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## THE PENSIONS WHITE PAPER

### 1 INTRODUCTION

After a number of leaks in the press and alleged horse-trading behind the scenes, the Pensions White Paper was finally published today. The White Paper gives us the Government's thinking on the future of UK state pensions.

We can now see for ourselves what it really says, rather than just relying on what has been reported in the press.

Copies of both the executive summary and the full White Paper "Security in retirement" can be found at:

<http://www.dwp.gov.uk/pensionsreform/whitepaper.asp>

### 2 KEY POINTS

There are four headline messages in the White Paper:

- Basic state pension's link to earnings will be restored in 2012 (or thereabouts)
- State pension age will move up to 68 by 2046
- Women's pensions are set to improve
- Implementation of the National Pensions Savings Scheme

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### 3 THE PENSIONS COMMISSION

The story of the Pensions White Paper starts in 2002 with the establishment the Pensions Commission. The Pensions Commission was an independent body, headed by Lord Turner, set up to keep under review the system of private pensions and long-term savings in the UK.

The Pension Commission's First Report was published on 12 October 2004<sup>1</sup> with the aim of "stimulating debate" on dealing with the challenge of providing pensions for an ageing population, setting out a number of options for reform. The Pensions Commission then made a number of recommendations in its Second Report dated 30 November 2005.<sup>2</sup> It published a Final Statement in April 2006, following up points arising out of its Second Report.

The White Paper now takes up the baton of UK pensions reform.

### 4 WHITE PAPER – HEADLINE MESSAGES

There are four headline messages in the White Paper:

- Restoring the link between earnings and the basic state pension age from 2012 (see section 5);
- Increasing the State Pension Age (see section 6);
- Improving women's pensions (see section 7);
- The National Pensions Savings Scheme (see section 8).

<sup>1</sup> See our Sackers Extra Alert "Pensions Commission publishes report" dated 12 October 2004, available from the client area of our website [www.sackers.com](http://www.sackers.com) or from your usual contact

<sup>2</sup> See our Alert "Pensions Commission comes in from the Cold" dated 30 November 2005, again available from our website

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### 5 LINK TO EARNINGS

The White Paper recommends that the Basic State Pension (BSP) will once again be linked to the rise in earnings. But the catch is that the link will probably not be restored until 2012 "subject to affordability and the fiscal position". The exact date will be announced at the beginning of the next Parliament.

The link between the BSP and earnings was broken in 1981. Since then, the BSP has been linked to the rise in the retail prices index (RPI). This has seen the BSP fall in real terms from 22.4% of average earnings in 1985/6 to 15.6% in 2005/6<sup>3</sup>. In making its recommendations, the Government specifically recognises that linking the BSP to RPI does not match current expectations:

"People's expectations for their incomes in retirement are largely based on their earnings and standard of living during working age. If the state system is to serve as a foundation for their retirement planning, it must retain its level relative to these expectations. This will help address the problem of undersaving by enabling people to predict with confidence what they are likely to receive from the State when they retire, and therefore what they will need to save in addition to meet their expectations."

### 6 STATE PENSION AGE

The State Pension Age (SPA) will rise to 68 by 2046. The rise in the SPA was also one of the key recommendations of the Pensions Commission.

The change will be effected in stages:

- The first increase from 65 to 66 will be phased in over two years, starting in 2024;

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<sup>3</sup> Information taken from the National Association of Pension Funds website

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- the second increase, from 66 to 67 will again be phased in over two years from 2034; and
- the third increase, from 67 to 68, will also be phased in over two years from 2044.

These increases build on changes to women's SPA which are already in the pipeline, as part of the long-planned equalisation of the SPA as between men and women. By 2020 women as well as men will receive their pensions at 65.

It is important to remember that these changes will only affect the date on which the state pension is available. It will not affect the date on which private pension arrangements become payable.

## 7 WOMEN'S PENSIONS

The Pensions Commission was asked by the Government to consider the problems faced by people - often women - with interrupted work records.

The BSP is "earned" by making national insurance contributions. At the moment, men must build up 44 years of contributions and women 39 years if they are to be entitled to the full state pension. On the current figures, this system of contributions means that many fewer women than men are entitled to a full BSP.

The original proposal of the Pensions Commission was that eligibility for the BSP should be based on residency rather than contributions. However, this was rejected by the Government on the grounds that it would be too slow in improving pensions for women.

Instead, the White Paper suggests changes to the contributory system by making a reduction in the number of contributory years an individual needs to accrue before qualifying for the full pension to 30 years for everyone. At the same time, the tax credit system for carers will be altered to make it easier for them to build up qualifying years.

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### 8 NATIONAL PENSION SAVINGS SCHEME

The National Pension Savings Scheme (NPSS) was one of the key recommendations of the Pensions Commission and, as widely anticipated, has been carried forward into the White Paper. The NPSS is, in effect, a top-up to the BSP.

The proposals are that the NPSS would be ready for operation in 2012 and membership will be automatic for employees, with an option to opt-out and would have a default level of contributions of around 8% of earnings above the "Primary Threshold"<sup>4</sup> and below the Upper Earnings Limit.

The proposals for making contributions to the NPSS are:

- Members would be expected to contribute 4% "post-tax pay".
- The state would provide 1% as tax relief.
- Employers would be expected to pay 3% of "matching compulsory employer contributions". This requirement will be phased in over 3 years (and may be even longer for small businesses).
- Voluntary contributions on top of the default level will also be allowed, subject to a cap – enabling the individual and/or his employer to double the default amount.

To encourage existing occupational pension provision, employers will be able to opt-out of the NPSS if they already provide more generous contributions than the default level.

### 9 MISCELLANEOUS

There are also a number of other more minor but nonetheless important changes proposed by the White Paper:

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<sup>4</sup> This is the level at which Income Tax and National Insurance become payable i.e. £4,888 in the tax year 2006/7

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- The Financial Assistance Scheme, designed to help people whose schemes wound up in deficit before May 2004, will be extended to those people within 15 years of their scheme's normal retirement age - up from the current three year limit.
- The State Second Pension (S2P) will evolve into a flat rate top up pension by 2030.
- The current system of "contracting out" from the state second pension will be abolished for defined contribution schemes and personal pension schemes, but will be retained for defined benefit schemes "for the foreseeable future".
- There is recognition that the system of tax relief can be difficult to understand and, with half the benefits being taken by higher rate tax payers, potentially inequitable. But the White Paper has not recommended reform "particularly given the major changes already planned for implementation in April 2006, which have entailed significant implementation complexity". No doubt pension managers and pensions professionals everywhere will be breathing a sigh of relief at this decision!

## 10 WHAT NOW?

The consultation period on the White Paper runs until 11 September 2006. The Government says in the White Paper that it will publish a response on "how we intend to proceed" within three months of the close of the consultation period.

Given the lengthy consultation period we can now expect a period of intense political debate on pensions. The main thrust of the White Paper is on state pension provision and this will be the focus for discussions but with key changes like the increase to SPA affecting everyone, we anticipate that occupational pension schemes will need to keep up to speed with the changing pensions landscape.