



## White Paper on Pensions Reform

### Introduction

The Government published its White Paper on pensions reform entitled [Security in retirement: towards a new pension system](#) ("the White Paper") on 25 May 2006. The White Paper is a compromise within Government based on the ideas advocated by Lord Turner in the [Second Report of the Pensions Commission](#) ("the Turner Report"). The White Paper is subject to a consultation period which ends on Monday 11 September 2006.

This News Digest summarises the key points of the White Paper.

### State Pension Scheme

#### Basic State Pension

During the next Parliament, it is proposed to re-link the Basic State Pension to National Average Earnings ("NAE"). The intention is to make the change from Retail Price Inflation ("RPI") to NAE in 2012, "subject to affordability and the fiscal position" but, in any event, the change will be made by the end of the next Parliament.

The number of years required to qualify for a full Basic State Pension will also be reduced from 44 for men and 39 for women to 30 years on an equal basis. [Note: The Turner Report had put forward a residence-based approach, rather than a change to the number of qualifying years.]

The requirement that a person must have a contribution record covering a minimum of 25% of the years required for the full Basic State Pension (i.e. 9 years for women and 10 years for men) is also to be removed.

#### State Pension Age

The State Pension Age will be raised to 68 by 2046 as follows:

- Over a 2 year period from April 2024 from 65 to 66;
- Over a 2 year period from April 2034 from 66 to 67; and
- Finally, over a 2 year period from April 2044 from 67 to 68.

#### State Second Pension ("S2P")

It is proposed that S2P will gradually become a flat-rate top-up. The phasing-in process will start at the same time as the NAE link is reintroduced for the Basic State Pension i.e. probably in 2012.

It is estimated that by around 2030 S2P will be completely flat rate and, for each year of (employed) work, parenting or caring, it will accrue at a minimum flat rate level of £1.20 per week (increased in line with NAE). This minimum rate of accrual is consistent with the (flat) rate at which benefits accrue under the current S2P regime for earnings up to the Lower Earnings Threshold ("LET") of £12,500, assuming an increase of the State Pension Age to 68. A slightly higher flat rate will apply where an individual has a lower State Pension Age.

The impact of the change is that the earnings-related addition which currently applies under S2P for earnings over the LET will be phased-out by around 2030.

It should be noted that, whilst the flat-rate S2P benefit will increase by NAE prior to State Pension Age, unlike the proposals for the Basic State Pension, it will still increase in payment in line with RPI.

There are no proposals to extend S2P to the self-employed.

#### Home Responsibilities Protection ("HRP")

It is proposed that HRP (which protects the Basic State Pension and provides S2P entitlements for those caring for children or the severely disabled) will be replaced by weekly (rather than annual) National Insurance credits.

For the care of children, these credits will apply for both the Basic State Pension and S2P until the youngest child reaches 12 years old. The current rules are that HRP applies in relation to the care of children to age 6 for S2P and age 16 for the Basic State Pension. [Note: Although this change will reduce the number of years' credit for the Basic State Pension from 16 to 12 years, this should be put in the context of the new regime where it is only necessary to have credits for 30 years to qualify for the full Basic State Pension, with no minimum number of years.]

Credits will also be available for those who care for the severely disabled for more than 20 hours per week, rather than the current 35 hours rule under HRP and, for those eligible, the Carer's Allowance.

Similar crediting arrangements will also apply to those entitled to bereavement benefits.

#### Adult dependency increases ("ADI")

It is proposed that ADI's will be abolished from 6 April 2010. ADI's in payment at that date will be protected up to 2020.

The purpose of ADI's is to provide an increased Basic State Pension where a person in receipt of the Basic State

Pension has a dependent spouse or other person having care of the recipient's children. The dependency rules require that the dependent person must not be in receipt of benefits or have earnings/pension benefits in excess of the jobseeker's allowance of currently £57.45 per week.

The current ADI rules are less favourable for a recipient who is a wife as they impose an additional requirement that the recipient must have been getting an increase in Incapacity Benefit for their partner prior to the Basic State Pension coming into payment. [Note: It had been planned to remove this additional requirement from 2010 which is the start of the 10 year period over which the State Pension Ages for men and women are being equalised.]

Under the current rules, ADI is primarily granted to Basic State Pension recipients with non-working wives below State Pension Age and so these are the people who will be mainly affected by the Government's proposals to abolish the benefit.

### Autocredits

It is proposed to abolish autocredits. Autocredits provide men aged 60 to 64 with the right to National Insurance credits. They were introduced at a time of high unemployment alongside the ending of the requirement that men aged 60 or over had to register as unemployed to qualify for Supplementary Benefits.

### Pension Credits

There are two parts to the means-tested Pension Credits, the Guarantee Credit and the Savings Credit.

It is proposed to continue uprating the Guarantee Credit, which provides a minimum guaranteed income of £114.05 per week (£174.05 for couples), in line with NAE. Previously, the Government had only committed to continuing this link until 2008. [Note: The amount of the Guarantee Credit is higher for those with severe disabilities and other specific groups.]

The purpose of the Savings Credit is to provide some reward to people aged 65 years or over who have made some additional provision for their retirement. It accrues at the rate of 60p in the pound for qualifying income up to the maximum Savings Credit award. Where income is above the Guarantee Credit (including any adjustments for severe disability and other reasons), the Savings Credit is reduced by 40p in the pound for the excess.

The key component in determining the value of the Savings Credit to a potential recipient is how the maximum Savings Credit award is calculated. At present, the maximum is set at 60% of the difference between the Basic State Pension and the Guarantee Credit. However, the maximum has been growing faster than NAE. This is because the lower threshold of the Basic State Pension has only been increased in line with RPI whereas the Guarantee Credit has been increased in line with NAE.

It is proposed to correct the problems with the maximum Savings Credit award from 2008 by increasing the lower threshold by NAE. In addition, it is proposed to freeze the maximum amount from 2015 in RPI terms. The overall effect of these changes will be to reduce significantly the amount of means-tested Savings Credit claimed in future years.

## Personal Accounts

The Government proposes the introduction of low-cost, portable, Personal Accounts (the new name for the National Pension Savings Scheme) from 2012 for those without access to adequate pension savings. The key features are as follows:

- Automatic enrolment for all employees aged 22 or over (the age at which the adult rate for the National Minimum Wage is payable) and below State Pension Age, provided the employee's earnings are above a minimum threshold of £5,035

per annum (the Primary Threshold for National Insurance purposes);

- Employers with schemes satisfying certain requirements (e.g. with contributions at least as high as those proposed for the Personal Accounts or with defined benefit arrangements that have equivalent value) will be able to apply from exemption from the automatic enrolment requirements;
- Employees will be able to opt-out;
- Self-employed, those not in paid work, young people and those over State Pension Age (on entering service), will be able to opt-in, subject to a maximum contribution of £3,600 per annum for those not in paid work. Young people and those above State Pension Age will automatically benefit from employer contributions if they opt-in;
- Minimum contributions of 8% of "band earnings" between £5,035 per annum (the Primary Threshold) and £33,540 (the Upper Earnings Limit) broken down as follows:
  - (1) Employer contributions for all enrolled employees of 3% of "band earnings";
  - (2) Employee contributions of 4% of "band earnings"; and
  - (3) Tax relief of 1% of "band earnings".

The contributions will be phased-in over a period of 3 years from 2012;

- The contribution rates have been set to provide a replacement rate (when coupled with State Pension entitlements) of around 45% of earnings prior to retirement for a lifetime median earner starting to save at around 30 years old;
- Employers and employees will be encouraged to make additional contributions;
- An organisational structure with centralised collection of contributions which ensures low charges, a choice of funds (including SRI funds) and good-quality service. Where a

member fails to make a choice of funds, the personal account will be invested in a default fund;

- The Personal Accounts will be subject to the usual pension scheme tax rules including the ability to take 25% tax free cash; and
- On retirement by age 75, an individual would be expected to purchase an annuity to secure their retirement income, rather than allowing drawdown benefits.

Apart from the requirement for the centralised collection of contributions, the precise organisational structure including the governance arrangements has not been determined, although the initial analysis favours a single organisational structure along the lines of the Pensions Commission's proposals. An alternative is put forward whereby there would be competition between providers for administration of the accounts with a centralised collection function. There would be a default provider under this structure where the member failed to make a choice.

The aim is to keep charges as low as possible but not necessarily as low as the 0.3% per annum suggested by the Pensions Commission, although it is suggested in the White Paper that this may be possible. The White Paper in its illustrations of the effect of low charges compares a 0.5% per annum charging rate with the 1.5% per annum applicable to stakeholder pensions.

The Government will put forward its proposals on the precise operational structure for Personal Accounts later this year.

## Existing pension provision

### Abolition of contracting-out for defined contribution arrangements

It is proposed to abolish contracting-out of S2P for occupational defined contribution schemes and (individual and group) personal

pensions. The proposal is that contracting-out rebates for DC schemes will end at the same time as the Basic State Pension is re-linked to NAE i.e. probably in 2012.

The removal of contracting-out rebates will naturally cause employers to review their pension arrangements where they currently have occupational DC schemes which are contracted-out of S2P.

There are no plans to end contracting-out for occupational DB schemes.

### Guaranteed minimum pension ("GMP") conversion

Pension schemes will be allowed to convert GMP's into normal scheme benefits which offer an actuarially equivalent value. This will simplify scheme administration and make transfers of such contracted-out rights somewhat easier.

### Extension of the Financial Assistance Scheme ("FAS")

The Government will extend the FAS (which provides some assistance to pension scheme members whose employer became insolvent prior to the introduction of the Pension Protection Fund) to members of under-funded pension schemes who were within 15 years of scheme pension age prior to 14 May 2004. Scheme benefits will be tapered to pay 80% of full benefits to those within 7 years of scheme pension age, 65% to those within 8-11 years and 50% to the remainder.

### Rolling deregulatory review

The Government proposes a rolling review process. This will cover matters such as:

- The need for employers to designate stakeholder pension schemes once Personal Accounts are introduced;
- Mandatory indexation of pensions in payment;
- Restrictions on changes to accrued rights;

- Payments to employers where surplus funds exist;
- Member-nominated trustees;
- Administrative and internal control requirements;
- Deemed buy-back; and
- Internal dispute resolution.

### Pensions Law Rewrite

The Government proposes a pilot exercise to see whether it would be beneficial to rewrite the current Pensions Law along the lines of the recent Tax Law Rewrite.

### Golding Smith & Partners 26 May 2006

For further information, please contact:



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A New Pension Settlement for the Twenty-First Century, The Second Report of the Pensions Commission, November 2005.



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