ABG Bulletin

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The new State Pension and the end of contracting out

The Department for Work and Pensions (DWP) has published its long-awaited pension reform. The centrepiece of this is the introduction of a higher flat-rate pension, with the objectives of both increased simplicity and greater equality, although the future direction of the State Pension Age (SPA) is also considered. As the intention is that these reforms will be broadly cost-neutral (and if anything will ultimately reduce the Government's expenditure on pensioner benefits), they will produce 'losers' as well as 'winners'.

Key features of the proposals are:

- The new single-tier pension, replacing the current Basic State Pension (BSP) and the earnings-related State Second Pension (S2P), will be at a level (slightly) above that of the current Pension Credit Standard Minimum Guarantee, assumed to be about £144 per week in current terms. The Government's costing's have been based on the assumption that this pension will be increased in line with the 'triple lock' (highest each year of prices, earnings and 2.5%), although the minimum legislative requirement would, as for the current BSP, only be for increases in line with earnings.
- The new pension will apply only to those who reach SPA after the implementation date, which will be no earlier than April 2017 – older people will continue to receive benefits under the current rules.
- The full pension will accrue over a 35-year period of making National Insurance Contributions (NICs) or receiving credits (for example, for incapacity, unemployment or caring responsibilities), but there would be no entitlement at all for those with fewer years of contributions or credits than a 'minimum qualifying period', expected to be something between seven and ten years.
- Contracting out of S2P will cease from the implementation date. Employees in contracted-out schemes and their employers will see an increase in their NICs. The DWP is proposing an 'override' facility to ensure scheme benefits can be reduced to offset the increase in employer costs, but this may still be another catalyst for the closure of defined benefit schemes. However, the Government has not yet decided whether a similar facility should be extended to former nationalised industries subject to 'protected persons' provisions, and has also confirmed that public service pensions will not be amended to offset this extra cost to the employer.
- The 'simplicity' of the new system will be affected by various transitional provisions. Anyone who has been contracted out at any time since 1978 can expect to see their State benefit reduced to reflect the private scheme benefit thereby earned, but such individuals would appear to have more opportunity to accrue further State benefits compared to their counterparts who have not been contracted out and have already reached, or almost reached, the £144 per week level. However, those who have already accrued a State benefit of more than the new single-tier amount will be able to retain that higher benefit.
- The SPA will be subject to a five-yearly review and, if necessary, adjustment to reflect changes in life expectancy. The Government envisages that at least ten years' notice would be given of any change.

We will provide further details and analysis of the proposals shortly.