Department for Work & Pensions

Post-legislative scrutiny of the Pensions Act 2007

Presented to Parliament
by the Secretary of State for Work and Pensions
by Command of Her Majesty
January 2015

Cm 9001

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Introduction 1

Post-legislative scrutiny of the Pensions Act 2007

Introduction
In December 2002 the Pensions Commission was established to review the UK's system of pension provision and to advise on whether the existing system of voluntary private pensions would deliver adequate results. The Pensions Act 2007 was the first piece of the statutory framework for the UK pensions landscape, created by successive administrations, following on from the Commission's reports in 2004 and 2005.

It included measures which:

- Strengthened and extended coverage of the basic State Pension;
- Required the basic State Pension to be uprated in line with earnings rather than prices;
- Simplified the State Second Pension;
- Increased the State Pension age in line with increases in longevity;
- Provided the foundation for the National Employment Savings Trust;
- Introduced a scheme to convert guaranteed minimum pensions into rights in an ordinary scheme pension;
- Abolished contracting out for defined contribution pension schemes;
- Removed the Secretary of State's role in approving actuarial guidance for a number of pieces of existing legislation;
- Updated the provisions of the 2004 Pensions Act by introducing an alternative route in the dispute resolution process and extending the Financial Assistance Scheme; and
- Established the Personal Accounts Delivery Authority.

Many of the measures in the Act have largely been superseded by subsequent legislation, such as the Pensions Act 2011 on the timetable for increasing State Pension age and the Pensions Act 2014 on state pension generally, while the Personal Accounts Delivery Authority wound up in 2010. However, the key principles underpinning the 2007 Act, namely ensuring people make adequate saving for their retirement and making the state pension fairer and more widely available, remain at the core of the reformed pensions system.

Management summary 2

Part 1

Largely stemming from recommendations made by the Pensions Commission in its second report and the findings of the Department's report on Women and Pensions, Part 1 of the Act included measures to strengthen and simplify state pension provision in the UK. In particular:

- Sections 1 and 3 relaxed the contribution conditions for people reaching State Pension age from April 2010 onwards, extended the crediting arrangements for people caring for one or more severely disabled persons, and, for the purposes of eligibiliy for credits for both basic and additional State Pension credits, aligned the upper age limit for the child being cared for at. Under the reformed contribution , the percentage of women reaching State Pension age with a full basic pension increased from a pre-implementation figure of just over 40% in 2009-10, to around 80% in 2012-13. As a result of aligning the upper age limit for the cared for child at age 12 for both basic and additional State Pension purposes, approximately 2 million more people are potentially being credited for additional pension purposes, but around 1.3 million fewer people are potentially being credited for basic pension purposes.
- Section 2 removed the requirement that a person had to claim their Category A pension before their spouse or civil partner could qualify for a Category B pension derived from their contributions. The change applied from April 2010 to both existing pensioners and people reaching State Pension age from that point onwards. (Data are not available on the number of people who benefited from this easement.)
- Section 4 abolished increases of state pension for an adult dependent (normally an under-pension age wife) other than for existing recipients from April 2010. Existing entitlements were transitionally protected until, at the latest, 2020. The latest available data show approximately 22,000 of these increases are still in payment.

- Sections 5 and 6 provided for basic State Pension, Industrial Injuries Death Benefit, and Pension Credit standard minimum guarantee to be uprated annually at least in line with growth in average earnings. The provision applied from April 2008 in the case of Pension Credit standard minimum guarantee and from April 2011 in the case of basic State Pension and Industrial Death Benefit.
- Sections 7 and 8 removed the statutory link between the lower earnings limit for National Insurance contributions and the rate of basic State Pension. As a result, the lower earnings limit is currently £2 per week lower than the rate of basic State Pension.
- Sections 10, 11 and 12 introduced a range of measures designed to simplify the State Second Pension and accelerate its transition to a flat-rate top up to the basic State Pension. From 2012, variable accruals on earnings up to the Low Earnings Threshold (currently £15,100 pa) were replaced by a flat rate accrual amount which is currently (2014-15) worth £92 per annum.
- Section 13 provided for State Pension age for men and women to increase: from 65 to 66 by 2026, from 66 to 67 by 2036 and from 67 to 68 by 2046. The timetable for increasing the age to 66 and 67 has been superseded by the 2011 and 2014 Pensions Acts respectively.

Part 2

- Sections 14 and 15 dealt with issues relating to contracting-out of the additional state pension. Section 14 introduced the ability for defined benefit contracted-out occupational pension schemes to convert members' accrued rights to a Guaranteed Minimum Pension (GMP) into ordinary scheme rights. This option appears to have been little used, but the Pensions Act 2014 has made provision for guidance to be given on GMP conversion. Section 15 abolished contracting-out for defined contribution pension schemes. Regulations to support abolition were made in 2011 and came into force in April 2012, introducing transitional arrangements for National Insurance rebates. A review will be carried out in 2015, when the arrangements are due to end, but interim feedback from HMRC operations indicates that arrangements are working well.
- Section 16 introduced a single stage dispute resolution process whereby all decisions can be taken by trustees or managers. Schemes were, however, permitted to retain the previous two stage process if they wished.
- Section 17 and its accompanying Schedule 5 removed the requirement for the Secretary of State to approve three Guidance Notes and one Technical Memorandum. The Financial Reporting Council now provides this function and continues to update and revise the Guidance Notes and Technical Memoranda.
- Sections 18 and 19 address the Financial Assistance Scheme (FAS). Section 18 provided for the extension FAS through replacing tapered payments with a single amount no less than 80% of an individual's expected pension; payments to begin at normal pension age, rather than 65; and initial payments to be set at 80% and at 45% for a survivor. The final extension of FAS was announced in December 2007, including an increase in the expected pension coverage from 80% to 90% and the changes were implemented through a series of regulations in 2008 and 2009. Section 19 required the Secretary of State to pass regulations which temporarily restricted the purchase of annuities by trustees of qualifying schemes that were still winding up. These regulations came into force in September 2007 and expired in June 2008.

Part 3

Part 3 of the Act provided details of the Personal Accounts Delivery Authority. The impetus for this body came from the White Paper *Personal accounts: a new way to save* which made clear that delivering and managing a major occupational pension scheme should not be a task for government, instead proposing a Non-Departmental Public Body which could utilise the skills of the private sector to advise on and later implement proposals:

- Section 20 and Schedule 6 established the Personal Accounts Delivery Authority and set out its composition.
- Section 21 set out the initial function of the Authority as advising the Government on relevant proposals about personal accounts. This section was repealed by section 79 of the 2008 Pensions Act. Section 79(6) then went on to extend the function of the Authority by providing it with additional executive powers.
- Section 22 provided that the Authority must have regard to general guidance relating to the management of a Non-Departmental Public Body and to the principles of good corporate management.
- Section 23 allows for the dissolution of the Authority at an appropriate time by an Order. The Personal Accounts Delivery Authority Winding Up Order 2010 (SI 2010/911) came into force on 5 July 2010, repealing sections 20 and 22, and Schedule 6 of the 2007 Act. The Authority's property, rights, and liabilities were transferred to NEST.

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Part 1: State Pension

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Background

1. Part 1 enacts a range of state pension reforms proposed in the White Paper *Security in retirement: towards a new pensions system*, Cm 6841, published in May 2006.[1]

2. These proposals stemmed in the main from recommendations made by the Pensions Commission in its second report: *A New Pension Settlement for the Twenty-First Century* published in 2005.[2]

3. The proposals also came from the findings of the Department's report *Women and Pensions: The Evidence*, published in 2005.[3]

4. The state pension reforms were primarily intended to:
   - make the system simpler and more generous, and to ensure that pensioners share in rising national prosperity; and
   - make the state pension fairer and more widely available.

Measures in Part 1:

Relaxation of contribution conditions – sections 1 and 3

5. For people reaching State Pension age from 6 April 2010, section 1 of the Act introduced a single contribution condition of 30 'qualifying years' of National Insurance contributions or credits, replacing the dual contribution condition of, first, a minimum of one year of paid contributions and second, qualifying years for approximately 90% of the working life.

[1] http://webarchive.nationalarchives.gov.uk/20121125084459/http://www.dwp.gov.uk/docs/white-paper-complete.pdf
[2] http://webarchive.nationalarchives.gov.uk/+/http:/www.dwp.gov.uk/publications/dwp/2005/pensionscommreport/main-report.pdf
[3] http://webarchive.nationalarchives.gov.uk/20130128102031/http:/dwp.gov.uk/docs/women-pensions.pdf

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6. Section 3 of the Act also provided for years of 'Home Responsibilities Protection' to be converted into qualifying years under new section 23A(5) and (6) of the Social Security Contributions and Benefits Act 1992. Under the original Home Responsibilities Protection scheme introduced in 1978, tax years spent caring for a child or severely disabled person reduced the number of years required for entitlement to a full basic pension to a minimum of 20 years. This meant that, in addition to her Home Responsibilities Protection, a woman normally also needed at least 19 years of paid or credited contributions to qualify for a full basic pension (including a minimum of one year of paid contributions).

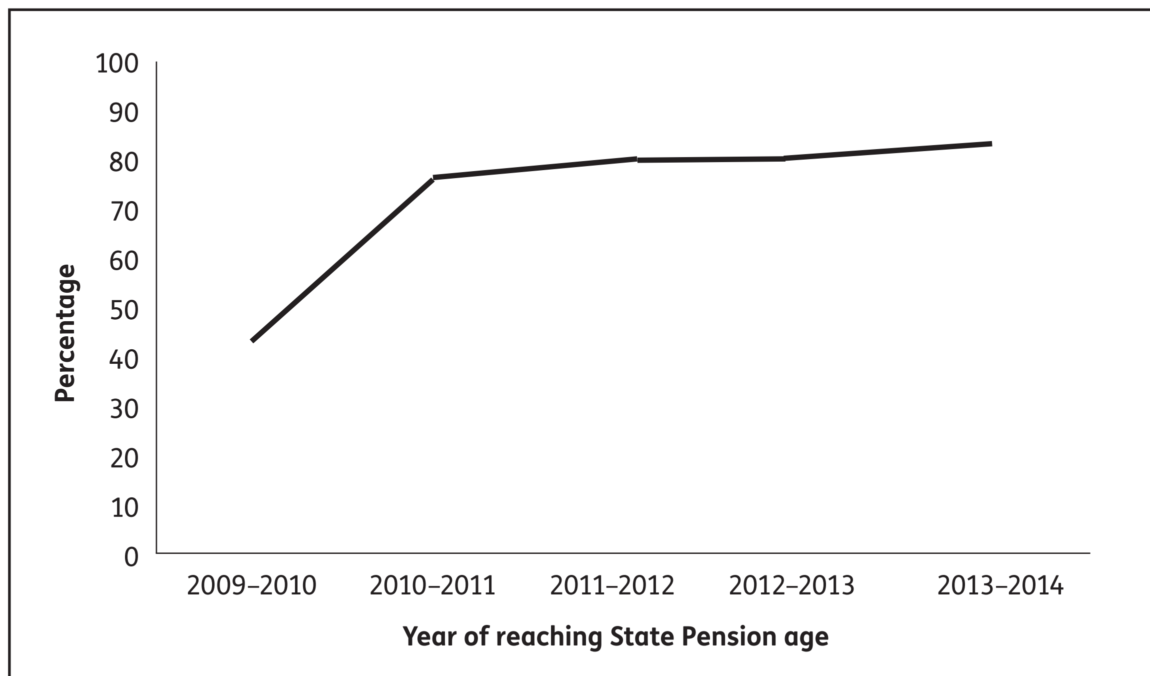
7. The primary purpose of these reforms was to improve the basic pension entitlements of women born on or after 6 April 1950 (who reach pensionable age from 6 May 2010 onwards), in line with recommendations made by the Pensions Commission. However the relaxation of the contribution conditions also assisted some men.

8. The Department originally forecast[4] that around three-quarters of women in the UK in the cohort born 6 April 1950 – 5 April 1951 reaching State Pension age in 2010/11 would have a full basic pension and that the proportion with a full basic pension would gradually increase to around 90% for cohorts reaching State Pension age from 2020 onwards.

9. The new contribution condition has been operative since 6 April 2010 for cohorts of women born 6 April 1950 onwards and cohorts of men born 6 April 1945 onwards.

10. Figure 1.1 shows the percentage of women in Great Britain with entitlement to a full Category A basic pension, as a proportion of those who have claimed and have some entitlement, split by the year in which they reached State Pension age. The percentage has increased from just over 40% in 2009-10 to just over 80% in 2013-14.

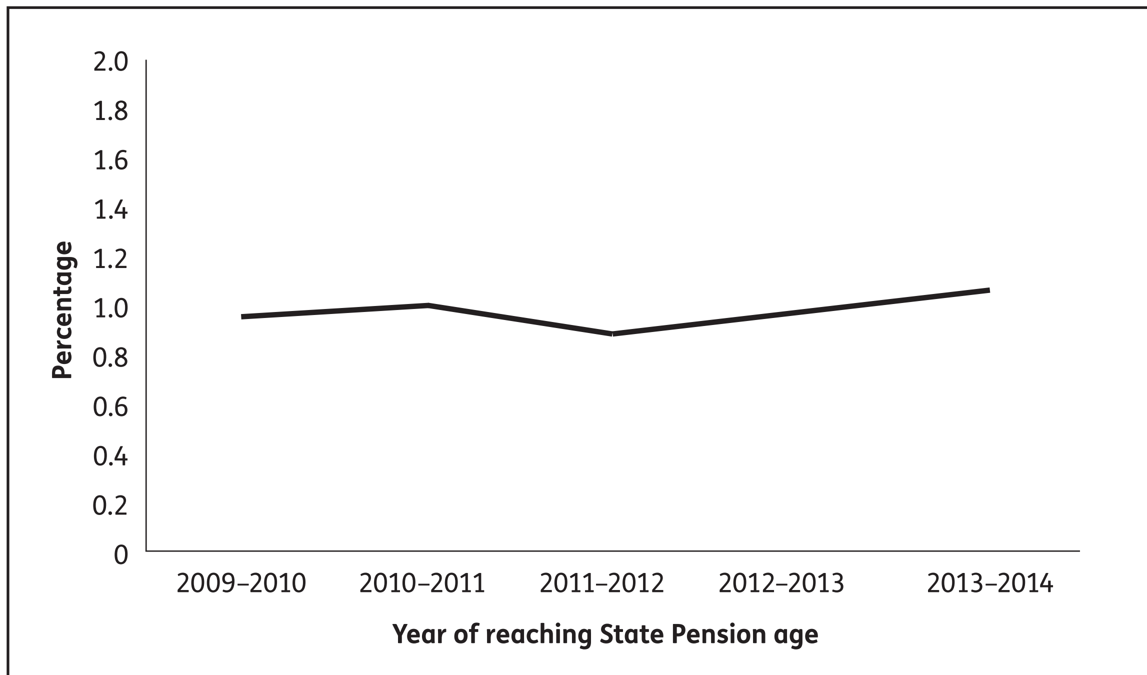
Figure 1.1 Percentage of women resident in GB receiving full basic State Pension by year of State Pension age



[4] *Pensions Bill – Regulatory Impact Assessment*: p38, available at: http://webarchive.nationalarchives.gov.uk/20121125084459/http://www.dwp.gov.uk/docs/pensions-bill-ria.pdf

11. The reforms did not carry forward the contribution condition known as the 25% *de minimis* entitlement to basic pension, which applies by virtue of section 60 of the Social Security Contributions and Benefits Act 1992 and regulation 6 of the Widow's Benefit and Retirement Pension Regulations 1979. Under this rule, those whose contribution records would otherwise result in an entitlement of less than 25% were not entitled to basic State Pension. An exception applied if they had been insured, or resided, in another European Economic Area Member State, Switzerland or a country with which the UK had a suitable bilateral agreement thus enabling a *pro rata* UK entitlement of less than 25%. The adverse effect of the *de minimis* condition on ethnic minority women who face barriers to paid work was part of the rationale behind removing the condition. However, as the graph below illustrates, the proportion of women who have recently reached State Pension age who have entitlement to a basic pension of less than 25% has not changed significantly since 2009/10, the year before the *de minimis* condition was removed. The likeliest explanation for this is that conversion of years of Home Responsibilities Protection into qualifying years referred to at paragraph 6 significantly boosted the entitlements of women who have had only minimal participation in the labour market. For example, a woman who has only three qualifying years and 19 years of Home Responsibilities Protection would under the pre-2010 arrangements have had a notional basic pension entitlement of 15% and thus fail the *de minimis* condition; under the arrangements from 2010 onwards she would have 22 qualifying years giving her a basic pension entitlement at around three-quarters of the full rate.

Figure 1.2 Percentage of women aged 60 to 65 years resident in GB receiving less than 25% of full basic State Pension by year of State Pension age



Removal of restriction on entitlement to Category B 'married person's' pension – section 2

12. Section 2 of the Act removed the requirement that, in order for one party – B – to qualify for a Category B pension derived from his or her spouse's or civil partner's National Insurance contribution record, the other party – A – had to claim his or her Category A retirement pension. If party A deferred claiming, or elected to stop claiming in order to gain deferred benefits, the Category B pension was then unavailable.

13. This was a minor 'tidying up' measure designed to remove a disincentive for party A to defer drawing his or her Category A pension and remove the potential for malicious deprivation by the other party of a separated spouse's or civil partner's Category B pension entitlement.

14. Unlike other measures in the Act it applied to both current and future pensioners.

15. No specific data are held on the number of existing pensioners who came forward and claimed following the removal of this restriction and it was not practicable for the Department to identify those who could do so.

Contribution credits for parents and carers – basic and additional pension – section 9

16. As noted above, from 6 April 2010 section 3 of the Act inserted section 23A into the 1992 Social Security Contributions and Benefits Act. This provides for a National Insurance credit for the purposes of basic State Pension in place of the previous system of Home Responsibilities Protection and, under section 9 of the Act, for a person to be credited into State Second Pension, for a week during any part of which the person is:

    a. entitled to Child Benefit in respect of a child under the age of 12 (a reduction from the age of 16 in the upper age limit in the case of credits for basic pension purposes, and an increase from the age of six in the case of credits for additional pension purposes);
    b. a foster carer; or
    c. engaged in caring, defined by regulations made under section 23A[5] as caring for one or more persons for 20 hours or more a week where the person being cared for is in receipt of Attendance Allowance; the care component of Disability Living Allowance (at the middle or highest rate); the daily living component of a Personal Independence Payment, Armed Forces Independence Payment, equivalent benefits under the War Pensions or Industrial Injuries schemes, or where the Secretary of State considers the level of care to be appropriate.

17. Where the person being cared for is not in receipt of a relevant benefit, the applicant is required to provide a declaration signed by an appropriate person as to the level of care required for each person they care for. For these purposes, an appropriate person is a person who is: (a) involved in the health care or social care of the person cared for; and (b) considered by the Secretary of State as appropriate to make a declaration as to the level of care required.

[5] The Social Security (Contributions Credits for Parents and Carers) Regulations 2010, SI 2010 no.19.

18. It should be noted that the provisions for those engaged in caring are additional to the pre-existing arrangements for National Insurance credits for people drawing Carer's Allowance, which are awarded automatically.

19. Departmental management information data show that up to 15 January 2015 there have been approximately 7,500 successful applications for credits from people caring for one or more severely disabled persons for at least 20 hours a week.

20. The key change in the crediting arrangements for people caring for children, as noted above at paragraph 16, was the alignment of the upper age limit for the child being cared for both for basic and additional pension to age 12.

21. Credits for both basic and additional pension purposes where a person is receiving Child Benefit for a child under the age of 12 are awarded automatically. Data on the impact of these credits on individuals' pension entitlements are not available – in the case of basic pension it is not possible to determine this until a person has completed their working life. However data produced by HMRC on the Child Benefit recipients[6] filtered by the age of the youngest child in respect of whom benefit is payable show that at 31 August 2013, approximately 5.4 million people were receiving Child Benefit for one or more children under the age of 12 and therefore potentially benefiting from credits for both basic and additional pension purposes. At the same point in time approximately 6.7 million and 3.4 million people were receiving Child Benefit for one or more children under the age of 16 and 6 respectively.

22. The table below, based on the August 2013 data, illustrates the differences in credits available following the 2010 reforms compared to the situation had the reforms not taken place.

Age of Youngest Child	**Number of recipients per group**	**Without reform**		**With reform**	
		Basic Pension	**Additional Pension**	**Basic Pension**	**Additional Pension**
Under 6	3,400,000	✓	✓	✓	✓
6 to <12	2,000,000	✓	X	✓	✓
12 to <16	1,300,000	✓	X	X	X
Total		6,700,000	3,400,000	5,400,000	5,400,000

23. Therefore, in summary, as a result of the changes from 2010, approximately 1.3 million fewer people whose youngest child is between the age of 12 and 16 are being credited for basic pension purposes while approximately 2 million more people whose youngest child is between the ages of 6 and 11 are being credited for additional pension purposes, and therefore receiving potential credits for both basic and additional pension.

24. As the new crediting arrangements have only been in place for a relatively short period, they have yet to make an appreciable impact on existing pension entitlements – in particular in so far as they apply to periods of childcare.

[6] Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/286670/Child_Benefit_statistics_geographical_analysis_August_2013.xls

Abolition of adult dependency increases – section 4

25. Section 4 of the Act provided for the abolition of adult dependency increases of state pension from April 2010 with transitional protection for existing entitlements until 6 April 2020 or, in the case of an increase paid in respect of a wife, if earlier, until she reached pensionable age.

26. Eligibility for adult dependency increases was largely restricted to married men.[7] The original intention was that eligibility should be extended to women from 2010 in order to comply with EC Directive 79/7 on equal treatment for men and women in matters of social security; however, abolition of the provision made this unnecessary.

27. Eligibility for adult dependency increases was generally contingent on the dependent not drawing another social security benefit of equal or greater value than the increase and not having weekly earnings or an occupational or personal pension of more than standard rate of contribution-based Jobseeker's Allowance for a person aged 25 or over – currently £72.40 per week.

28. Prior to 2010, adult dependency increases of state pension were paid at the same rate as the Category B 'married woman's pension' a pensioner's wife became entitled to, based on his National Insurance contributions, once she reached State Pension age. (However, since 2010 they have been paid at a slightly lower rate, currently £64.90 per week compared to £67.80 per week, due to being uprated on different bases.) As a result, adult dependency increases have, in the main, been payable to male pensioners in respect of their younger wives who had not yet reached pensionable age.

29. With increasing participation in the labour market by married women, the number of adult dependency increases in payment had been steadily declining in the years prior to their abolition. Between May 2002 and February 2010 the number in payment reduced by more than half from around 85,000 to 39,000.

30. Since abolition in 2010 the number in payment has further reduced – estimated at around 22,000 in May 2014 the latest date for which figures are available[8]. Of these:

    a. around 15,000 are being paid to people resident in Great Britain; and
    b. around 14,000 are payable in respect of women who will not reach State Pension age until after the 6 April 2020 cut-off point for transitional protection. However, entitlement to the increase may possibly cease before that point for a variety of reasons, such as the dependent entering the labour market or increasing her earnings, or the death of the recipient (that is, the husband to whom the increase is payable).

31. We estimate that by April 2020, when transitional protection is due to be removed, in the region of a quarter of the increases in payment at 6 April 2010 will still be in payment. This is in line with the original projections at Annex B of the White Paper. Arrangements will be made to ensure that those affected will be given advance warning of the cessation of the payment and advice on the availability of other support.

[7] The provisions also enabled a married woman who had been entitled to an adult dependency increase of incapacity benefit for husband prior to pensionable age to be entitled to such an increase of retirement pension and for women to be entitled to an adult dependency increase in respect of a person having care of her child(ren) on the same terms as a man.
[8] Caseload data from WPLS.

Uprating – sections 5 and 6

32. Sections 5 and 6 of the Act dealt with uprating. Section 5 inserted the new section 150A in the Social Security Administration Act 1992 which provided for certain specified benefits to be uprated annually by at least the level of growth in average earnings rather than, as had previously been the case, price inflation under section 150 of the Administration Act. Basic State Pension had been increased in line with price inflation since 1980 and one of the key recommendations of the Pensions Commission was that indexation by reference to earnings growth should be restored to prevent further erosion of its value in relation to earnings. The benefits specified are:

    - Basic categories A and B state pension;
    - Non-contributory categories C and D state pension;
    - Industrial death benefit;[9] and
    - The standard minimum guarantee in Pension Credit.

33. Section 6 principally provided for a number of consequential amendments to section 150 of the Administration Act to preserve the uprating by reference to prices for widow's and bereavement benefits, the rates of which had previously been linked to those of basic categories A and B state pensions.

34. Other than in relation to its application to the standard minimum guarantee in Pension Credit, section 150A of the Administration Act was not commenced on Royal Assent. Sections 5(3) to (6) provide for flexibility in the timing of earnings uprating of the other amounts to reflect the commitment in the 2006 White Paper to restore earnings uprating of the basic State Pension: 'Our objective, subject to affordability and the fiscal position, is to do this in 2012, but in any event by the end of the Parliament at the latest.' In practice, this meant that earnings uprating of these amounts would start no later than 2015. The timing would be confirmed in advance, with the Secretary of State required to make an order before 1 April 2011 designating the first tax year in which the amounts would be reviewed with reference to earnings growth as part of the annual uprating process. Earnings uprating would then take effect from the following tax year.

35. An order under section 5(4) stating 2010/11 as the designated tax year was made on 26 October 2010.[10] Thus section 150A has been engaged in setting the rate of the relevant benefits for the 2011-12 and subsequent tax years.

36. Due to the Global Financial Crisis, the economic landscape has changed significantly since the Pensions Act 2007 was enacted. In particular, levels of earnings growth have been significantly lower in the intervening years than was originally factored into the projections of the impacts of measures such as that providing for the uprating of basic pension in line with average earnings.

37. Under the current administration, the provisions of section 150A have been supplemented by the non-statutory 'triple lock' enshrined in the Coalition Agreement.[11] Under the triple lock, basic state pensions and industrial death benefit are uprated by the highest of average earnings growth, price inflation (as measured by the CPI from 2012) or 2.5%.

[9] Industrial injuries death benefit (IIDB) was abolished for new claims in 1988 but with transitional protection for existing beneficiaries the bulk of whom are elderly widows. Historically IIDB had been paid at the same rate as Category B retirement pension as they serve the same function there are structural links between them.

[10] *The Uprating of Basic Pension Etc. (Designated Tax Year):* 2010/2650.

[11] Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/78977/coalition_programme_for_government.pdf

38. The triple lock has had an impact in every year since section 150A became fully operative as price inflation or 2.5% has in every year to date been higher than the growth in average earnings, as is illustrated in the table below.

Year	Rate of basic pension (£)	% increase over previous year	Annual earnings growth[12] May-July quarter of the previous year %
2011-12	102.15	4.6[13]	1.3
2012-13	107.45	5.2	2.8
2013-14	110.15	2.5	1.6
2014-15	113.10	2.7	1.2
2015-16	115.95	2.5	0.6[14]

Removal of the link between basic pension and the lower earning limit – sections 7 and 8

39. The lower earnings limit (LEL) for Class 1 National Insurance contributions had, since 1975, been linked to the rate of basic Category A State Pension. The LEL was historically the level of weekly earnings required to trigger liability for Class 1 National Insurance contributions and latterly, with the introduction of the 'primary threshold' as the trigger for liability in 2000, the minimum level of weekly earnings required in order to be treated as having paid National Insurance contributions.

40. Section 7, together with section 8 in relation to Northern Ireland, provides, alongside the reintroduction of earnings indexation of basic pension, for the statutory link between the LEL and basic State Pension to be broken in order to prevent an adverse effect on lower paid workers in terms of coverage under the National Insurance scheme.

41. As a result of breaking the link the LEL is currently £111 (2014-15) which is £2 lower than it would otherwise have been had the link with basic State Pension been maintained.

Additional pension – simplification of accrual rates – sections 10-12

42. The State Earnings Related Pension Scheme (SERPS), under which additional pension first became payable, was introduced in 1978 under provisions contained in the 1975 Social Security Pensions Act.

43. SERPS provided the first earnings-related component of the state pension which was originally intended to provide a pension equivalent to 25% of a person's earnings between the lower and upper earnings limits for payment of National Insurance contributions, averaged over the 'best' 20 years of his or her working life.

[12] ONS Average Weekly Earnings.
[13] Figure determined using RPI.
[14] 2015/16 figures announced in 2014 Autumn Statement, subject to the passing of uprating orders.

44. The scheme was subject to a number of modifications – principally under the 1986 Social Security Act to reduce the accrual rate from 25% in steps of 0.5% for people reaching State Pension age between 1999 and 2008, levelling it off at 20% for people reaching State Pension age from 2009 onwards, and for earnings to be averaged over a person's full working life rather than the 'best' 20 years.

45. The State Second Pension (S2P) scheme, introduced in 2002 under measures contained in the Child Support, Pensions and Social Security Act 2000, provided an enhancement to SERPS for those with low to moderate earnings and extended additional pension accruals to people caring for a young child or a severely disabled person and people with long-term incapacities.

46. In addition to the new crediting arrangements, the key features of the S2P scheme were:

- Low earners and those being 'credited in' were deemed to have earned a minimum amount, set at just over half median average earnings, thus boosting the value of their accruals. This is known as the low earnings threshold (LET). The LET is revalued annually and is currently £15,100 a year.
- A first band of earnings – between the lower earnings limit (LEL) and the LET – so deemed at the LET if below – which attracted an accrual rate of double the SERPS rate.
- A second band of earnings which attracted an accrual rate of half the SERPS rate. This was for earnings over the LET but below a limit – set at an amount equivalent to three times the LET minus two times the annual equivalent of the LEL. In current terms this would be around £33,750 a year.
- A third band for earnings above the limit of the second band which attracted accruals at the SERPS rate.

47. This three band structure whereby the higher accrual rate in the first band of earnings was counterbalanced by the lower accrual rate in the second was designed to taper off the boost provided by the S2P scheme, with higher earners in the third band effectively having the same overall accrual rate as under SERPS.

48. The original intention was that the earnings-related elements of the S2P scheme would be withdrawn once Stakeholder Pensions had become established[15] leaving earnings related pensions to be provided solely through occupational and personal pension arrangements. Under this model, accruals in future years under the S2P scheme would have provided a flat rate addition to the basic pension. The original plan to 'flat rate' S2P was not implemented.

49. In its second report, the Pensions Commission identified that, although the decision had been taken not to 'flat rate' S2P, the complex three band structure would over time lead to a flat rate. This was based on the assumptions that in the longterm earnings growth would exceed price inflation and that the limits for National Insurance liability would continue to rise broadly in line with prices. The effect of this would be, firstly, the erosion of the third band and then eventually, by around the middle of the century, the erosion of the second band of accruals because the LET would be increased in line with growth in average earnings.

50. The Commission suggested that the Department should accelerate this process in order to remove earnings-related accruals from around 2030. Sections 10 to 12 of the Act were thus intended to both simplify the basis on which additional pension accrued, and to accelerate the transition to a flat-rate top up to the basic pension.

[15] A New Contract for Welfare Partnership in Pensions (Command 4179 December 1998).

51. To achieve this, the then upper end of the third band, the Upper Earnings Limit in National Insurance, would be replaced by an Upper Accrual Point which would be fixed in value. Section 12 of the Act provided for this with an introduction date determined by the introduction of the flat rate accrual amount (described below). However, because of changes to National Insurance announced in Budget 2007 the National Insurance Contributions Act 2008 introduced the upper Accrual point from 2009. The Upper Accrual Point is set at £40,040. The annual equivalent of the Upper Earnings Limit is, by way of comparison, currently (2014/15) £41,865.

52. The Act also included two further measures intended to simplify S2P.

53. Firstly, section 10 provided for the removal of the third band from April 2010 in the expectation that by that point it would be subsumed by growth in the upper limit of the second band. However, as earnings growth in the intervening period was significantly lower than originally projected this was not the case.

54. Secondly, section 11 provided for a 'flat-rate' accrual amount – revalued in line with average earnings growth prior to the point a person reaches State Pension age. This replaced the existing variable formula based accruals on earnings up to the LET which had meant the values varied from cohort to cohort. The flat-rate accrual amount was intended to provide clarity as to the minimum amount a person could expect to accrue in a year under the S2P scheme.

55. This measure was implemented from 2012 by Social Security Pensions (Flat Rate Introduction Year) Order 2011 (S.I. 2011/2953). The annual flat rate accrual amount specified at para 13(2) of Schedule 4B to the 1992 Contributions and Benefits Act[16] was revalued under the provisions of section 148AA of the Social Security Administration Act 1992 by the Social Security Pensions (Flat Rate Accrual Amount) Order 2012 (S.I. 2012 No. 189) from £72.80 to £88.40. Under the most recent such Order (S.I. 2014 No.369), the current (2014/15) flat rate accrual amount is £92.00 a year.

State Pension age – section 13

56. Until 2010, the UK State Pension age had remained unchanged at 65 for men and 60 for women since 1940.

57. From April 2010, legislation introduced by the Pensions Act 1995 to increase women's State Pension age to 65 over a ten-year period began to take effect. The move to equalise men's and women's State Pension age was given impetus by the adoption, in 1984, of EC Directive 79/7 on equal treatment in social security. Although the Directive requires the progressive implementation of equality in social security matters for men and women in Member States, it contains an important derogation in respect of the State Pension age, permitting pre-existing unequal treatment to continue subject to review, in order to allow Member States time to adjust their systems. The timetable introduced by the 1995 Act allowed 15 years' notice of the change. The decision to equalise at 65, rather than lowering men's State Pension age, was based on a growing recognition that demographic change was leading to a reducing old-age support ratio and the fact that an increasing number of European States were equalising their State Pension ages at 65 or older.

[16] Inserted by section 11 of, and Schedule 2 to, the 2007 Pensions Act.

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58. However, actual and projected growth in the UK pensioner population has continued faster than anticipated, as a result of increasing longevity and falling birth rates. These factors led the Pensions Commission to recommend that raising the State Pension age was essential to ensuring the long-term sustainability of the UK State Pension system if the link to earnings growth was to be reintroduced; the alternative would be to face seeing the value of the basic pension continue to decline. Increasing the State Pension age was intended to keep the inevitable increases in public expenditure within GDP limits which would be fair between generations and sustainable over the long term.[17]

59. The White Paper supported the Pensions Commission's recommendation. Thus, paragraph 3.34 of the White Paper set out a schedule to increase the State Pension age by one year per decade, starting in the mid-2020s and reaching 68 by 2046.

60. Based on the 2004 principal projections of median cohort life expectancy at State Pension age in the White Paper, it was expected that this timetable would broadly maintain the proportion of adult life spent in receipt of the State Pension at the 2020 level – around 30% for men and between around 32% and 34% for women. Furthermore, it was anticipated that these changes alone would reduce the costs of the pension system by £30 billion by 2050 while seeking to stabilise the proportion of adult life spent in retirement.

61. The 2007 Pensions Act accordingly provided for the State Pension age to increase to 66 by 2026, 67 by 2036, and 68 by 2046 spread over 2 years to reduce the impact on individuals.

62. However, since the 2007 Act came into force, once again framed by increasing life-expectancy rates and the need to keep spending on pensioners fair and sustainable, the timetable set out in section 13 of the Act has already been largely superseded by both the 2011 and 2014 Pensions Acts.

63. Section 1 of the 2011 Pensions Act accelerated the process of State Pension age equalisation, meaning that the State Pension age for women will now reach 65 by December 2018.

64. The dates at which the State Pension age will increase to 66 and 67 have also been brought forward. Under section 1 of the 2011 Act, the rise in State Pension age to 66 will be in place by October 2020 for both men and women. In addition to this, section 26 of the 2014 Pensions Act provides for the State Pension age to increase to 67 between 2026 and 2028.

65. While neither the 2011 nor the 2014 Act specifically reviewed the 2007 Act's provisions for increasing the State Pension age from 67 to 68 between 2044 and 2046, section 27 of the 2014 Act has provided for a review of the State Pension age at intervals of not more than six years, similar to that initially proposed in paragraphs 3.39 and 3.40 of the 2006 White Paper.

66. Under the terms of section 27, this review will be informed by:

- Analysis from the Government Actuary's Department on the appropriate State Pension age based on maintaining the principle of spending a defined proportion of adult life in receipt of state pension.
- An independent body commissioned to review additional factors to be taken into account when determining State Pension age.

[17] The 2nd Report of the Pensions Commission, page 12.

67. The Secretary of State of the day will then publish a report on any changes to the State Pension age timetable based on the outcome of these reviews. The first review must be completed by May 2017.

68. It is thus entirely possible that the timetable set out in the 2007 Act for the increase in State Pension age from 67 to 68 could change as a result of this periodic review process. Indeed, based on life-expectancy projections and if the principle of spending one-third of adult life in retirement is retained, it is currently anticipated that, State Pension age would rise to 68 by the mid-2030s and 69 in the late 2040s.

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Part 2: Occupational and Personal Pension Schemes 4

Contracting-out: conversion of Guaranteed Minimum Pensions – section 14

69. Section 14 of the Act inserted sections 24A-H into the Pension Schemes Act 1993. This introduced the ability for defined benefit (final salary) contracted-out occupational pension schemes to convert members' accrued rights to a Guaranteed Minimum Pension (GMP) into ordinary scheme rights by using actuarial equivalence (i.e. the value of the post-conversion benefits must be at least equivalent to the pre-conversion benefits offered to the member). The intention of this provision was to allow schemes to adopt a unified approach to their benefit structure and so streamline, and potentially make savings to, their administrative processes. This approach could also deliver clarity for members in terms of understanding the benefits available to them from the scheme. Use of this provision is not mandatory.

70. The Department has been considering the issues around GMPs with a working group of industry experts and discussing the operation of the above–mentioned provisions with that group, and our understanding is that they are little used. In part, the industry tells us, that this is because of concerns with European legal requirements about providing equal pensions for men and women and how these interact with the GMP legislative requirements. The Department wants to encourage schemes to use these measures, so provision has been made in the Pensions Act 2014 to amend the Pensions Schemes Act 1993 in order for guidance to be given, as appropriate, about GMP conversion – paragraph 20 to Schedule 13 to the Pensions Act 2014. The Department is working with the industry to understand how best to use the provision.

Contracting-out: abolition of contracting-out for defined contribution pension schemes – section 15

71. Section 15 abolishes contracting-out for occupational and personal pension schemes that contract out on a defined contribution (money purchase) basis. Subsequent to that provision, section 106 of the Pensions Act 2008 ('PA 2008'), provided for the abolition of 'protected rights',[18] and many of the consequential amendments in Schedule 4 of the 2007 Act were repealed to reflect that change. Because of the link between the two, sections 15 of the 2007 Act and 106 of the 2008 Act were brought into force on 6 April 2012. Regulations to support abolition under both Acts were made in 2011 and came into force on 6 April 2012. The regulations made under the 2007 Act[19] introduce transitional arrangements for National Insurance rebates. Prior to abolition, National Insurance rebate payments were made by HMRC to contracted-out defined contribution schemes at the end of each tax year through an automated payment system. The regulations provide for 'late' receipt and recovery of National Insurance rebates in the three-year period following abolition. They ensure that the automated process of rebate payments and recoveries which existed between HMRC and formerly contracted-out schemes prior to abolition is maintained in most cases for a transitional period. The transitional period will ease administrative burdens on schemes and HMRC.

72. Where automated payments to schemes are not possible because, for example, the member has left the scheme, payments will be made direct to individuals. Once the transitional period ends on 5 April 2015, all rebate adjustments after this date will be paid direct to individuals and be handled clerically by HMRC.

73. Government is committed to doing a review of the transitional arrangements in order to establish whether the transitional arrangements are working satisfactorily, for both schemes and HMRC. The review will be carried out in 2015. Interim feedback from HMRC operations is that the arrangements are working well, with no complaints from the pension providers.

Dispute resolution arrangements – section 16

74. Trustees or managers of occupational pension schemes are required under rules introduced in the Pensions Act 1995 to have in place formal arrangements for the resolution of disagreements relating to the scheme. However, prior to the change in section 16, the dispute resolution procedure required a two stage process, with someone nominated by trustees giving a decision at the first stage, and then the matter being referred to the trustees if the applicant is still not satisfied.

75. The measure in section 16 made it possible to replace the two-stage internal dispute resolution procedure with a single-stage arrangement whereby all decisions would be taken by trustees or managers. This change was not compulsory, however, and schemes would be able to retain the present two-stage arrangements if they wished.

76. The change in section 16 gave effect to the proposal announced in the 2002 Green Paper *Simplicity, security and choice: Working and saving for retirement*.

[18] Protected rights' is the collective term for the NI Rebate, tax relief and investment return.

[19] The Pensions Act 2008 (Abolition of Protected Rights) (Consequential Amendments) Order 2011. SI 2011/ 1246; The Pensions Act 2008 (Abolition of Protected Rights) (Consequential Amendments) (No 2) Order 2011. SI 2011 / 1730; The Pensions Act 2007 (Abolition of Contracting-out for Defined Contribution Pension Schemes) (Consequential Amendments) (No 2) Regulations 2011. SI 2011/ 1724; The Pensions Act 2007 (Abolition of Contracting-out for Defined Contribution Pension Schemes) (Consequential Amendments) Regulations 2011. SI 2011 /1245; The Pensions Act 2007 (Commencement No 4) Order 2011.SI2011 /1267; and The Pensions Act 2008 (Commencement No 10) Order 2011.SI 2011/1266.

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77. The internal dispute process remains an important part of the overall procedures members of occupational pension schemes can use to put right problems they may face in their scheme.

Actuarial guidance – section 17 and Schedule 5

78. In order for actuaries to calculate pension schemes' liabilities consistently, all are required to use an agreed set of guidelines. These guidelines were contained in documents referred to either as 'Guidance Notes' or as a 'Technical Memorandum'. There were seven Guidance Notes and one Technical Memorandum referred to in pensions legislation. The Secretary of State was required by primary legislation to approve three of these Guidance Notes and the Technical Memorandum.

79. Historically, the Actuarial Profession has produced these documents. The professional bodies for actuaries – the Institute of Actuaries in England and Wales and the Faculty of Actuaries in Scotland – have combined the role of regulator with that of professional body.

80. The Morris Review of the Actuarial Profession recommended that the Financial Reporting Council should establish a new regime to set actuarial standards and to oversee the regulation of the Profession. The Financial Reporting Council is the UK's independent regulator for corporate reporting and governance. The Government accepted this recommendation and the Financial Reporting Council set up the Board for Actuarial Standards to promote confidence in corporate reporting and governance by setting high quality actuarial standards. The Institute of Actuaries in England and Wales and the Faculty of Actuaries in Scotland continue to exist as the professional bodies for the profession in their respective jurisdictions.

81. On 6 April 2007, the Board for Actuarial Standards adopted and took responsibility for the existing versions of the pensions Guidance Notes and the Technical Memorandum.

82. In order to maintain the independence of the Financial Reporting Council, and through it the Board for Actuarial Standards, as the UK's independent regulator for corporate reporting and governance, section 17 and its accompanying Schedule contained provisions removing from primary legislation the requirement for the Secretary of State to approve the three Guidance Notes and the Technical Memorandum.

83. Since the Board for Actuarial Standards was set up in 2006, it has removed the majority of adopted Guidance Notes and, where necessary, the detail has been incorporated into legislation.

Financial Assistance Scheme – sections 18 and 19

84. The Financial Assistance Scheme (FAS) was announced on 14 May 2004 to assist those who had lost or who stood to lose significant amounts as a result of their pension scheme winding up underfunded with an insolvent employer. Section 186 of the Pensions Act 2004 established the FAS and required the Secretary of State to make Regulations setting out the details. These Regulations were made in July 2005 and the majority of those regulations came into force on 1 September 2005. These regulations provided the calculation rules for assistance payments and, specifically:

- tapered amounts depending on proximity of the member to normal retirement age; and
- entitlement to begin generally at age 65.

85. In the Chancellor's budget speech on 21 March 2007, an extension of the FAS was announced. Part of this extension was achieved by the Pensions Act 2007, by way of amendments to Section 186 of the 2004 Act. These changes were:

- the replacement of tapered payments by a single amount which was to be no less than 80% of the individual's expected pension (subject to a cap and less any payments from the pension scheme);
- payments to begin at normal pension age, rather than age 65;
- initial payments for the scheme member (that is, payments on account of entitlement) to be set at 80% and at 45% for a survivor; and
- regulations to be able to amend the level of the initial payments.

86. These measures were brought into force on 14 December 2007 and were effective from the date of first entitlement.

87. In April 2007 the Department and HMT had asked Andrew Young of the Government Actuary's Department to see if greater value could be obtained from the funds remaining in schemes by taking them into government, rather than using them to purchase annuities. Young's final report, the *Financial Assistance Scheme Review of Assets*, was published on 17 December 2007. On the same day the then Secretary of State announced to Parliament that the Government had accepted the recommendations of the Young Report and that the FAS was to be extended further to offer levels of assistance comparable with PPF compensation. This would be financed by taking in the assets of qualifying schemes and also by a further increase in Government funding.

88. In December 2007 the final extension to the FAS was announced, including an increase in the percentage of the expected pension covered by the FAS from 80 to 90%. These changes were implemented through a series of regulations during 2008 and 2009.

89. As mentioned above, between April 2007 and December 2007 consideration was being given to whether or not greater value could be obtained from the remaining scheme funds by transferring them to government, rather than annuitising.

90. Section 19 required the Secretary of State to make regulations which imposed a temporary restriction on the purchase of annuities by trustees of qualifying schemes that were still winding up (unless they had entered into a binding commitment to do so or have obtained the permission of the FAS scheme manager). The regulations, which must have been made as soon as is reasonably practicable, applied for nine months from the date on which they come into force.

91. This Section came into force on 26 July 2007 and the relevant regulations came into force on 26 September 2007, which means they expired in June 2008.

Part 3: Personal Accounts Delivery Authority 5

91. In 2005, the Pensions Commission recommended a radical set of reforms to both the UK state and private pensions systems[20]. The specific recommendations the Pensions Commission made to increase private pension saving were:

    a. harnessing the power of inertia through the automatic enrolment of workers by employers into pension schemes to boost pension saving;

    b. requiring employers to make a minimum contribution to their workers' pension funds to improve the incentive to save; and

    c. a new pension scheme, designed to provide a simple and low-cost way of saving for low to moderate income earners.

92. The introduction of automatic enrolment for all eligible workers, with a minimum employer contribution, would mean that for the first time millions of workers would have a right to a workplace pension with contributions from their employer and government in the form of tax relief. These reforms to private pension savings were introduced by the Pensions Act 2008 and subsequent secondary legislation. In December 2006, the Government published the White Paper *Personal accounts: a new way to save,* CM 6975[21]. This recognised that designing and delivering a new pension scheme should not be a task for government. It proposed the establishment of the Personal Accounts Delivery Authority, a Non-Departmental Public Body that could harness the skills and expertise of the private sector to initially advise on and later implement proposals.

[20] http://webarchive.nationalarchives.gov.uk/+/http:/www.dwp.gov.uk/publications/dwp/2005/pensionscommreport/main-report.pdf
[21] https://www.gov.uk/government/publications/personal-accounts-a-new-way-to-save-third-annual-report.

93. The White Paper also made clear that the introduction of a new trust-based occupational scheme, the Personal Accounts Scheme (now the National Employment Savings Trust (NEST)), needed to extend the benefits of an occupational pension scheme to millions of people who were without access to good quality workplace pension provision. In developing the scheme, it was essential to maintain a focus on this target group. The delivery of this scheme was a substantial programme of work at the heart of the private pensions reform programme. For the scheme to be a success it was critical to get the design of the system and the delivery of its infrastructure right.

94. The Personal Accounts Delivery Authority, (the Authority), was established under section 20 of the Pensions Act 2007. The Authority was initially set up to provide independent advice to Government on the development of a new, low cost pension scheme. It was able to manage its own affairs and utilise the necessary professional expertise and knowledge in order to provide detailed operational advice on the design of the scheme to Government. Schedule 6 gives details of the membership and structure of the Authority. The Authority was led by a Chair and Chief Executive and they were supported by legal, commercial, operational, business and financial expertise.

95. Section 21 set out the initial function of the Authority. This was limited to advising the Government on the preparation for the implementation of, or for advising on the modification of, any relevant proposals about personal accounts. This included (i) providing advice and recommendations to the Government by helping it to think through the operational and commercial implications of its policy options; and (ii) providing for the implementation of a national low-cost portable pension savings scheme by preparing financial, technical and commercial strategies. The Authority was prevented from borrowing money from any person in connection with this function.

96. Section 22 specified that the Authority must have regard to general guidance relating to the management of a Non-Departmental Public Body and to the principles of good corporate management. Section 23 allowed for the winding up and dissolution of the Authority by an Order.

97. Alongside the introduction of legislation for automatic enrolment, the Authority's functions were extended by section 79 of the Pensions Act 2008 which also provided that section 21 of the Pensions Act 2007 ceased to have effect. The Authority was provided with new powers under section 79(6) of the Pensions Act 2008 to enter into agreements and borrow money which enabled it to implement the commercial and procurement strategies and to go on to design, build and test the IT systems in preparation for the implementation of the pension scheme.

98. By July 2010 the Authority had completed its work; the scheme design, including the scheme order and rules[22] (which is equivalent to a trust deed) were finalised and the procurement processes for services to support the operation of the scheme were well advanced. Some of the implementation activities, including for example those dependent on the adoption of a Statement of Investment Principles which could only be signed off by the trustee of the scheme. The remaining implementation was therefore completed by NEST Corporation – the sole corporate trustee of NEST. NEST Corporation now has ongoing responsibility for the operation and strategic direction of the scheme.

[22] http://www.nestpensions.org.uk/schemeweb/NestWeb/public/aboutUs/contents/order-and-rules.html

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99. The Personal Accounts Delivery Authority Winding Up Order 2010 (SI 2010/911) came into force on 5 July 2010 ('the Order'). The Order was made under the affirmative power in section 23 of the Pensions Act 2007. It repealed sections 20 and 22 of, and Schedule 6 to, the Pensions Act 2007 and sections 79 to 85 of the Pensions Act 2008 which relate to the Authority. It made arrangements for the transfer of the Authority's property, rights and liabilities to NEST Corporation, apart from certain property, rights and liabilities which were transferred to the Secretary of State. The transfer to NEST Corporation included (but was not limited to) all rights and liabilities with respect to employees of the Authority, any contracts that the Authority had entered into, and records that the Authority held. The transfer to the Secretary of State included property, rights and liabilities in connection with records covering advice or assistance to the Secretary of State on questions of policy, assistance or advice to the Secretary of State or the Pensions Regulator on the automatic enrolment requirements in Part 1 of the Pensions Act 2008 and records that related to the oversight of the Authority's affairs as a Non-Departmental Public Body. Ownership of these records transferred to the Secretary of State. This then enabled the NEST Corporation to take forward and finalise implementation in order to establish and operate the NEST pension scheme in the best interests of future members.

100. NEST Corporation launched the scheme in 2011 to prepare for the onset of automatic enrolment in October 2012. It is successfully supporting the introduction of automatic enrolment and currently has in excess of 1.7 million members and over 10,000 participating employers. The Department estimates that by the end of automatic enrolment implementation in 2018, NEST will have between 2 and 4 million members and around 750,000 participating employers.

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Glossary of State Pension terms

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Additional pension	An earnings-related pension paid under the State Earnings Related Pension Scheme (SERPS) or the State Second Pension (S2P) scheme. Normally paid with basic pension but can be paid in isolation.
Adult Dependency Increase	Increase of State Pension paid to a man in respect of his wife where she is under pension age and economically inactive.
Basic pension	A flat rate contributory pension with reduced amounts paid where the contribution condition is not fully satisfied and a flat rate non-contributory pension payable subject to satisfaction of a residence test where a person either does not qualify for a contributory pension or any entitlement to a contributory pension is lower than the rate of non-contributory pension.
Category A pension	Basic or additional pension normally based on a person's own National Insurance contributions.
Category B pension	Basic or additional pension based on a person's spouse's, civil partner's, or late spouse's or civil partner's National Insurance contributions.
Category C pension	Now largely obsolete. It is paid to the widows of men who reached State Pension age before the introduction of the post-war contributory pension scheme in 1948.
Category D pension	Non-contributory pension.
National Insurance credits	Credits of earnings awarded by the Government in certain circumstances (for instance, when someone has caring responsibilities or is registered unemployed). They cover periods when a person is not paying National Insurance contributions.
National Insurance record	An individual's history of National Insurance contributions and credits.
State Pension age	Minimum age at which a person can qualify for a state pension.

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