

Freedom of Information request 585/2014 & 670/2014

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Information request

I have been looking at the internet and have seen "Extract From White Paper, The single-tier pension: a simple foundation for pension"

No 3 managing the end of contracting out, in the white papers it states minimise the impacts on employers, schemes and individuals.

The part that concerns me is the impact to individuals, on page 7 paragraph 74 it states vast majority of those who pay a higher rate of National Insurance as a result of the ending of contracting out will be able to get extra state pension etc. Further, around 90 percent of individuals who reach state pension age in the first two decades of single-tier will gain enough extra state pension to offset both the increase in the National Insurance contributions they will pay over the rest of their working lives and any potential adjustments to their occupational pension.

1) Can you please advise if in your assumptions you used in your calculations loss of GMP increases paid by DWP with additional state pension.

1 a) If you did not please advise that if a non public service person gains enough benefit by paying Full NI to make up loss of GMP increases.

1 b) Can you please advise for only non public service scheme employees how many years of NI at full rate it will take for them to make up loss of GMP increases paid by DWP with additional state pension.

1 c) How many many non public service employees will never make up loss of GMP increases after single-tier pension starts.

You state that people will also be able to make up loss of any potential adjustments to their occupational pension.

A) Can you please advise what adjustment you assumed to non public service occupational schemes. ie Increases in (a) contributions, (b) future accrual or (c) a mixture of both.

B) Advise your assumptions for a, b, and c.

c) Please confirm that contracted out people in non public service schemes with loss of future accrual in their pension of from 60 to 70 years, increase of NI by 1.4% and loss of GMP increases normally paid by DWP with additional pension will be able to make up loss of GMP increases normally paid by DWP with state additional pension.

D) What do you estimate the maximum loss for males and females separately will be for GMP increases normally paid by DWP with additional state pension for non public service employees who have to pay full NI when contracting out ceases after 5 April 2016.

On the 11th of February you asked:

I have seen mention on the internet in Hansard 13 Jan 2014(pt0001) Grand Committee Monday 13 January 2014 Pensions Bill page 8 of 45.

Referring to those private sector employees who are contracted out immediately before implementation, who reach state pension age in the first decade of single tier, around 75% of them will receive enough extra state pension to offset both the increase in national insurance contributions that they will pay over the rest of their working lives and any potential adjustment to their occupational pension schemes.

That is an argument that was deployed by the Pensions Minister in the House of Commons, too, when addressing that issue.

If this is the case can you please tell me what assumptions were used regarding potential adjustments to occupational pension schemes and if you took into any other adjustments and value put on them other than increase in NI by 1.4% and reduction in future pension accrual and if so what reduction or an employee contribution increase and if so what increase.

Can you please advise for the first five years how many private sector employees reach state pension age and what percentage will gain extra pension under single tier compared to existing arrangements for private sector employees.

DWP response

As both of these queries are mainly about the assumptions underlying the Department's analysis of the impact of the ending of contracting out I have

combined the responses into a single answer, addressing each of the points from your first query in turn, and highlighting where they also apply to your second query.

Before addressing the detail of your queries I would like to restate the position on Guaranteed Minimum Pension, and clarify the figures that you have quoted above.

As explained previously¹, increases to Additional Pension (AP) for inflation may mean that a person receives increases to their overall income reflecting the movement in prices due to inflation, even though any Guaranteed Minimum Pension (GMP) in respect of periods before 1997 is not required to be increased in line with inflation. This is not because the Department for Work and Pensions (DWP) is paying increases to GMP, but because of the way the AP and GMP relate to one another.

The figure of 90% which you referenced from the White Paper has as the denominator those people who would reach State Pension age in the first twenty years after the implementation of single-tier and would have to pay more National Insurance due to the ending of contracting out. Note that not all of this group will have had a GMP relating to contributions paid before 1997 and that not everyone with such a GMP would still be contracted out at the point the single-tier pension is introduced.

In the White Paper we estimated that for 90% of these individuals, the single-tier reforms would lead to an increase in their lifetime income from state pension that exceeded the total additional National Insurance contributions and any adjustments to their occupational pension scheme. This estimate was subsequently revised to 85% in the updated version of the Impact Assessment that was published in October 2013². This revision reflected updates to the Office for Budget Responsibility's economic assumptions.

The figure of 75% you quoted in your second query is also included in the Impact Assessment. It is estimated on the same basis as the 85% figure, but is restricted to people who would have been contracted out in the private sector after April 2016.

The same method and assumptions were used to generate both estimates. Note that both figures refer to people who would have been contracted out of the State Second Pension at some point after 6th April 2016 if the single-tier reforms were not introduced. Not all of these people will have a GMP associated with contributions made between 1978 and 1997, and not everybody with such a GMP would fall into this group.

Below I have attempted to answer your detailed queries.

¹ Freedom of Information reference 2013/3495

² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/254151/a-pensions-bill-single-tier-ia-oct-2013.pdf

1) Can you please advise if in your assumptions you used in your calculations loss of GMP increases paid by DWP with additional state pension.

1 a) If you did not please advise that if a non public service person gains enough benefit by paying Full NI to make up loss of GMP increases.

In the updated impact assessment which we published when the Bill entered the Lords, this estimate was revised to 85%. This calculation is based on a comparison of individuals' total state pension under the current and single-tier systems. The modelling of the current system baseline includes individuals whose Additional Pension rises faster than the standard CPI uprating due to the GMP associated with contributions from 1978/79 to 1987/88 being frozen. There is no quantification of the potential effect of the 3% cap on uprating of GMPs associated with contributions from 1988/89 to 1996/97 as the Office for Budget Responsibility's long-term assumption for annual CPI inflation is 2%.

1 b) Can you please advise for only non public service scheme employees how many years of NI at full rate it will take for them to make up loss of GMP increases paid by DWP with additional state pension.

This would depend on a number of factors including longevity, the size of the GMP, and whether or not an individual has spent much of their career contracted back in to SERPs or the State Second Pension. However, for someone with average life expectancy, a GMP of around £25 relating to contributions between 1978/79 and 1987/88 (which would represent roughly an average salary over the full ten years) and with little or no Additional Pension, only one additional qualifying year after April 2016 would be required to give a lifetime state pension in excess of the total that they would have received under the current system.

At the illustrative starting rate of £144, one qualifying year would be worth £4.11 per week, uprated at least in line with earnings and payable immediately from State Pension age, whereas the interaction of the frozen GMP with their gross accrual would lead to an increase in net Additional Pension each year worth around only 50p a week.

1 c) How many many non public service employees will never make up loss of GMP increases after single-tier pension starts.

As discussed above, there is no specific loss that can be directly attributed to uprating of GMPs. Looking at the reforms as a whole, we estimate that around a quarter of individuals with a 1978/79-1987/88 GMP relating only to private sector employment will either receive less state pension over their lifetime than they would have done under the current system, or will not gain enough

in state pension to offset the additional National Insurance contributions or scheme adjustments resulting from the end of contracting out.

You state that people will also be able to make up loss of any potential adjustments to their occupational pension.

A) Can you please advise what adjustment you assumed to non public service occupational schemes. ie Increases in (a)contributions, (b)future accrual or (c) a mixture of both.

B) Advise your assumptions for a,b,and c.

The analysis underlying the estimates you enquired about does not involve any specific assumptions about the design of adjustments to occupational pension schemes. The potential impact was modelled by treating private sector employees as if they were paying both the employee and employer components of the additional National Insurance contributions. An actuary must certify that any changes to scheme rules recoup no more than an employer's increase in National Insurance contributions as a result of the abolition of contracting out.

c) Please confirm that contracted out people in non public service schemes with loss off future accrual in their pension of from 60 ths to 70 ths, increase of NI by 1.4% and loss of GMP increases normally paid by DWP with additional pension will be able to make up loss of GMP increases normally paid by DWP with state additional pension.

As set out above, the Department's analysis does not attempt to model the impact of specific types of adjustment which employers may make to pension schemes. Outcomes will depend on a number of factors, and it cannot be confirmed that individuals with particular private pension circumstances will definitely be better off under the current or single-tier system.

D) What do you estimate the maximum loss for males and females separately will be for GMP increases normally paid by DWP with additional state pension for non public service employees who have to pay full NI when contracting out ceases after 5 April 2016.

As set out above, and in an earlier response³ the DWP does not pay GMP increases, and as such there can be no loss specifically associated with a GMP. Most employees who switch to paying full National Insurance from April 2016 will have a higher state pension under the single-tier reforms than under the current system.

³ Freedom of Information reference 2013/3945

The maximum weekly value of a GMP relating to contributions made on high earnings between 1978/79 and 1987/88 is around £50 at today's prices, and the maximum for contributions between 1988/89 and 1996/97 is around £30.

Can you please advise for the first five years how many private sector employees reach state pension age and what percentage will gain extra pension under single tier compared to existing arrangements for private sector employees.

In the context of the rest of your query, I am taking this question as being about those private sector employees who pay additional National Insurance contributions in the first five years after the implementation of single-tier due to the ending of contracting out. On the same basis as the analysis discussed above, it is estimated that there will be around 70,000 such employees, 80% of whom will have an increase in their lifetime income from state pension that outweighs the additional National Insurance contributions and any adjustments to their occupational pension.