

# Chapter 7: Further simplifying State Pensions

## Consolidation of Additional Pension rights

### Objectives

- 7.1 The Pensions Act 2007 introduces measures that will help simplify basic State Pension and State Second Pension. The measures mark a step forward in helping people understand their pension entitlement. However, the three entitlements that make up state pension: basic State Pension, the state second pension schemes and Pension Credit still remain complex in some areas and further work needs to be done to simplify those.
- 7.2 The proposals outlined here will provide a further and significant simplification of the state second pension schemes. The proposals build on the Pensions Act 2007 and are consistent with the Government's five tests for reform; to promote personal responsibility, be fair, simple, affordable and sustainable.

### Rationale

- 7.3 Having put in place measures to simplify State Second Pension in the future this Bill takes steps to simplify the three additional State Pension schemes that today's workers may have contributed to in the past and in which they will have a stake in for many years to come. At the moment these pension accruals are only notional and cannot be given a firm cash value until a contributor retires.
- 7.4 We propose that the three schemes are brought to account after the end of the 2011/12 tax year and given a cash valuation. This cash amount will be revalued by earnings until the contributor retires. People of working age will then know the amount of pension their past contributions have paid for and will be able to estimate in a straightforward way the value of the pension they will be able to build up in the future. Simplifying additional State Pension in this way, combined with an earnings uprated basic State Pension, will provide contributors with a much better understanding of their retirement income from the State and its value to them as a foundation for private saving.

### Summary of proposals

- 7.5 The key proposal is to consolidate the existing additional State Pension rights currently being built up by people of working age. All additional State Pension rights for this group up to 2011/12 will be converted into a cash valuation. This valuation will be based on the rules and calculations that would have been normally applied to the accruals in a contributor's account at the point they

reached State Pension Age. Only those reaching State Pension age after 5 April 2020 will have their additional State Pension consolidated in this way. The cash valuation would be posted onto contributor's accounts and we intend to bring forward an amendment during the passage of the Bill to enable the cash valuation to be revalued in line with earnings up to State Pension age.

- 7.6 When the Additional Pension is calculated, it will be necessary to reduce that amount for those who have been contracted out, in line with what currently occurs at State Pension age. The method of calculating this reduction and thus the impact on the individual will be unchanged, with the exception of the period from April 1978 to March 1997. During this period contracting out was taken into account by deducting any entitlement to a Guaranteed Minimum Pension<sup>146</sup> from the Additional State Pension (the contracted-out deduction). Guaranteed Minimum Pension rules mean that the correct rate of the contracted out deduction is not known until State Pension age, as it can change depending upon the circumstances of an individual. It is our intention to bring forward an amendment during the passage of the Bill which will fix the contracted out deduction in relation to the Additional State Pension using a method which is actuarially fair. This proposal will not disturb any entitlement that a contributor has to a private pension.

## **Costs and benefits**

### ***Government***

- 7.7 The proposal in effect rolls up calculations from three distinct pension benefits into a single cash sum. It will no longer be necessary for DWP staff to have a working knowledge of the complex rules of these benefits – Graduated Retirement Benefit (1961-1975), the State Earnings Related Pension Scheme (1978-2002) and unreformed State Second Pension (2002-2012). This simplification cannot start until pay as you earn (PAYE) returns are made for the 2011/12 tax year and at this stage we have not fully identified all the opportunities this will have on reducing complexity in our business processes. In the long-term, it will be possible to close the old schemes and at the same time remove the complex calculation routines, the guidance and the need for staff to be trained in these benefits. Without these changes the need for continued detailed knowledge could extend to the end of the century.

### ***Individuals***

- 7.8 The proposals, together with reforms of State Second Pensions in the Pensions Act 2007, will enable contributors to have a much clearer picture of their State Pension outcomes, both the value of pension accrued to date and projected forward. The reforms of the contracted-out deduction which we are proposing to bring forward during the passage of the Bill will, for the first time, provide contributors with a valuation of the amount of additional State Pension they will receive in retirement. These proposals will help provide a key element of

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<sup>146</sup> Guaranteed Minimum Pension is the statutory minimum a Defined Benefit scheme must be designed to produce for anyone contracted-out in the years 1978 to 1997.

information to contributors so that they can make fully informed savings decisions.

### **Gender, race, disability impact**

7.9 These reforms will affect additional State Pension rights previously and currently accrued until the Pensions Act 2007 reforms take effect. They will apply equally to all affected pension accrual records irrespective of gender, race or disability.

### **Competition impact**

7.10 The reforms will not raise any concerns regarding competition because the objective does not relate to specific markets or companies. The amount of pension payable by private and occupational pension schemes will be unaffected by this proposal.

### **Implementation and delivery plan**

7.11 Plans on implementing the changes have yet to be finalised. However, flexibility over the conversion window will be required, with commencement possible from the end of the 2011/12 tax year. We do not expect to bring forward the calculation for anyone who reaches State Pension age before 2020.

## **Pension Credit simplification – assessed income period run-on**

### **Objectives**

7.12 This proposal removes the need to review older pensioners' changes in circumstances in respect of their Pension Credit entitlement and is part of a package of simplification measures aimed at:

- improving the customer experience;
- optimising operational efficiency;
- providing more accurate assessments; and
- reducing fraud and error.

### **Rationale**

7.13 When Pension Credit was introduced in October 2003 the cases that migrated from Minimum Income Guarantee were set an automatic assessed income period of between five and seven years. During this period recipients of Pension Credit

were not required to declare increases in capital and other similar changes of circumstance. The assessed income period on these cases will start to mature between October 2008 and October 2010. In addition all new claims with assessed income periods from October 2003 rolling forward will have an assessed income period maturing from October 2008 onwards.

7.14 This proposal will reduce the number of cases requiring a review after April 2009 thus reducing the administrative burden the Pension Service will experience. It will also reduce the level of intrusion and uncertainty that the customer experiences every five years with having to provide the same level of information and verification as at the outset of their claim.

### **Summary of proposals**

7.15 An assessed income period is a specific period of up to five years during which time the Pension Credit customer's or partner's capital or savings are deemed to stay the same. Those customers aged 65 and over can have an assessed income period if they satisfy the relevant qualifying conditions.

7.16 The assessed income period is a fundamental part of the design of Pension Credit. It was introduced to reduce the level of intrusion normally associated with an income-related benefit. During the assessed income period the customer is not required to report changes to capital or savings.

7.17 When the assessed income period matures there is a requirement to then consider the setting of another assessed income period. At this point the customer is asked to provide information and evidence of their current circumstances. This process is similar to what the customer would have needed to provide at the outset of their claim.

7.18 To reduce the level of intrusion further and to simplify procedures, we are proposing to remove the limit of five years on the assessed income period for those customers aged 80 and over and for those customers who have an assessed income period spanning their 80th birthday. This means that the assessed income period will continue to run-on and will therefore remove the need for the Pension Service to review the case and the customer to provide detailed information every five years.

### **Costs and benefits**

#### ***Costs to Government***

7.19 The financial impacts of this policy are relatively small. Currently, increases in the value of individual's capital holdings over the assessed income period are taken into account when their Pension Credit entitlement is recalculated at the end of an assessed income period. For those individuals affected by the policy this will no longer be the case and consequently the policy will incur a small cost to the Government in terms of benefit expenditure; estimated to be less than £1 million in each of the years 2009/10, 2010/11 and 2011/12 (2007/08 prices).

7.20 However, the policy will also alleviate the administrative burden on the Pension Service creating some savings for the Government. Under the current system, when an assessed income period matures the case is reviewed and the customer asked to provide detailed information regarding their income and capital. The policy removes the need for this process and is estimated to create administrative savings of around £4 million in 2009/10, around £3 million in 2010/11 and around £1 million in 2011/12<sup>147</sup>.

### ***Individuals***

7.21 Older customers will experience less intrusion. Additionally, an increase in capital over an assessed income period will not reduce their income. Evidence suggests that only a small minority of customers are likely to benefit in this way.

### ***Employers***

7.22 This proposal is not expected to have any impact on employers.

### **Gender, race and disability impact**

7.23 The change will affect all of those pensioners aged 80 or over with an assessed income period and those who have an assessed income period that spans their 80th birthday. The effect will be dependant upon their age and whether they have an assessed income period. It would apply equally irrespective of gender, race or disability.

### **Competition impact**

7.24 This proposal will not raise any concerns regarding competition because the objective does not relate to specific markets or companies.

### **Implementation and delivery plan**

7.25 Plans on implementing the changes have yet to be finalised. Based on current assumptions the earliest implementation date for this change would be April 2009.

7.26 The qualifying conditions that govern when an assessed income period is appropriate in Pension Credit are covered in the State Pension Credit Act 2002. Any changes to the qualifying conditions must be enacted through legislation and in this case must be primary legislation. There is no non-regulatory alternative to legislation.

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<sup>147</sup> 2007/08 prices, rounded to the nearest £million.

