

Details of the New Single-Tier State Pension from 2017

On the 14th January 2013 the government yesterday announced plans to simplify the state pension by introducing a single-tier system and confirmed its plan to launch this in 2017. We have summarised below the key points of the proposed changes:

The long-awaited changes will see everyone entitled to a standard rate of £144 a week in today's terms, as long as they have built up enough (35 years of) national insurance contributions, and will do away with the second state pension and 'contracting out'.

To help pay for these changes alongside the single-tier pension will come increases in the state retirement age.

So what will be happening from 2017?

Currently, anyone retiring can qualify for a basic state pension worth up to £107.45 a week. They may also have built up entitlement to a 'State Second Pension' through National Insurance (NI) contributions.

Currently a higher earner can get a second state pension worth more than £150 a week on top of the basic state pension. From 2017 rather than paying two separate pensions of varying amounts, the government will provide a single pension worth up to £144 a week (in 2012/13 terms). The change will be introduced in April 2017 (at the earliest).

As previously announced, the state pension age will increase to 67 between 2026 and 2028.

Will I get the new Single Tier pension of £144 per week?

Not if you retire before 2017, in which case you will receive pensions under the current system. When the change is introduced it will only affect people who retire from the date it is introduced (it won't be retrospective).

If you retire after 2017 you will only qualify for the full amount if you have built up a full record of NI contributions. That will be 35 years – an increase from the 30 years currently needed. You will (as now) be able to make up contributions for any years you have missed. You will also get National Insurance Credits for any years where you hold certain qualifying roles, such as bringing up children or caring.

The government says that by the 2040s it expects 80% of pensioners to qualify for the full amount. You are likely to be required to have at least 10 years of NI contributions in order to qualify for any state pension. If you have made fewer than 10 years' of NI contributions you will not get any state pension at all. If you have between 10 and 35 years of contributions you will qualify for the pension on a pro rata basis. For example if you have 30 years' of qualifying contributions you will be entitled to 30/35ths of the full rate, or approx. £123 per week.

Is £144 per week more than I would get under the current system?

Yes, if the only pension you are on track to receive is the basic state pension. Currently you can boost that with the means-tested pension credit (depending on your financial circumstances), but even then the combined value is £142.70 a week, so slightly less than the flat-rate pension.

It is also more if you are self-employed or a public sector worker on a final-salary scheme. Currently you would only be entitled to the basic rate pension.

However, if you are someone who may have been able to build up a healthy state second pension (currently known as S2P & formerly referred to as SERPs) before you retired then you will actually be worse off and one of the 'losers' under the proposed changes.

According to the Pensions Policy Institute, in 2010 workers received an average of £33.19 a week from their additional state second pensions, which would take their income to less than the flat-rate pension. However, men typically received £54.10 a week, which would mean they would get more than the proposed new flat rate.

The government's own figures show that by 2060 more than 50% of new pensioners will lose at least £2 a week as a result of the abolition of the second pension.

So what about the all the contributions I've already paid into the second state pension (S2P & SERPs)?

The good news is that the government does not plan to take away money from anyone who has built up a second state pension. This means some people will receive more than £144 at the outset (this is where the simplicity ends!!).

What about people who have contracted out of the state second pension?

Under the current system, people in final salary schemes are allowed to contract out from the second state pension, reducing their NI contributions as they do so. These people will see their contributions increase under the new regime, as will the employers providing their pensions. The increase in National Insurance that will be paid by people who are currently contracted out will be 1.4% or 1.4p for each pound they earn between the lower limit of £146 per week and the upper limit of £770 per week. Their rate of National Insurance contributions will increase from 10.6% to 12% on these 'band earnings' (the rate that anyone who is not contracted out currently pays). As an example someone earning £41,000 per year will pay an extra £454 per year in National Insurance contributions.

So are the changes and the new single tier pension a good thing?

Ultimately it should make things much less complicated and ensure the poorest pensioners get a decent income without having to fill in complex forms to claim pension credit. Removing the complex & time consuming means testing system should also save the government (all tax payers) a significant sum of money.

Having a flat rate pension should make it easier for people to plan for retirement – they no longer have to worry that paying a small amount into a pension may cause them to lose better benefits through means-testing (this has been a real deterrent for people on modest incomes considering saving for their retirement).

The government says that at least half of those reaching retirement age before 2050 are likely to be better off. However, in the long term more people will get lower pensions. There is also a danger future governments will start tinkering and the system will quickly become complex again (we have a great tradition of this in Britain!).

People who will be worse off

Higher earners will eventually lose out (and some significantly so) under the new system because they will no longer be able to build up a second state pension. This can currently be worth more than £150 a week on top of the basic state pension.

Younger people will also be worse off as the government says half of workers retiring in 2060 will be at least £2 a week worse off. This is mainly down to the abolition of the second state pension.

Public sector workers who are still working will have to start paying higher NI contributions – currently they can contract out of the second state pension, but that option will go once that pension is abolished.

Married women without enough qualifying years to be entitled to their own single-tier pension will lose out. Currently, women who have no entitlement at all can get a state pension worth 60% of their husband's state pension, and inherit his pension when he dies, but the new rules will base pensions on each individual's NI contributions. A married couple will lose £28 a week, while a widow could lose £107.45 a week.

People who will be better off

Married couples where both have qualifying years built up. A married couple currently gets £171.85 a week, but under the new system they could get up to £144 each, or £288 between them.

Self-employed people will be better off. They do not currently qualify for the second state pension and would only be able to receive more than £107.45 a week from the state if they qualified for the means-tested pension credit. Now they will qualify for the whole flat-rate pension.

Carers - People who have taken time out to care for family or bring up children should be better off. The government says about 750,000 women reaching state pension age in the first 10 years after implementation will receive an average of £9 a week more.

Public sector workers are likely to be better off when they retire, as long as it is after 2017. Currently they can only qualify for the basic state pension on top of their workplace pension, but in future they will qualify for the flat rate of £144.

Government Calculations

The government reckons about 90% of those reaching state pension age in the first two decades after implementation will gain enough extra state pension over retirement to offset both the increased NI contributions they will pay over the rest of their working lives and any potential adjustments to their occupational pension.

Other potential implications – The last straw for Final Salary Pension Schemes?

Given the increase in Employers' National Insurance contributions, which will be significant, when their employees in the company pension can no longer Contract Out this could lead to even more employers closing final salary pension schemes.

If you have any questions on this or any other areas of financial planning then please don't hesitate to contact us on **0116 2592371**

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