.[32]

The Government believes that, in order to deliver a simple, modern State Pension which recognises people's contributions to the economy and wider society, it is necessary to remove the facility to rely on a spouse or civil partner's NI record at the earliest opportunity. Furthermore, the Government believes that the broad crediting regime to sufficiently recognise individuals' contributions to society has been in place for long enough to ensure that no one who reaches State Pension age today will have those contributions overlooked.

Women born between 1952 and 1953

Recommendation 13

We [the WPSC] heard from many women born between 1952 and 1953 who believed that they would suffer a double adverse effect on their State Pension income, arising from the increases in their State Pension Age combined with their ineligibility for the Single-tier Pension, if it was introduced in 2017 as set out in the White Paper. It appears that the Government's decision to bring forward the implementation date of the STP to April 2016 will mean that around 85,000 women born between 6 April and 5 July 1953, whose SPA had been increased a second time in the 2011 Pensions Act, will now be eligible for a State Pension under the new system. However, the change in the implementation date does not appear to bring any of the remaining women in the cohort born between April 1952 and April 1953 within the scope of the STP. We [the WPSC] recommend that the Government clarifies whether this is the case, and sets out the range of impacts on the State Pensions of these women, in the revised Impact Assessment for the STP which we [the WPSC] have requested that it publishes when the final Bill is introduced.

Recommendation 14

It is important that women who are affected by the increases in their State Pension Age understand their individual State Pension circumstances. We [the WPSC] believe that this group should be prioritised as part of the overall communications strategy for the STP. We [the WPSC] recommend that DWP publish detailed information on its website to help this cohort of women to calculate their State Pension entitlement. This should explain the option to defer taking the current State Pension, and set out the benefits this offers.

[32] Pension rates for 2013/14 can be found in Department for Work and Pensions, *Benefit and Pension Rates*, April 2013, DWP035, v1.0 (April 2013).

The Government agrees that this cohort of women should be a priority in terms of communications activity and, in March 2013, the DWP published a paper analysing the State Pension outcomes of the cohort of women who may receive a State Pension based on the current system, while men born the same day may receive a pension based on the single-tier system. This analysis has now been updated to reflect the new implementation date of 2016.[33] The DWP has informed stakeholders of the publication of this new analysis, and will continue to work with these groups to communicate how individuals will be affected by the reforms and address areas of misunderstanding.

The paper clarifies that bringing forward the implementation date to 2016 means that every man born on and after 6 April 1951, and every woman born on and after 6 April 1953 will reach State Pension age in the new system. This includes all those women affected by the acceleration of the State Pension age equalisation process in the Pensions Act 2011.

There is a group of approximately 700,000 women (born between 6 April 1951 and 5 April 1953) who may receive a pension based on the current system where a man born on the same day may qualify for a single-tier pension. This is due to the fact that women in this cohort will begin drawing their State Pension between two and four years before a man born the same day. Of these women, around 25 per cent have already reached State Pension age, and around 90 per cent will receive more overall from the State over the course of their lives by drawing their State Pension at their State Pension age than they would if they drew it at age 65 under the single-tier system.[34] This paper also considers the impact of deferring receipt of the State Pension and provides a link to further detailed information available on GOV.UK, including the leaflet, *State Pension Deferral – your guide*.[35]

[33] The revised paper, *The single-tier pension: Note on the cohort of women born between 6 April 1951 and 5 April 1953*, (April 2013, Department for Work and Pensions) and previous version, *Note on the cohort of women born between 6 April 1952 and 5 July 1953*, (March 2013, Department for Work and Pensions) are available at: www.gov.uk

[34] Department for Work and Pensions, April 2013, *The single-tier pension: Note on the cohort of women born between 6 April 1951 and 5 April 1953*, Department for Work and Pensions.

[35] Deferral information can be found at: https://www.gov.uk/deferring-state-pension/what-you-may-get

Annex A

Summary of changes to Part 1 of the draft Pensions Bill

The Government has made the following changes to Part 1 and Schedules 1-14 (which relate to Part 1) between publication of the Pensions Bill in draft and the introduction of the Bill into the House of Commons. This summary comprises the main amendments made to the legislation, but does not include minor drafting changes. We have indicated where changes have been made in response to comments received as part of the informal consultation on the draft Bill or the Committee's Report.

Clause 1(2) – implementation date – this has been amended to specify that the single-tier pension will be introduced on 6 April 2016, in response to the Committee's recommendation. There are a number of consequential amendments throughout the Bill, including:

- Clause 22(3) – the Henry VIII power to amend the Bill to specify the implementation date after it has been commenced has been removed as it is no longer necessary.
- Clause 47(5) and (6) – consequential change to the commencement provisions.

Clause 2(3) and Clause 4(2) – Minimum Qualifying Period – following the Committee's Report, these provisions now state that the MQP will not exceed ten years.

Schedule 1 – transition calculation (paragraph 2) – this has been amended to include reference to the single-tier foundation amount (step 3) and clarify that Schedule 1, paragraphs 3-6 provide further explanation of the calculation.

Schedule 13 – revaluation of earnings factors for early leavers (paragraphs 16 and 38) – this amendment has been made in response to comments from stakeholders. It maintains the original policy intention for scheme early leavers and clarifies that the end of contracting out will not be an automatic trigger for early leaver status.

Schedule 14 – removal of the single use restriction on the statutory override (paragraph 9) – this change allows employers to use the override more than once, within other restrictions. For instance, it will not allow employers to recoup more than the value of the increased employer NI contributions. Many employers may not wish to fully adjust to the loss of the NI rebate, but need the confidence that they retain the ability to do so when making changes. It is not thought that many employers will want to use this power more than once, but this amendment provides greater flexibility.

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