

Chapter 2 – State Pension Reforms

Objectives

- 2.1 The Government aims to reform the state pensions system to make it :
- fair – recognising the contribution of parents and carers in the same way as contributions from paid work;
 - provide a firm foundation for private savings;
 - simple – so people can understand their entitlement; and
 - be affordable and sustainable for the long term.

Background and rationale for government intervention

- 2.2 The White Paper set out proposed state pension reform measures, building on the analysis and recommendations of the Pensions Commission.
- 2.3 Pensioners' incomes are higher now in real terms than they have been ever before. Average pensioners' incomes have grown faster than earnings over the last two decades.
- 2.4 However this situation has masked growing inequalities between pensioners. This is why the Government introduced first the Minimum Income Guarantee, and then Pension Credit, to tackle existing pensioner poverty. The number of pensioners in relative poverty has fallen from 2.7 million in 1996/7 to 1.7 million in 2004/5 and a pensioner is now less likely to be in poverty than the rest of the population when incomes are measured after housing costs.¹
- 2.5 The Pensions Commission's second report and the White Paper have set out a number of long term trends and existing circumstances which must be taken into account for the future:
- under saving and falling saving in private pensions which underline the importance of a state system that promotes saving;
 - demographics and changing family structure;
 - increasing participation by women in the labour market;
 - women's lower State Pension entitlement;

¹ Households Below Average Incomes 2004/5

- the current pension system is complex, and if it continues to evolve as it is doing now it would result in a significant majority of pensioners becoming entitled to Pension Credit.

State Pension reforms: detail of proposed measures

- 2.6 The following state pension reform measures will be brought forward in the Pensions Bill (unless otherwise stated). Most of these measures were outlined in the White Paper. New proposals not presented in the White Paper, resulting from consultation feedback and further policy development, are clearly identified in the text.
- 2.7 Each of the reform measures is presented here with a summary of the Government's policy aims and the purpose and effect of each measure. Projected costs of state pension benefit expenditure are covered in Annex A.

A fairer system - improving coverage

Qualifying conditions – a single contribution condition

- 2.8 The Pensions Bill sets out provisions for a single contribution condition. The measure will:
- reduce the number of qualifying years to 30 years for a full basic State Pension - from 39 for women and 44 for men now;
 - remove the condition that at least one year must be paid, so that a record may be composed solely of credited contributions, for example through childcare; and
 - remove the *de minimis* rule so that every year of contributions or credits counts with 30 years providing a full entitlement to the basic element of the State Pension.
- 2.9 This single contribution condition will come into force for those people reaching State Pension age on or after 6 April 2010.

Qualifying conditions – current rules

The State Pension is paid to people who have reached pensionable age - currently 65 for men and 60 for women born before 6 April 1950. Pensionable age for women is already set to rise from 60 to 65 between 2010 and 2020 for women born after that date. To qualify for a full basic state pension, a person must have paid, been treated as paid, or have been credited with, National Insurance Contributions for at least 44 years (39 for women) . The amount of basic State Pension a person will receive depends on the number of qualifying years they have built up. To get a full rate basic State Pension, people must have qualifying years for about 90 per cent of their working life.

To qualify for any basic State Pension, people must satisfy two conditions:

- the first contribution condition requires a person to have one qualifying year from paid contributions only; and
- the 25 per cent *de minimis* requires a person to have a further 9 or 10 qualifying years from paid contributions or credits
- the “one year of paid contributions” rule is the basic entry test and would prevent people building entitlement on the basis of credits alone, through caring for example. The 25 per cent rule would prevent women with fewer than 10 qualifying years, even if one of them was from paid contributions, from getting any basic State Pension (men normally need 11).

Replacing Home Responsibilities Protection

- 2.10 The Government will replace Home Responsibilities Protection with a system of weekly credits for :
- parents who are awarded Child Benefit for children up to the age of 12;
 - foster parents of children up to the age of 12; and
 - carers who provide 20 or more hours care a week for one or more people receiving Attendance Allowance, Constant Attendance Allowance, or the middle or highest rates of the care component of Disability Living Allowance.
- 2.11 These credits will help build entitlement to the basic State Pension and certain bereavement benefits (Widowed Parent’s Allowance and Bereavement Allowance). The new system will help people be more certain about their State Pension entitlement. For those people reaching pensionable age on or after 6 April 2010, each complete year of HRP awarded under the existing rules of the scheme will be converted into a qualifying year for basic State Pension and relevant bereavement benefits.

Abolition of the Labour Market Attachment test

- 2.12 The Pensions Bill provides for the abolition of the Labour Market Attachment test for long-term disabled people from 2010. This will mean that people no longer have to work and pay contributions for 10 per cent of their working life for their credits to count towards the State Second Pension, thus benefiting those with a contribution history consisting largely of credits from incapacity benefits

Earnings factors for a qualifying year.

- 2.13 Similarly, the Government will introduce measures to allow people to combine contributions and credits in a tax year to earn a qualifying year for State Second Pension. Currently contributions and credits can be combined to earn a qualifying year for the basic State Pension, but not for State Second Pension. This measure will improve the pension outcomes for women and carers.
- 2.14 The measures also provide for new qualifying conditions and more generous access for the new State Second Pension. Parents will be credited into the State Second Pension until their youngest child reaches age 12 as opposed to age 6 under current rules. For the first time foster parents will be able to accrue State Second Pension. People benefiting from the new Parent's and Carer's credit will also be credited into State Second Pension.

A firm foundation for private saving

- 2.15 The Government's objective, subject to affordability and the fiscal position, is to uprate the basic State Pension in line with earnings from 2012, but in any event by the end of the next Parliament at the latest. This change allows people to plan with confidence for their retirement, providing a state underpin that rises with living standards, enabling people to predict what they are likely to receive from the State when they retire.
- 2.16 There are a number of consequential measures as a result of earnings uprating of the basic State Pension which leave the present prices uprating arrangements in place, or, in the case of Industrial Death Benefit continue to link the benefit rate to the level of the basic State Pension. These measures have little or no cost and are included here for completeness:

- **De-linking basic State Pension and lower earnings limit**

The lower earnings limit (effectively a “benefits entry point”) denotes the point at which a person starts to accrue basic State Pension entitlement, but a low earner is not liable to pay National Insurance contributions. Under current legislation, the lower earnings limit is linked to the value of the full rate basic State Pension and uprated with prices. The Government will retain the lower earnings limit as a benefits entry point and break the link with the level of the basic State Pension. The Government will separately consider the appropriate uprating of the lower earnings limit once the link with the basic State Pension is broken.

- **Uprating provision for Widow’s Benefit and bereavement benefits**

Widow’s and bereavement benefits, which are benefits payable to people under pension age, are currently linked to the rate of the basic State Pension. The Government would break the link between pensions and bereavement benefits to leave bereavement benefits uprated by prices. This maintains the current position and has no implications for state pension funding. Again, it is included here for completeness.

- **Uprating provision for Industrial Death Benefit.**

This is a preserved rights benefit under the Industrial Injuries Scheme. The benefit was abolished for new claims from 1988. Historically Industrial Death Benefit has been linked to the basic State Pension, the Government will retain this link.

- **Uprating provision for adult dependency increases**

The proposed abolition of adult dependency increases was announced in the White Paper. The Government committed to provide transitional protection for existing recipients for ten years until adult dependency increases are abolished. The adult dependency increases in payment for the transitional period until 2020 would be uprated by prices, as currently, rather than earnings. The Government cannot see any justification for increasing the rate of a benefit component that would be abolished for the next cohort of pensioners.

- **Uprating provision for pension increments**

A person who defers claiming his or her State Pension can earn an increase in the weekly rate: these increases are known as increments. They are paid in addition to basic State Pension, Additional Pension and Graduated Retirement Benefit and have been uprated in line with their

component parts of State Pension in recent years, that is, by prices. Changes to State Pension deferral were introduced in April 2005 which made deferral more generous by increasing the rate at which increments accrue from 7.5 per cent to 10.4 per cent per annum and also provided the opportunity for those who defer for 12 months or more to take a lump sum as an alternative to increments. Increments will also accrue on a more generous State Pension when the basic State Pension begins to increase in line with earnings. Taking these improvements into account the Government has decided that all increments in payment should continue to rise in line with prices.

Simplifying the State Pension

2.17 The Government has set out in its White Paper response its belief that the time is right to address the complexity in the state system. A simpler system is needed because:

- contributors need very clear information on their expected pension outcome from the state so they can take the savings decision that are right for them;
- a straightforward contract between the state and contributors makes for an enduring settlement.

Here we describe measures in the Bill which simplify the State Pension.

Basic element of State Pension

2.18 The introduction of a single 30 qualifying year contribution condition and the new credits for parents and carers now make the eligibility conditions of the basic element of State Pension clearer and more straightforward.

- **Removal of restrictions on entitlement for Category A and Category B pensions**

2.19 Under the current provisions, a married woman (and, in the future, a married man or a civil partner) cannot become entitled to a Category B spouse's retirement pension on her husband's insurance until her husband actually claims his own basic State Pension – the Category A pension. So if a married man defers claiming his pension, his wife automatically has to defer drawing her Category B pension. This has produced unfair outcomes when spouses take decisions which prevent their (often estranged) wives from drawing a pension.

2.20 The Government's policy intention is that entitlement to a Category B retirement pension based on a spouse (or civil partner's) contribution record should cease to be conditional on the spouse having claimed his own pension. This measure would be to simplify the deferral arrangements to enable spouses to make independent decisions on when (and whether) to claim retirement pension and remove disadvantages resulting from a spouse's decision.

2.21 This measure is a new reform measure since the publication of the pensions White Paper

- **Abolition of adult dependency increases**

2.22 Adult dependency increases would be abolished. These are currently awarded in addition to basic State Pension where the pensioner's spouse (or, from 2010, civil partner) is below State Pension age. No new awards would be made and any increase in payment at the time of abolition would be phased out over the following ten years.

2.23 The rationale for abolition of adult dependency increases from April 2010 is rooted in the principle that the reforms would enable a person to accrue pension entitlement in their own right. There are more households nowadays where both members of the couple are economically active. The abolition of adult dependency increases removes a disincentive for women to continue in work up to at least State Pension age and the Government's position is that the principle of dependency in the benefit system is outdated.

- **Phasing out of autocredits**

2.24 This is a measure to remove an element of pension calculations that will no longer be needed. This was outlined in the White Paper and, although the legislative provisions would be brought forward in Regulations, the measure is included here for completeness.

Second element of State Pension

2.25 The original structure of the State Earnings Related Pension Scheme (SERPS) was reasonably straightforward. Contributors would receive a pension of a quarter of the average of their best 20 years worth of earnings. However, reforms over the last decades have added complexity to the system.

2.26 Maintaining pensions scheme rights that have been built up in the past (which take many years to work themselves through) on top of a pension

system which has been shaped to deliver targeted social policy, has resulted in great complexity.

- 2.27 The Bill provisions make large-scale reforms to the State Second Pension to make a simplified state structure a reality. The Bill provides for the following:
- 2.28 The flat rate element of State Second Pension will be replaced with a new fixed rate amount. This will provide someone employed with earnings above £4,368, and those people credited into the system, with a weekly pension of £1.40 for each year of qualification. This amount (which is in 2006/07 earnings terms) will be uprated by earnings during a working life and prices in payment.
- 2.29 Accruals to the earnings (SERPS) element of State Second Pension will continue to start at earnings of £12,500 (the current level of the lower earnings threshold) and end at a new Upper Accrual Point (set at the same level as the upper earnings limit on introduction, but then frozen). This will allow for the gradual withdrawal of earnings related pension as recommended by the Pensions Commission and discussed in the White Paper.
- 2.30 Earnings between the lower earnings threshold and the upper accrual point will attract accruals of 10 per cent.
- 2.31 The current highly complex State Earnings Related Pension Scheme transitional arrangements will be withdrawn to coincide with the introduction of the new scheme.

Summary

- 2.32 From the time this new system is introduced, contributors will be able to determine their minimum pension outcomes by simple reference to the rate of basic State Pension and multiples of the fixed rate amount to reflect the expected length of their working life. Both basic State Pension and the fixed rate amount will accrue by earnings and therefore be set in a currency that contributors can relate to when they make savings decisions.
- 2.33 The Government will review its information products to ensure they meet the needs of those near to retirement and to savers and potential savers.
- 2.34 The measures here will provide for a straightforward State Pension where rights and responsibilities for pension provision are clear to all.

Impact on defined benefit schemes

- 2.35 There are two areas where changes being made to simplify State Second Pension will have an impact on contracting out for defined benefit (DB) schemes – National Insurance rebates and the Reference Scheme Test (the test DB schemes must meet if they wish to contract-out).
- 2.36 The Secretary of State sets a certain rebate rate percentage which represents a reduction in National Insurance contributions paid by employers and employees. This rebate rate is then applied to a certain band of earnings – at present the band is the lower earnings limit to the upper earnings limit (the same earnings band on which State Second Pension is accrued). The Bill provisions change this from the lower earnings limit to the new upper accrual point, to reflect the changes being made to State Second Pension.
- 2.37 Since 6 April 1997, occupational DB pension schemes wishing to contract-out their members from the State Second Pension must provide benefits which are broadly equivalent to, or better than, those which would be provided by a Reference Scheme Test. In order to satisfy the Reference Scheme Test, schemes must calculate their benefits by reference to the same band of earnings on which State Second Pension is accrued (ie earnings falling between the lower earnings limit and the upper earnings limit). It is therefore logical that if this band of earnings is changing for State Second Pension it should also change for Reference Scheme Test purposes. Therefore legislation will provide for amendments to the Reference Scheme Test calculation to refer to the band of earnings between the lower earnings limit and the upper accrual point.

Uprating arrangements for Pension Credit

Pension Credit standard minimum guarantee

- 2.38 The Government will continue to protect the poorest pensioner households by uprating the Pension Credit standard minimum guarantee in line with average earnings over the long term.
- 2.39 There is currently no mandatory requirement to uprate the standard minimum guarantee element of Pension Credit, although the Government has given a commitment to continue to uprate it every year by earnings until 2008. To formalise this current discretionary uprating strategy the Bill provides a mandatory requirement to continue uprating by earnings from 2008 and beyond.

Pension Credit Savings Credit

- 2.40 The structure of the Savings Credit, and the powers to set the level of the threshold in regulations, is already in Primary legislation. The threshold is increased each year as part of the Uprating Order, which is subject to approval by both Houses. No additional legislation is needed to provide for this element of pensions reform but, as a measure proposed in the White Paper, it is included here for completeness.

A sustainable system - State Pension age

- 2.41 The Government believes that a rise in State Pension age should form part of a combination of measures (along with encouraging people to work longer, save more and some increase in spending on pensioners) to ensure that people in the future have an adequate pension when they retire.
- 2.42 With fewer people of working age supporting an increasing number of people over pension age, the Government concludes that reform is needed to share more equitably the cost implications of rising longevity between those of working age and those of pension age.
- 2.43 The Bill provides for a rise in State Pension age by one year per decade from 2024 to 2046, broadly in line with predicted increases in average life expectancy, with each change phased in over two years.

Consequential impacts of the rise in State Pension age

- 2.44 Age thresholds within the benefit system that are already linked to State Pension age, including Jobseeker's Allowance and bereavement benefits, will rise automatically in line with rising State Pension age without the need for express amendment to those provisions. This is already factored in to the overall costs of the reform package. There is no direct impact on **Tax Credits** as there is no upper age limit on entitlement. The Bill however does amend provisions relating to the age threshold for Disability Living Allowance, Attendance Allowance and the Savings Credit within State Pension Credit.
- 2.45 The purpose of the upper age limit in **Disability Living Allowance (DLA)** and the lower age limit in Attendance Allowance (AA) is to focus the additional help with disability-related extra costs on people who are disabled in childhood or when of working age. This additional help takes the form of the higher and lower rates of the DLA mobility component and

- the lower rate of the DLA care component. They have no equivalents in AA.
- 2.46 Although the DLA/AA age 65 limits are not linked to State Pension age, and there is no statutory requirement to raise them in line with increases to that age, the equalisation of State Pension age in 2020 will more clearly make age 65 the boundary between working age benefits and pensioner benefits for both men and women. It will also more clearly link the DLA/AA age limits with that boundary.
- 2.47 The Bill provides that the upper age limit for DLA and the lower age limit for AA will, from 6 April 2024, be linked to State Pension age. As a consequence, these age limits will rise in line with changes to State Pension age described above.
- 2.48 The Bill would also amend the qualifying age for the Savings Credit element of **State Pension Credit**. This is already set at 65 and it is therefore consistent that this should increase in line with rising State Pension age.
- 2.49 The qualifying age for access to the State Pension Credit Guarantee Credit is linked to female State Pension age and so will gradually rise to age 65 by 2020 due to State Pension age equalisation. It has been suggested that the Guarantee Credit should continue to be available from age 65 when State Pension age rises above that from 2024 onwards. The Government believes that it is appropriate to consider this nearer the time, in the light of the contemporary evidence relating to life expectancy for different social groups.

Other schemes and concessions

- 2.50 Other Government departments administer a number of schemes and concessions for, or have duties with regard to, older people. In a very small number of cases, the age threshold is set by reference to State Pension age as defined by the social security legislation, and in these instances, the proposed change in the definition of State Pension age will read across automatically.
- 2.51 In other cases, where age thresholds are set at 60 or 65, the relevant departments are currently considering the implications of the changes to State Pension age, initially in the context of the forthcoming rise in female pension age and by extension the further increases for both men and woman from 2024. They will decide on whether changes to their own schemes are required in due course, taking account of the objective

justification for the respective age qualifications which may or may not be linked directly to State Pension age.

- 2.52 Similarly, the proposed increases to the State Pension age do not impose any requirement on non-statutory bodies and organisations which provide benefits such as age-related discounts for older people to follow suit. It will be up to each organisation to decide future policy in this area.

Pension scheme ages

- 2.53 The State Pension age is the minimum age at which people may start drawing their State Pension. The proposed changes do not directly affect the normal age for drawing a pension from non-State pension schemes, including those in the public sector.

Assessment of projected costs and outcomes of state pension reforms

Costs

- 2.54 Estimates of costs and outcomes of state pension reforms, shown here, have been updated since those presented in the White Paper in May 2006.
- 2.55 The main costs of the measures are in benefit expenditure. Figures 2.1-2.3 show the costs of benefits paid to pensioners with no reform, with an earnings linked standard minimum guarantee, and then with the full package of reform. They are presented in both cash, 06/07 prices and a percentage of GDP. Annex A contains further details on estimates of costs and the methodology that has been used to estimate them.
- 2.56 There are also some administrative costs associated with changing computer systems, and providing updated information to telephone callers, and revision of leaflets. Estimates of these costs are contained in Figure 2.4.

Figure 2.1: Total expenditure on pensioner benefits, cash, £ billion

	2010	2020	2030	2040	2050
(a) without reform:					
Basic State Pension	56.2	84.7	137.9	204.7	285.2
SERPS / S2P	13.5	25.5	49.4	92.2	186.2
Pension Credit	7.3	5.9	4.6	3.1	2.1
Other Pension Benefits	3.0	3.4	5.0	7.2	10.4
Total pensions spending	80	119	197	307	484
Housing and Council Tax Benefits	8.6	6.7	7.5	9.4	14.6
Attendance Allowance & Disability Living Allowance	9.7	15.1	25.2	39.1	56.3
Total Pensioner Benefits	98	141	230	356	555
(b) with an earnings-indexed standard minimum guarantee:					
Pension Credit	9.4	16.5	35.1	73.8	139.6
Total pensions spending	82	130	227	378	621
Housing and Council Tax Benefits	8.6	10.9	18.4	32.0	62.9
Total Pensioner Benefits	100	156	271	449	741
(c) with other reforms:					
Basic State Pension	56.2	98.0	185.3	327.6	519.1
SERPS / S2P	13.5	25.6	49.8	96.6	186.1
Pension Credit	8.9	10.3	11.9	13.4	15.1
Other Pension Benefits	3.0	3.4	4.9	7.0	10.1
Total pensions spending	82	137	252	445	730
Housing and Council Tax Benefits	8.6	10.3	14.6	22.2	40.7
Attendance Allowance & Disability Living Allowance	9.7	15.1	24.5	37.7	53.3
Total Pensioner Benefits	100	163	291	505	824

Figure 2.2 : Total expenditure on pensioner benefits, 2006/7 prices, £ billion

	2010	2020	2030	2040	2050
(a) without reform:					
Basic State Pension	50.5	57.8	71.4	80.4	85.0
SERPS / S2P	12.1	17.4	25.6	36.2	55.5
Pension Credit	6.5	4.0	2.4	1.2	0.6
Other Pension Benefits	2.7	2.3	2.6	2.8	3.1
Total pensions spending	72	82	102	121	144
Housing and Council Tax Benefits	7.8	4.6	3.9	3.7	4.3
Attendance Allowance & Disability Living Allowance	8.8	10.3	13.0	15.3	16.8
Total Pensioner Benefits	88	96	119	140	165
(b) with an earnings-indexed standard minimum guarantee:					
Pension Credit	8.5	11.3	18.2	29.0	41.6
Total pensions spending	74	89	118	148	185
Housing and Council Tax Benefits	7.8	7.5	9.5	12.6	18.8
Total Pensioner Benefits	90	107	140	176	221
(c) with other reforms:					
Basic State Pension	50.6	66.9	95.9	128.6	154.7
SERPS / S2P	12.1	17.5	25.8	37.9	55.4
Pension Credit	8.0	7.0	6.2	5.3	4.5
Other Pension Benefits	2.7	2.3	2.5	2.8	3.0
Total pensions spending	73	94	130	175	218
Housing and Council Tax Benefits	7.8	7.0	7.6	8.7	12.1
Attendance Allowance & Disability Living Allowance	8.8	10.3	12.7	14.8	15.9
Total Pensioner Benefits	90	111	151	198	246

Figure 2.3 : Total expenditure on pensioner benefits, per cent of GDP

	2010	2020	2030	2040	2050
(a) without reform:					
Basic State Pension	3.5	3.2	3.2	3.0	2.6
SERPS / S2P	0.8	1.0	1.2	1.4	1.7
Pension Credit	0.4	0.2	0.1	0.0	0.0
Other Pension Benefits	0.2	0.1	0.1	0.1	0.1
Total pensions spending	4.9	4.5	4.6	4.5	4.4
Housing and Council Tax Benefits	0.5	0.3	0.2	0.1	0.1
Attendance Allowance & Disability Living Allowance	0.6	0.6	0.6	0.6	0.5
Total Pensioner Benefits	6.1	5.3	5.4	5.2	5.1
(b) with an earnings-indexed standard minimum guarantee:					
Pension Credit	0.6	0.6	0.8	1.1	1.3
Total pensions spending	5.1	4.9	5.4	5.6	5.7
Housing and Council Tax Benefits	0.5	0.4	0.4	0.5	0.6
Total Pensioner Benefits	6.2	5.9	6.4	6.6	6.8
(c) with other reforms:					
Basic State Pension	3.5	3.7	4.3	4.7	4.6
SERPS / S2P	0.8	1.0	1.2	1.4	1.7
Pension Credit	0.5	0.4	0.3	0.2	0.1
Other Pension Benefits	0.2	0.1	0.1	0.1	0.1
Total pensions spending	5.0	5.1	5.9	6.4	6.5
Housing and Council Tax Benefits	0.5	0.4	0.3	0.3	0.4
Attendance Allowance & Disability Living Allowance	0.6	0.6	0.6	0.5	0.5
Total Pensioner Benefits	6.2	6.1	6.8	7.3	7.3

Notes: Figures refer to financial years, eg 2020 refers to 2020/21. Pension spending includes benefits specifically targeted at pensioners. Pensioner benefits include all benefits to which pensioners are entitled. More details – including knock on effects of pension reform on working age benefits - are given in Annex A.

2.57 The estimated administration costs of state pension reform (both DWP and HMRC) are set out in the table below.

Figure 2.4 : Administration costs, £ million

£m	07/08	08/09	09/10	10/11	11/12	2012-22	Total
State Pension Reforms	13	31	47	30	14	57	192

*Costs expressed in nominal terms

Source: *The Pension Service, Her Majesty's Revenue and Customs*

Effects on individuals

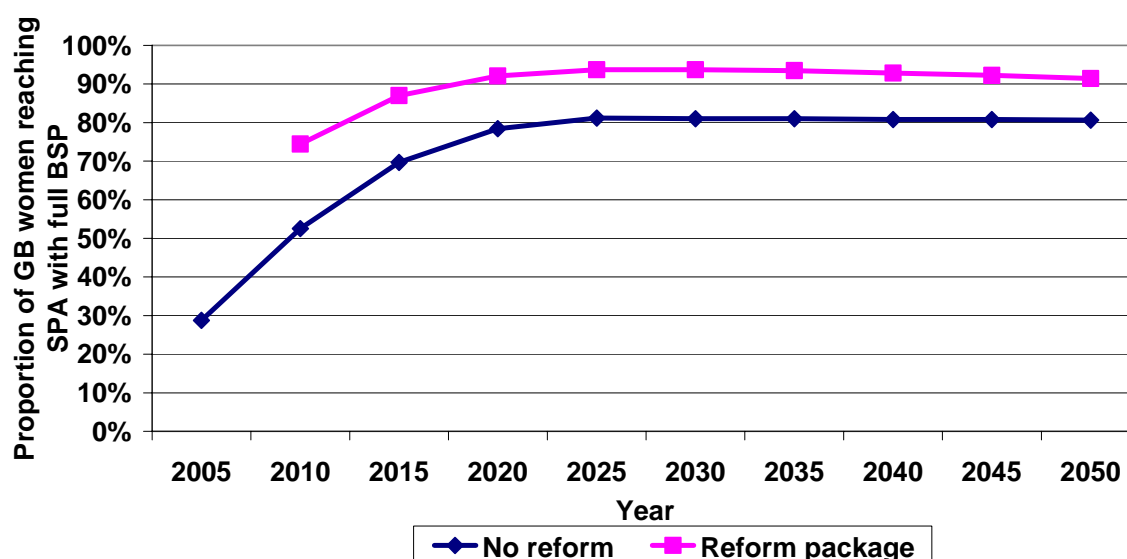
- 2.58 This section sets out the impact of the State Pension reform package on individuals. The analysis is set out in main sections on:
- **improved coverage of the State Pension** – reflecting changes to both the basic and State Second Pension;
 - **a firm foundation for private saving** – reflecting the more generous basic State Pension, and flat rating of State Second Pension;
 - **improved incentives to save** – with analysis on returns to save, and the number of people on Pension Credit; and
 - **the impact of changes to the State Pension age.**
- 2.59 Sections after this cover race and gender impact separately. Annex B also has additional detail on the analysis of the outcomes that people might expect.

Improved coverage of the basic State Pension

- 2.60 Currently only around 30 per cent of women in Great Britain reaching State Pension age are entitled to a full basic State Pension, compared to around 85 per cent of men. The package of basic State Pension coverage reforms (which includes a reduction in the number of qualifying years needed for a full basic State Pension to 30, and more generous credits for parents and carers) will mean that:
- around three quarters of women reaching State Pension age in 2010 will be entitled to a full basic State Pension, compared to around half without reform;
 - in 2025, almost half a million extra women over State Pension age will have a full basic State Pension;
 - from 2025, over 90 per cent of both men and women reaching State Pension age will retire with a full basic State Pension;
 - by 2050, around 95 per cent of all GB pensioners will be entitled to a full basic State Pension.

Figure 2.5 below illustrates how the proportion of women reaching State Pension age with a full basic State Pension will be increased by the coverage reforms.

Figure 2.5: Proportion of women reaching State Pension age with full basic State Pension, with and without reform



Source: DWP projections using the Government Actuary's Department's Retirement Pension Model, GB.

Note: A woman's entitlement is based on her own and her husband's contributions.

Accrual of State Second Pension

- 2.61 In any one year some 70 per cent of the working age population are accruing or being credited with accruals to State Second Pension, a significant improvement to the situation under SERPs where around 55 per cent of the work age population accrued rights. Reforms propose to extend credits to those caring for children aged 6 to 12 and further extend credits for carers of sick and disabled people – these will both raise the proportion of the working age population accruing State Second Pension.
- 2.62 The main reason people do not accrue State Second Pension are due to periods of self-employment (around 13 per cent of the working age population) and unemployment (around 6 per cent of the population). Average durations of self-employment tend to be around 10 years,² and some 80 per cent of the unemployed move out of unemployment within a year.³
- 2.63 Although reform should increase the number of people accruing rights to State Second Pension, these reforms will take time to significantly change

² Labour Force Survey, Spring 2006.

³ The average duration of unemployment has fallen in recent years as the Government's active labour market policies and economic stability have reduced the average duration of unemployment.

outcomes. State Second Pension is calculated for each year of work or credited activity prior to the person being eligible for a State Pension. Figure 2.6 shows the maximum number of years of additional pension someone retiring at the start of each decade could have acquired. This shows that it will take time for reform to affect each cohort of retirees, with the number of years of State Second Pension exceeding that of SERPs for new retirees from the mid-2020s.

Figure 2.6 : Maximum number of years a person, reaching State Pension age between 2010 and 2050, accrues under State Earnings Related Pension SERPs and reformed State Second Pension.

Reaching State Pension age in:	Maximum number of years of ...			
	SERPs	S2P	S2P after reform	Total years of additional pension
2010	24	8	0	32
2020	24	10	8	42
2030	22	10	18	50
2040	13	10	28	51
2050	4	10	38	52

Source: DWP calculations.

Note: Shows maximum number of years for someone working from the age of 16. SERPs is accrued from when it was introduced in 1978 to 2002. State Second Pension is accrued from 2002 until reform in 2012. State Second Pension under reform is accrued from 2012 until the person reaches SPA or stops working / caring.

A firm foundation for private saving

Upating basic State Pension in line with earnings growth

2.64 The Government's objective, subject to affordability and the fiscal position is to uprate the basic State Pension in line with earnings growth from 2012, but in any event by the end of the next Parliament at the latest. Earnings uprating the basic State Pension ensures that it keeps its value and therefore continues to provide a solid base for people to save. Earnings uprating the basic State Pension would more than double its value in real price terms by 2050. The table below shows the value of the basic State Pension if it continued to be uprated by prices until 2050, the value of the basic State Pension with earnings uprating from 2012, and the gains from earnings uprating - all in earnings and prices terms.

Figure 2.7: Weekly full basic State Pensions entitlement, 2005/6 prices and earnings terms

	Earnings terms		Price terms	
	price uprated BSP	earnings uprated BSP	price uprated BSP	earnings uprated BSP
2012	£73	£73	£84	£84
2020	£62	£73	£84	£98
2030	£51	£73	£84	£120
2040	£42	£73	£84	£146
2050	£34	£73	£84	£178

Source: DWP calculations

Notes: Assumes receipt of full basic State Pensions when reaching SPA - which is 66 in 2030, 67 in 2040 and 68 in 2050. Price and earnings uprating starts from 2012.

State Second Pension

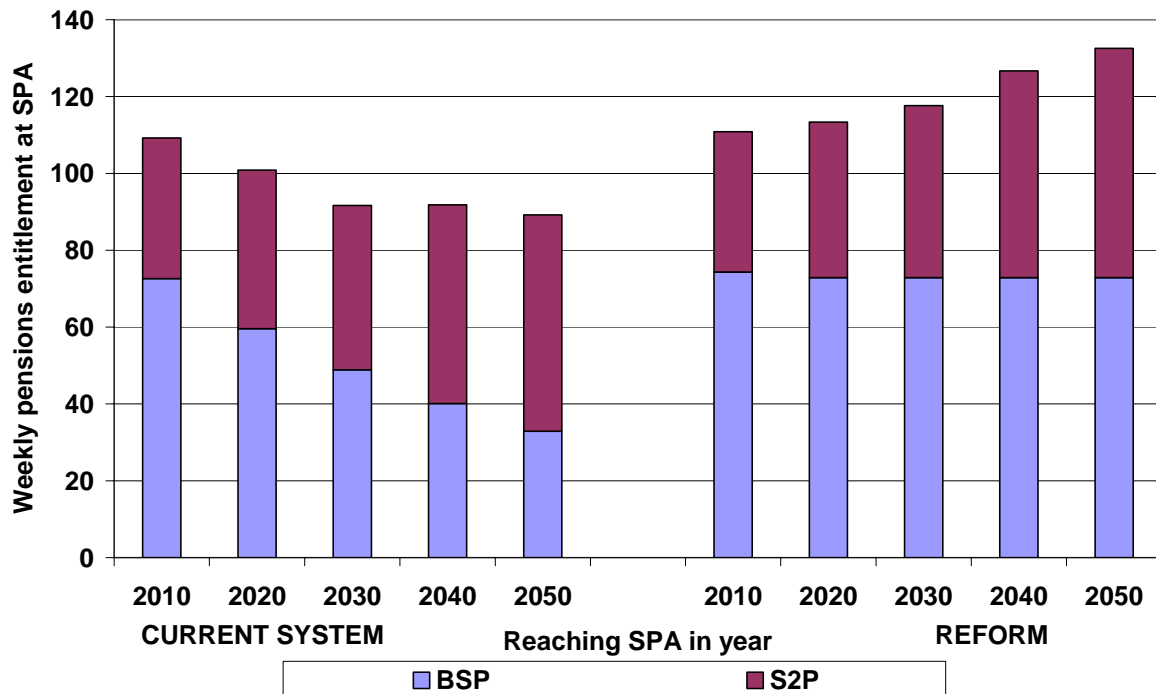
2.65 From 2012, every year of work or caring will be worth an extra £1.40 a week in retirement (in earnings terms). There will be a transitional earnings related element which will be phased out by around 2030. This further simplification will ensure that, in combination with the basic State Pension, the State provides a simple and solid underpin on top of which people can save.

An increasing State Pension underpin overall

2.66 Figure 2.8 shows the value of the State Pension (basic State Pension and Additional State Pension) at State Pension age for a low earner in 2010, 2020, 2030, 2040 and 2050 under the current system and after reform (further examples in Annex B). Under reform the amount provided through the basic State Pension remains constant in earning terms, the State Second Pension becomes increasingly flat rate – with each year of work or caring earning them an extra £1.40 a week in retirement. The result is that individuals would increasingly move towards an underpin of around £135 a week State Pension for working or caring from age 25 to State Pension age.

2.67 Increasingly the underpin provided by the State Pension (basic State Pension and State Second Pension combined) will take people out of Pension Credit. A median earner retiring in 2040 would have State Pension entitlement high enough to entirely avoid Pension Credit on reaching State Pension age. A low earner reaching State Pension in 2050 with 43 years work history would have sufficient State Pension alone to be above Pension Credit levels.

Figure 2.8: Basic State Pension and State Second Pension for low earner - reform compared to current system



Source: DWP calculations

Note: Assumes that a person has a good working life (works / cares from age 25 to State Pension Age) and earns £230 a week.

Upating the standard minimum guarantee by earnings

- 2.68 Upating the Pension Credit standard minimum guarantee in line with earnings in the long run, ensures a decent safety net for all pensioners, rising in line with working-age incomes. Without this, increasing numbers of pensioners would fall into relative poverty.
- 2.69 The table below compares the value of the standard minimum guarantee, upated by prices and earnings, from 2008 to 2050. Upating by prices ensures that pensioners in 2050 who rely on the standard minimum guarantee receive the same income in comparable terms as those in 2010 (see third column). However over time, relative to earnings, the value of the standard minimum guarantee would fall if it were upated by prices (see first column). Earnings upating maintains the standard minimum guarantee value in earnings terms, and more than doubles its value in prices terms by 2050.

Figure 2.9 : Weekly values for the Pension Credit standard minimum guarantee (SMG)

	In 05/06 earnings terms		In 05/06 prices terms	
	SMG uprated by prices from 2008	SMG uprated by earnings from 2008	SMG uprated by prices from 2008	SMG uprated by earnings from 2008
2010	105	110	114	121
2020	86	110	114	147
2030	70	110	114	180
2040	57	110	114	219
2050	47	110	114	267

Source: DWP calculations

Incentives to save

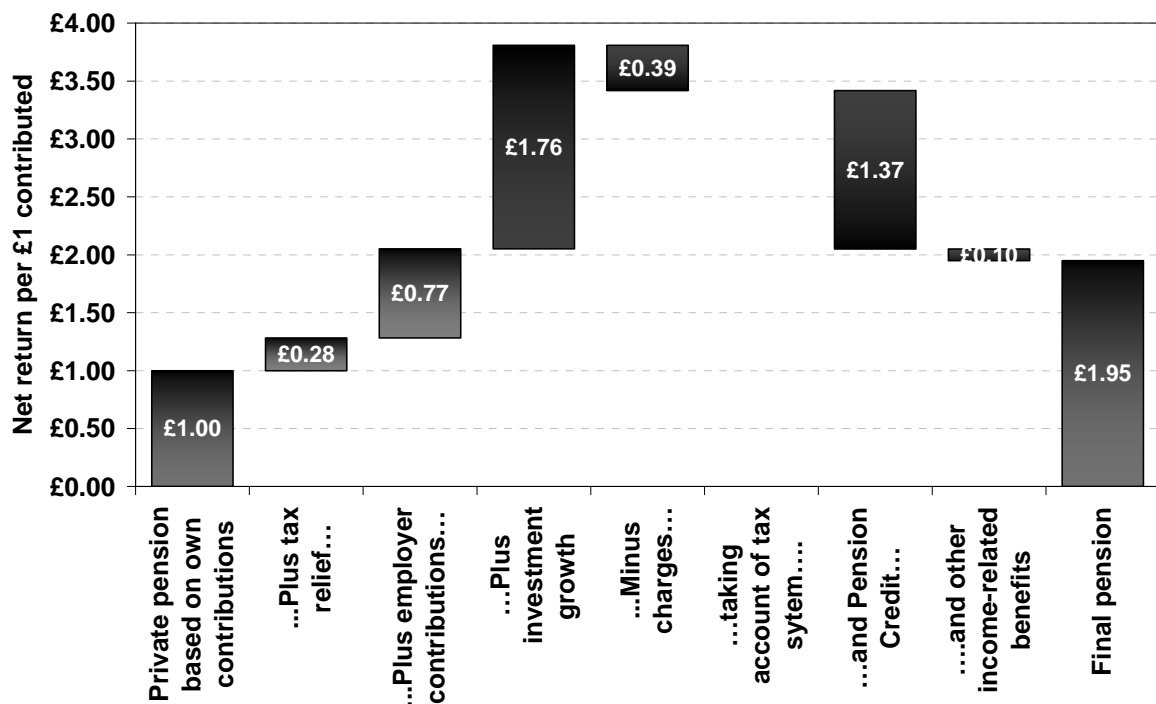
- 2.70 A key objective for State Pension reform is to allow most people to be confident that they can generally expect to get a reasonable payback from having saved. To test this is the case, analysis has been undertaken looking at what payback people can expect from saving in personal accounts. Results will depend upon many factors but for reasonable assumptions about such factors, under the reformed pension system, the large majority of people can expect to get more back, in real terms, than they have contributed. Analysis shows the benefit of tax relief and investment growth on pension saving (and in future it will also benefit from the presence of an employer contribution). There are also factors that operate in the opposite direction, including pension fund charges, tax, and/or lower benefit entitlements.
- 2.71 Commentators have suggested that income-related benefits discourage saving. Under the reformed system, most people can expect good payback from saving even if they are entitled to the savings credit – and under the reforms it is projected that only a third of people will be entitled to Pension Credit by 2050. In the following section effects are illustrated by considering the payback from savings, and numbers entitled to Pension Credit.
- 2.72 Results will depend upon many factors such as investment growth and annuity rates. The examples below show the expected payback from saving into a personal account for a median earner (£23,000 a year) aged 25 in 2012 under the current system with earnings uprating of the Guarantee Credit, and with the full package of state reform measures, based on reasonable assumptions about factors such as investment

returns.⁴ Both scenarios include the expected effects of personal accounts.

Without state pension reforms

2.73 Without state reforms, under these assumptions a median earner saving from age 25 to state pension age could expect a net payback of £1.95 for each £1 saved (Figure 2.10). This is made up of tax relief, the employer contribution and investment growth, less charges from the fund, tax on final income (where applicable), and less means-tested benefits which will be withdrawn because he now has higher private income.

Figure 2.10 : Projected payback from saving £1 – pre reform



Source: DWP modelling. This figure is for illustrative purposes only. It should not be used as the basis for individual decisions as specific circumstances or variation from the underlying assumptions will lead to different results.

Notes: Assuming owner occupier in retirement. This chart shows returns on saving over retirement not at a particular point in retirement.

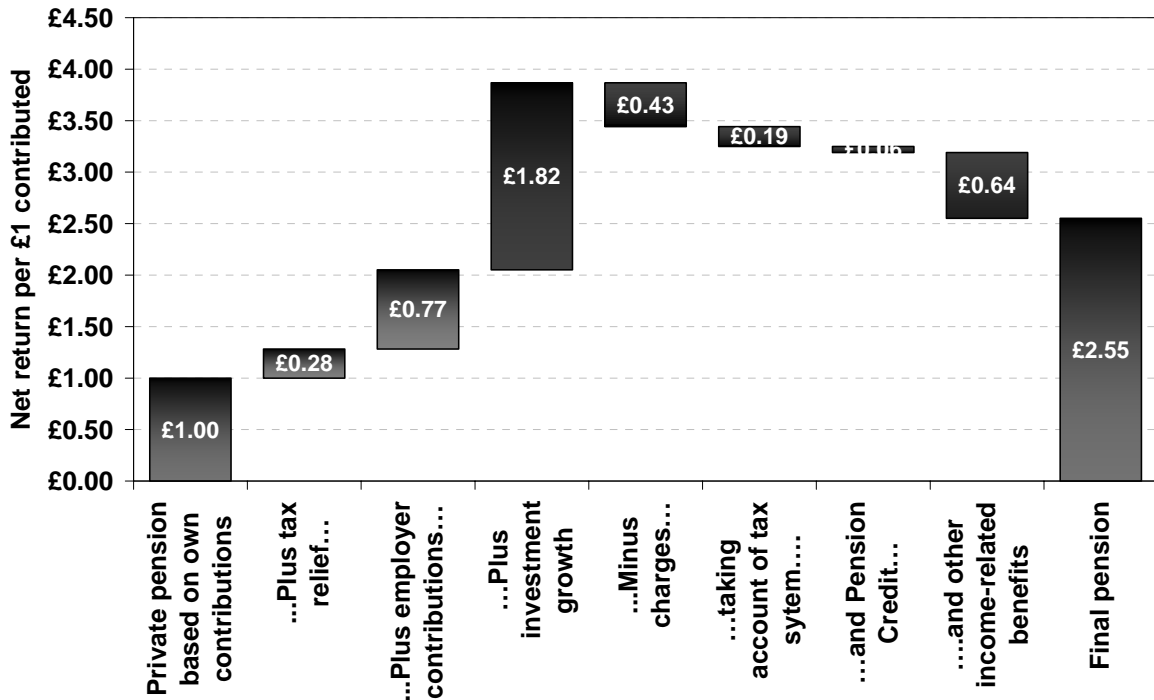
2.74 With state pension reform a person with earnings of £23,000 in 2006/7 can expect a very different payback to savings as a result of state pension

⁴ The most important of these are that real investment growth is 3.5 per cent and life expectancy is in line with Government Actuary’s Department projections. Full details are in Financial incentives to save for retirement

reforms. With state pension reforms he now faces a lower degree of Pension Credit withdrawal as he is eligible for a higher State Pension.

2.75 As a result of the reforms, he can expect a payback of £2.55 for every £1 that he contributes (Figure 2.11). He will face some income related benefit withdrawal due to Council Tax Benefit, but will be only marginally affected by Pension Credit later in retirement.

Figure 2.11 : Projected real payback from saving £1 – post reform



Source: DWP modelling. This figure is for illustrative purposes only. It should not be used as the basis for individual decisions as specific circumstances or variation from the underlying assumptions will lead to different results.

Notes: Assuming owner occupier in retirement. This chart shows returns on saving over retirement not at a particular point in retirement.

2.76 Some groups may face lower returns than set out in this example, or may be better advised not to save for other reasons (for example those people with large debts). More information can be found in the publication: Financial incentives to save for retirement.

2.77 Over 85 per cent of people aged 50 to State Pension age have either built up some private pension provision or at least £6,000 savings.⁵ A male

⁵ Source: English Longitudinal Study of Ageing. Savings of less than £6,000 are not taken into account by Pension Credit.

- median earner aged 55 in 2012 with savings of £20,000 (which would represent a pension of approximately £20 per week) could expect a payback of £1.60 for each £1 he saves in a personal account.
- 2.78 A couple could expect different results again – these could be expected to be at least as high as for single people in most cases as Pension Credit and Council Tax Benefit entitlement would be shared by the couple but tax is calculated on an individual basis. For example, a male aged 25 in 2012 with median earnings could expect a return of £3.22, if his partner receives the same level of income in retirement.⁶
- 2.79 People with different working patterns through their life will see different levels of payback on their investment. More information is contained in the publication Financial Incentives to Save for Retirement.
- 2.80 Each of the example cases can expect to get back significantly more in real terms than they put in, including those who find part of their personal accounts pension is offset against Pension Credit but who are not on the Guarantee Credit element only. These results are likely to compare well to other investments with similar risk profiles, which would not attract the matching contribution but could nevertheless affect tax due and entitlement to benefits in retirement.

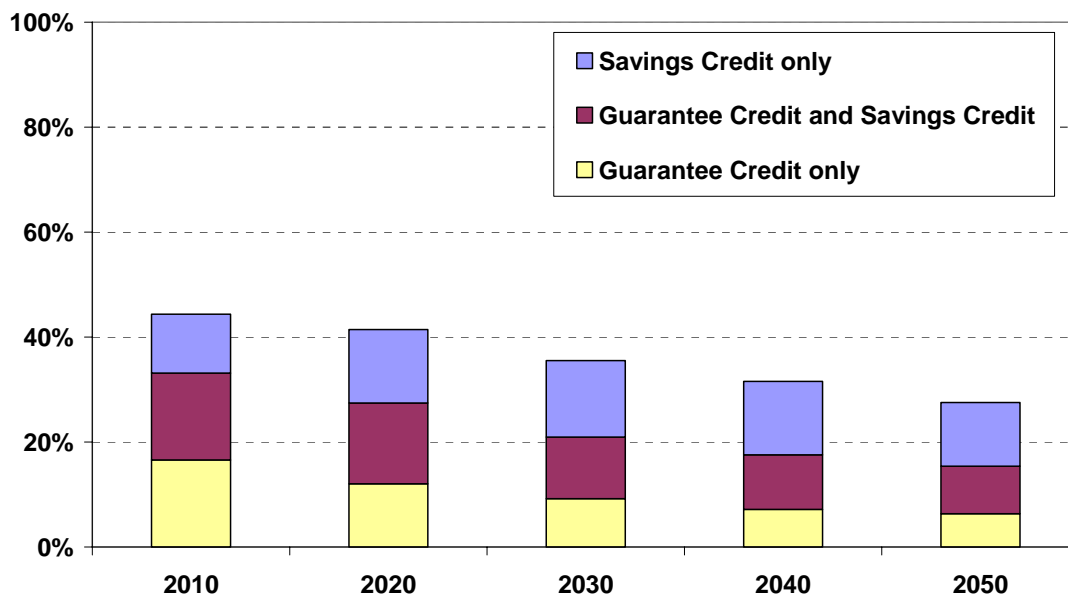
Numbers on Pension Credit

- 2.81 If the current uprating arrangements were to have continued over the long term, with the standard minimum guarantee uprated in line with earnings and the basic State Pension uprated in line with prices, then an increasing number of pensioners would have been entitled to Pension Credit – over 75 per cent by 2050. It has never been the Government's intention that this would have happened.
- 2.82 People can be entitled to Pension Credit and still see a reasonable return on their saving. The combination of a more generous State Pension and reforms to the Savings Credit will mean – over time - that fewer pensioners will be entitled to Pension Credit, at the same time as protecting the poorest by earnings uprating Pension Credit standard minimum guarantee.
- 2.83 Figure 2.12 shows the proportion of pensioners eligible for Pension Credit after the reforms. These projections show about 30 per cent of pensioners will be eligible for Pension Credit in 2050, with only about one in twenty

⁶ The returns for each individual assume that they remain in the couple until death. Where the individual outlives their partner their returns in the remaining years will be more like those of single people (though they may benefit from pension or other assets inherited from their late partner).

being eligible for the Guarantee Credit only. This is an updated version of projections presented in Figure 3.v in the White Paper. It takes account of revisions to modelling, assumptions and policy proposals since the White Paper (see box below).

Figure 2.12 – Proportion of pensioners eligible for pension credit over time



Source: DWP projections, using micro-stimulation modelling

Notes: This chart illustrates outcomes based on 2012 start date for earnings uprating of the basic State Pension and setting the saving credit in earnings terms from 2008 and then real terms from 2015.

2.84 The projections of Pension Credit entitlement do not include the effect of personal accounts. If personal accounts increase private pension saving, the proportion entitled to Pension Credit will fall.

2.85 Eligibility is strongly linked to the higher Pension Credit rates for disability and caring. Approaching half of those eligible for Pension Credit in 2050 get higher rates of Pension Credit because they also receive disability benefits, are carers, or have additional housing costs.

2.86 Further details of the projections that underpin the Pension Credit estimates and analysis which demonstrates the robustness of the estimates have been set out in a factsheet - *Projections of Pension Credit entitlement* - published by DWP.⁷

⁷ On the DWP website at - www.dwp.gov.uk/pensionsreform/forum/docs/fs-pc-projection.pdf

Projections of Pension Credit entitlement

The projection of pensioner incomes that underpins the projections of Pension Credit entitlement is based on the Pensim2 dynamic micro-simulation model that has been developed in DWP. The model builds up projections of income from a series of equations and assumptions that generate labour market and pension histories for a representative sample of the population. It simulates the accrual of state and private pensions by working age individuals, based on their projected labour market status. The model therefore directly incorporates the impact of trends in pension provision – for example broadening coverage of basic State Pension and State Second Pension – and changes in pensions policy.

Projections in the White Paper were based both on Pensim2 and a more traditional ‘static’ microsimulation modelling approach. This reflected that Pensim2 was a relatively new model and so it was important to validate its findings against another model. In the light of further analysis since the White Paper, DWP analysts now consider that Pensim2 provides more robust projections of Pension Credit entitlement, where the distribution of individual pensioner incomes is the key determinant. In particular, Pensim2 provides a technically superior approach to projecting future changes in the distribution of incomes from state pensions when entitlement to these is widening considerably over time.

While all long-term projections are subject to a high level of uncertainty, analysis presented in *Projections of Pension Credit entitlement* suggests that for plausible changes in the assumptions, the range of variation in the projections is fairly small. More details of methodology and assumptions used in this modelling are in Annex A.

Increases in the State Pension age

- 2.87 Increasing State Pension age would maintain the proportion of male life spent in retirement close to its current rate of 30 per cent. The increases are based on Government Actuary’s Department’s 2004-based projections of life expectancy at 65 for the average man. The number of years spent post State Pension age, after its increase to 68, will be higher than that spent today, 21 years in 2046 compared with 20 years now.
- 2.88 While there can be no certainty around the pace of future changes in life expectancy, it is a key principle of these reforms that people are able to plan with confidence for their retirement. Thus individuals must be given enough notice of changes in State Pension age. That is why the reform will legislate for increases of State Pension age up to 2046.

2.89 Although there are likely to be some increased costs for working-age benefits from increasing the State Pension age, these are relatively small in comparison to the savings in State Pension benefits. Annex A, figures A.2, A.5, and A.8 provides estimates of the impact of raising the State Pension age on increased costs for working age benefits along with the savings from less spending on State Pension benefits.

Figure 2.13: Improvement in life expectancy across all social classes



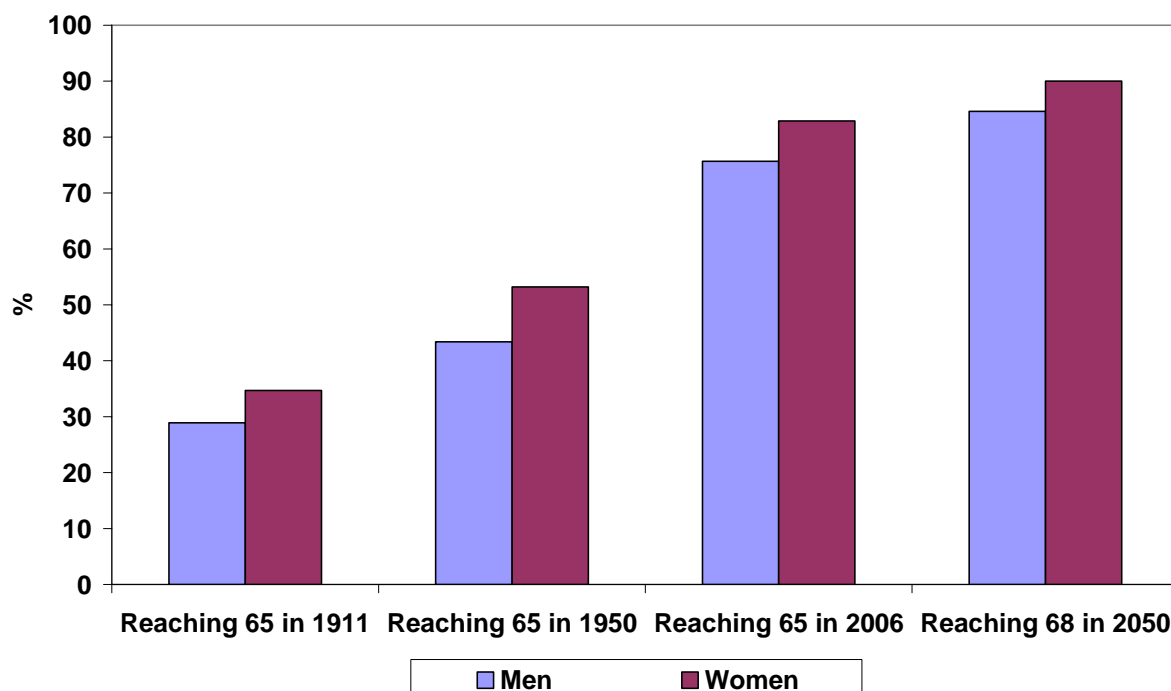
Source: DWP modelling. Detailed life tables by social class provided by the ONS's Longitudinal Study Unit.

Note: This graph shows life expectancy in years after reaching 65 for an average of 1977-81 and after 67 for an average of 1997-2001. Social Class categories are I Professional, II Managerial and Technical / intermediate, IIINM Skilled non-manual, IIIM Skilled manual, IV Partly Skilled, V Unskilled.

2.90 Having the same State Pension age for all means that some groups will (on average) not receive the State Pension for as long as others. However it is also important to acknowledge that increases in longevity have over the last two decades been experienced by all groups in society. Data from the Office for National Statistics (ONS) Longitudinal Study shows that life expectancy for men at 67 in social class V in 2001 was higher than life expectancy for men at 65 in the same social class twenty years previously.

2.91 In 1950, those who reached State Pension age constituted just 50 per cent of their generation, today this proportion has risen to three-quarters. By 2050, it is expected that those who reach the new State Pension age of 68 will constitute 90 per cent of their generation (Figure 2.14).

Figure 2.14: Proportions of a generation reaching a particular age by gender



Source: 2004-based Government Actuary's Department life tables

Note: Data for 1950 and 2006 estimated using England & Wales life table. Data for 2050 estimated using UK life table.

- 2.92 The Office for National Statistics does not compile projections of life expectancy by social class. But if the rate of increase seen in the last 2 decades persists, men in the lowest socio-economic group would not experience any reduction in the length of life after State Pension age.
- 2.93 DWP is publishing a technical working paper on the *Estimating the Economic and Social Welfare Impacts of Pension Reform*. This estimates the costs of State Pension age increases on labour market participation rates of older workers. The employment effects of the change once the rises in State Pension age are fully implemented (i.e. once State Pension age moves to 68 in 2044) range from approximately 300,000 under the lower bound estimate to 1.6m under the upper bound estimate. The middle estimate based on an average of these two gives an estimated employment increase of 900,000. Estimates of the resulting direct boost to the size of the economy in 2050 range from between 0.3 per cent and 2.5 per cent, with a central estimate of 1.4 per cent. Using a model of the whole economy to take into account the effects on the wider economy produces a central estimate of 2.0 per cent in 2050.

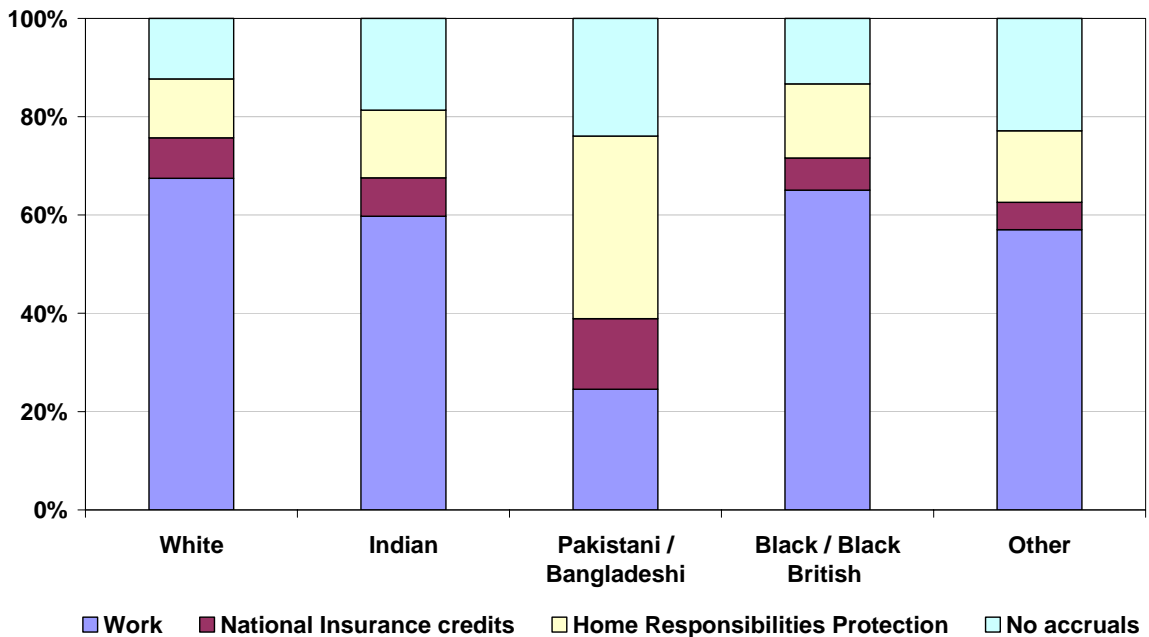
Race impact

2.94 Analysis on the basis of ethnic minority group is limited by:

- limited data on existing ethnic minority pensioners. About 2 per cent of current pensioners are from ethnic minorities, so that data from sample surveys, such as the Family Resources Survey, does not allow detailed analysis;
- administrative data, for example tax and contribution records do not contain data on ethnicity; and
- modelling of future trends depends heavily on the assumptions about ethnic minority employment rates and participation.

2.95 Figure 2.15 shows that some groups of ethnic minority women, particularly Pakistani and Bangladeshi women, are more likely to be entitled to HRP, less likely to be qualifying through earnings or credits and less likely to be accruing actual basic State Pension entitlement than women are on average.

Fig 2.15: Source of basic State Pension entitlement for women of working age by ethnic group



Source: Family Resources Survey. Average of 2002/03-2004/05.

2.96 Currently an individual cannot build up basic State Pension entitlement through HRP or credits alone. The abolition of the first contribution condition, and the measure to replace HRP with a system of positive weekly credits would therefore help those individuals whose working lives are significantly interrupted by caring responsibilities. The reduction in the number of years required for a full basic State Pension would provide greater flexibility for people to combine various activities other than those specifically recognised by the state system.

- 2.97 The equalisation of the upper age limit for credits for parents, until the youngest child reaches age 12, for both State Second Pension and the basic State Pension would also help those groups who do not return to the labour market until their youngest child attends secondary school. The age limit is decreasing for basic State Pension credits, and increasing for the State Second Pension, but as employment rates are lower for women with a youngest child aged under 12 than for those with one aged under 16, more women should gain credits than not.
- 2.98 Good evidence on past life expectancy trends by ethnicity does not currently exist, and it is therefore not possible to reliably assess whether raising State Pension age would have a disproportionate impact on people from different ethnic backgrounds. However, the ONS has this year set up a National Centre for Demography that should, in future, improve the evidence base. It has already published population estimates by ethnic group on an experimental basis.

Gender impact

- 2.99 The coverage reform measures will initially result in a larger increase in the proportion of women than men reaching State Pension age with a full basic State Pension, since only around half of women are projected to reach State Pension age with full basic State Pension without reform, compared to around 90 per cent of men. From 2025, over 90 per cent of men and women reaching State Pension age are projected to be entitled to a full basic State Pension under the reform measures.
- 2.100 For parents and carers, the replacement of Home Responsibilities Protection with weekly credits and the introduction of a new carer's credit would improve entitlement to State Pension. It is estimated that around 120,000 people, mainly women, could gain a credit for basic State Pension in 2010 through the carer's credit,⁸ whilst approximately 900,000 women could accrue State Second Pension as a result of the reforms to the parent's and carer's credits. There are more details of the effect of coverage measures in Chapter 2 - paragraphs 2.59 to 2.62.
- 2.101 The Government is publishing The Gender Impact of Pension Reform – a detailed gender analysis of the pension reforms, comparing outcomes for men and women.

⁸ This figure is based on estimates from the Family Resources Survey of the number of people who report that they are caring for 20 hours or more a week, and who are not otherwise qualifying for basic State Pension. Adjustments have been made to reflect a) estimates of the proportion of these carers who are caring for someone in receipt of a qualifying benefits, b) the latest departmental Carers Allowance caseload projections.

Impacts of State Second Pension flat rating on defined benefit contracting out

- 2.102 The calculation of the contracting out rebate is already gradually changing to reflect the flat-rating of State Second Pension (projected to occur around 2050 under the current system). The provision to accelerate flat rating – to be completed around 2030 – will increase the pace of this change.
- 2.103 Alongside this, individuals would benefit from a higher basic State Pension (due to earnings uprating) but some 7.6 million contracted-out members of Defined Benefit (DB) schemes (including 4.8 million in the public sector) could see a small and gradual reduction in the contracted-out rebate they receive. The maximum reduction will be incurred by high earners (those earning at or above the upper earnings limit). This group would see their contracting out rebate fall by around £6 a month in 2015 with its largest impact at around £11 a month in 2030. After 2030 the impact of reform on the rebate gradually declines.
- 2.104 In advising the Secretary of State on the appropriate level for the rebate for each quinquennium the Government Actuary will take into account any relevant changes to State Second Pension as well as a number of other factors including rate of return on assets and demographic trends.
- 2.105 However this would be balanced by other pay packet changes that could derive from other changes in the rebate (for example to cover longevity increases), changes to NI and tax thresholds, and general annual pay awards. Only very moderate general pay increases (far below inflation) are sufficient to ensure cash increases in pay packets year on year, despite the rebate changes that result from the reform.

Individuals: effect on pension entitlement

- 2.106 Any effect on individuals' ultimate pension entitlement would depend on the response of their scheme to these changes. If the scheme adjusted benefits in line with the changes to State Second Pension then, as with contracted-in individuals, they could face a lower pension entitlement from this part of their pension. However, this would be more than offset by the increases from the basic State Pension being uprated in line with earnings growth.

Employers

- 2.107 As with members of contracted-out DB schemes, the sponsoring employer would see a gradual reduction in the level of the rebate leading to an increase in payroll costs and associated training costs for

payroll staff. It would then be for schemes to restructure their benefits to reflect this if they wished.

Individuals and employers: aggregate reduction in rebate

- 2.108 Informal discussions between DWP and pension scheme professionals suggested that this gradual reduction in the rebate would not be expected, on its own, to lead to closure of DB schemes. Many DB schemes are facing a number of issues, such as longevity and poor investment returns, which have an impact on funding. These might lead to a review of the benefits provided by the scheme and changes to the rebate might be an additional factor to be considered as part of any such reviews.
- 2.109 The way in which the rebate reduces reflects the way in which the flat-rating of State Second Pension is being phased in. That is, calculating the rebate on a new band of earnings – from the lower earnings limit (LEL) to the upper accrual point⁹ – will mirror the band of earnings on which State Second Pension will accrue. This would introduce a further band of earnings (for National Insurance purposes) that employers would need to record on systems and end of year returns.
- 2.110 Initial analysis shows that contracted-out employers will have to make changes to their systems in order to calculate the contracted-out rebate on earnings between the LEL and the UAP rather than the LEL and UEL. Employers will need to report separately earnings between the UAP and UEL to HMRC.
- 2.111 It is estimated that there are currently around 5,500 contracted-out DB schemes covering 7.6 million employees. The Government estimates that the proposed changes will increase ongoing compliance costs for each such employer by around on average £200,000 per annum. The vast majority of this increased cost will be borne by large employers. Indeed, more than half of this increase will be faced by the public sector. There will also be a one-off cost for employers to train payroll staff and adjust payroll software to calculate full-rate National Insurance contributions payable on earnings between the upper accruals point and the upper earnings limit.
- 2.112 Employers will also need to take account of the effect on the Reference Scheme Test – which will effectively become a slightly weaker test over time to reflect the lower levels of State Second Pension given up by contracting out. The government do not expect there to be a significant cost for employers but they will need to update any relevant guidance,

⁹ Currently the rebate is calculated on the band of earnings from the Lower Earnings Limit to the upper earnings limit.

notification and possibly scheme rules (if these include details of the Reference Scheme Test).

Impacts on small firms

- 2.113 There are no specific impacts from these reforms on small firms. All employers will have to adapt their payroll systems to collect National Insurance Contributions beyond the (equalised) retirement age of 65, but payroll systems would generally be replaced in the normal course of IT renewal programmes anyway between 2010 and 2025.
- 2.114 The changes to the age thresholds for National Insurance Contributions as a consequence of increasing the State Pension age are likely to result in some additional but small costs to employers. Each increase to the State Pension age, from 65 to 66, 66 to 67 and 67 to 68 will be phased in over two years in each decade, following the same process as for the raising of female State Pension age by five years between 2010 – 2020. So, by the onset of these further changes in 2024, small firms will already have in place the systems needed to raise the pension age of their female employees. The precise impact on small firms will largely depend on two factors: the extent to which small firms continue to utilise clerical payrolls in the next 20 years and the future costs to small firms of payroll system changes. For small businesses which may still operate clerical systems when the first rise in State Pension age begins in 2024, some additional clerical activity, resulting in small administrative costs, would be required to calculate and manually record the employee's share of National Insurance Contributions for any employees aged over 65 but below the new State Pension age. Potential developments in IT and payroll systems in the next 20 years make estimating the likely costs to small firms as a result of the State Pension age changes very difficult until much nearer the time

Impact on competition

- 2.115 The state pension reforms do not raise any concerns regarding competition because the objective does not relate to specific markets or companies. Indeed, by providing greater clarity on the evolution of the state pension system, over time it enables financial services markets and employers to operate more efficiently.

Enforcement, sanctions and monitoring, implementation and delivery plan

Delivery

- 2.116 The Pension Service has initiated a Delivery Programme to coordinate, manage and deliver those changes to State Pensions where it is responsible for delivery, and to make necessary changes to its products and services to reflect other reform measures. Changes will be delivered through central programme teams coordinating activity of a number of projects working with the operational areas of both DWP and HMRC to bring about the necessary IT and operational changes.
- 2.117 The majority of the administrative activity will be in delivering those Pension reforms scheduled for 2010, with the link between the basic State Pension and rises in average earnings following later. Implementation of the rise in State Pension age will occur over three decades (2024-26, 2034-36 and 2044-46).
- 2.118 The scale of the changes, particularly to the many IS/IT systems affected, will necessitate long lead times for delivery plans, with the majority of the IT changes being developed between 2007-2012. The costs of delivery include allowance for targeted publicity to raise public awareness of the state pension reform changes, in particular for those customer groups most affected.

Monitoring and further information

- 2.119 The Government will continue to publish a wide range of statistics on: pensioners' incomes, benefit receipt, and take up, and undertake a range of research as it does now. The Government is committed to periodically report on older people following Opportunity Age .
- 2.120 The Government is working to improve the evidence base on pensions and retirement provision. One example is the new Household Assets Survey, a collaboration between DWP, ONS and other government departments. This longitudinal study will provide robust data on how individuals accumulate assets and pension rights over time, and how saving and debt patterns relate to major life events. The Government will also continue to keep under review the range of other data on pensions that is published by outside organisations, including English Longitudinal Study of Ageing which provides valuable information on retirement transitions and incomes in later life.

Post-implementation review

2.121 DWP will continue to monitor State Pension awards and accruals, the level and distribution of pensioners' total incomes, and levels of understanding of the state pension system through analysis of administrative data, surveys and other sources. It will continue to report on progress against its Public Service Agreements in its annual and departmental reports.

2.122 The Government proposes to commission reviews periodically drawing on a range of independent expert advice in the light of emerging evidence on demographic change on whether the timetable for increasing State Pension age - as set out in legislation - remains appropriate.

Summary and recommendation

2.123 The Government recommends option 2 - the package of State Pension reform measures.