



## **Written Response to the DWP Consultation**

### **A state pension for the 21<sup>st</sup> Century**

**June 2011**

## About N.F.O.P

1. The National Federation of Occupational Pensioners, formerly the National Federation of Royal Mail and BT Pensioners, is the oldest and largest occupational pensioners' organisation in the UK, with over 85,000 members nationwide organised into 180 Branches.
2. We campaign on behalf of our members and older people more generally, on issues such as improving pensions, health services and social exclusion. The views of our members are obtained by discussions in local Branches, at Annual Conference, responses to articles in our magazine and from elected Executive Committee members.
3. We welcome the opportunity to make a response to the consultation on A state pension for the 21<sup>st</sup> Century.

### Contact Details:

Mr Roger Turner  
General Secretary  
N.F.O.P  
Unit 6  
Imperial Court  
Laporte Way  
Luton  
LU4 8FE

Tel: 01582 721652  
Email: [roger.turner@nfop.org.uk](mailto:roger.turner@nfop.org.uk)

The National Federation of Occupational Pensioners  
A Company Limited by Guarantee  
Registered in England & Wales, Company Number 6996004  
Registered office: Unit 6, Imperial Court, Laporte Way, Luton, LU4 8FE

## Introduction

4. The Old Age Pensions Act 1908 was the beginning of UK State pension provision. It provided from 1909 a non-contributory old age pension for those aged over 70 and was paid at a rate of 5s a week (7s 6d for married couples) to half a million people who were eligible. The level of benefit was deliberately set low to encourage workers to also make their own provision for retirement. The pension was means-tested and to be eligible, a person had to be earning less than £21.10s per year, and had to pass a 'character test'; only those with a 'good character' could receive the pensions. Other restrictions reflected the Victorian/Edwardian beliefs in the deserving and undeserving poor. Those in receipt of poor relief, 'lunatics' in asylums, persons sentenced to prison for ten years after their release, persons convicted of drunkenness (at the discretion of the court), and any person who was guilty of 'habitual failure to work' according to one's ability, were excluded.
5. The Act was the first step towards a system of social security. The Beveridge Report of 1942, Social Insurance and Allied Services, set out the framework for the State pension as we know it today. At the heart of the report was the determination to slay the 'five giant evils' of Want, Disease, Ignorance, Squalor and Idleness. The proposal was to set up a system of Social Insurance, where contributions during a working life funded a flat-rate income in old age. However, the system adopted was 'pay-as-you-go', based on National Insurance contributions sufficient to pay current pensions, because of the significant cost of pensions to those who had already retired but made no contributions. This funding dilemma was to be the common theme from then on.
6. The National Insurance Act 1946 addressed the evil of Want by introducing universal coverage of social security and introduced the non-means-tested basic State pension with effect from 1948. The National Assistance Act 1948 formally abolished the poor law, and gave a minimum income to those not paying National Insurance.
7. N.F.O.P accepts that the basic State pension was never intended to be the sole source of income provided by the State in retirement and that individuals were expected to save to provide extra income. This is reflected in the development of occupational pension schemes from the 1950s onwards. Until recently, most employers saw occupational pension schemes as an important part of their employment and retention package.
8. Over the years since 1948 a raft of different State benefits has been introduced to provide extra income for those with little or no access to an occupational pension scheme, including a contributory second tier State pension system comprising Graduated Retirement Benefit, 1961-1978, State Earnings Retirement Pension Scheme (SERPS) 1978-2002 and then State Second Pension (S2P). SERPS was intended to provide a good, inflation proofed, earnings related additional pension. However, from the outset the future cost of provision was never properly assessed and successive Governments have watered down SERPS (and S2P) commitments.

9. A significant change arising from the Pensions Act 1995 was that revaluation of SERPS 'surplus' earnings shifted to prices not only for future accruals but also for past accruals. This change in pension rights has been one of the many policy changes of recent decades that have cumulatively eroded faith in pensions savings. Individuals had paid for, and assumed that they had accrued a right to, a benefit which was subsequently reduced. It is therefore no wonder that some have little confidence in the pension system if they can be disadvantaged much later on in their life and do nothing about it. For occupational schemes accrued benefits are protected, ironically under the same Act of Parliament, viz section 67.
10. The additional State pension schemes are all earnings related, although S2P is planned to become a flat rate provision. All of these changes have added complication as each new scheme has different accrual and contribution rates making it very difficult to know how much any person will get in retirement. People retiring today will have a mixture of provision; many will have all four elements.
11. Despite the above, pensioner poverty has remained stubbornly high. The National Statistics Office reported that in "2008/09, an estimated 1.8 million pensioners in the UK were living in poverty according to the most commonly used official measure: 60 per cent of equivalised contemporary median income after housing costs"<sup>1</sup>. Pension Credit was introduced to address this poverty and target money to the most needy. The Pension Credit Guarantee Credit, which replaced the Minimum Income Guarantee for Pensioners, has been successful in so far as many of the poorest pensioners are now better off and are passported into Housing Benefit and Council Tax Benefit. However because the Pension Credit is means-tested, too many eligible pensioners, approximately 1.6 million<sup>2</sup>, do not claim and therefore potentially lose not only the Guarantee Credit but also other benefits.
12. The means-test is the most disliked element of the current system; with many individuals angry that people who have chosen not to save for their retirement can still receive State benefits whilst others who have saved all of their working lives may just miss out on benefits and could even be worse off for having saved.
13. Women in particular have suffered under the contributory rules of the State pension. Until recently many women with children and/or caring responsibilities have a broken National Insurance contribution record and do not qualify for a full basic State pension. However the reduction in qualifying years to 30 for all and the crediting in for child care or other care will make a big difference.

---

<sup>1</sup> <http://www.statistics.gov.uk/ci/nugget.asp?id=2352>

<sup>2</sup> [www.ageuk.org.uk/noney-matters/claiming-benefits/pension-credit/](http://www.ageuk.org.uk/noney-matters/claiming-benefits/pension-credit/)

14. The self-employed likewise have been discriminated against in being ineligible to contribute to SERPS or S2P. As a result too many have inadequate pension provision and many have relied, unwisely, on the value of their business to provide for their retirement.
15. People on low pay or part-time employment – mostly women - have often fallen outside of the State pension provision because their earnings have been below the Lower Earning Limit for National Insurance Contributions. In the current climate with a move towards more flexible employment and increasing part-time work, this must be addressed.
16. Since the 1980s and following the removal of the earning link, the real value of State pension provision as a proportion of median earnings has declined from its peak of about 28 percent in 1975 to just over 10 percent today<sup>3</sup>. The Pensions Act 2007 was designed to stop this decline and therefore reduce the numbers of pensioners dependent on means-tested benefits.
17. The UK is unique in having a well-developed occupational and private pension system. However, complexity was added when contracting out of SERPS was introduced in the 1980s. Contracting out-rebates have not kept up with the value of the Guaranteed Minimum Pensions (GMP) DB schemes have to pay. Furthermore GMPs are so complicated that most individuals do not understand them. N.F.O.P receives many calls from members querying their pension payments and very many are found to be related to GMPs, particularly as men reach State pension age.
18. Added to this, Defined Benefit (DB) schemes have been closing at a rapid rate, often to be replaced with Defined Contribution (DC) schemes, making pension provision even more complicated and difficult to calculate what pension an individual is likely to receive on retirement. Individuals could have a mixture of contracted out DB, contracted in DC, SERPS, S2P and basic State pension, a real recipe for confusion.
19. This complexity is a significant barrier to encouraging people to save for their retirement. If you add to this a real distrust of the financial services industry and the pressures of paying back student loans, the cost of having children and mortgages for example, we have a recipe for significant under provision of retirement income and a danger of severe and increasing pensioner poverty in the future. Younger people are under great pressure and this was highlighted in a Report compiled by Dr Craig Berry for the International Longevity Centre:

“Today’s young people value living for now, and appear to spend a higher proportion of their income than other age groups.

We know, however, that today’s young people tend not to plan for retirement, and have only limited knowledge of the pensions system or indeed the nature of pensions saving. They are less likely to be

---

<sup>3</sup> IFS Briefing Note BN105, The history of state pensions in the UK: 1948 to 2010, page 60.

enrolled in an occupational pension scheme. Where they are enrolled, they are more likely to be a member of a defined contribution rather than defined benefit pension scheme, with lower overall contribution rates. Young people seem to exhibit a loss of faith in the pensions industry, and are less supportive of auto-enrolment than other cohorts.”<sup>4</sup>

20. N.F.O.P therefore welcomes any proposal to simplify the UK pension system to give clarity to the question: “Does it pay to save for my retirement?”
21. N.F.O.P accepts fully the first three of the guiding principles set out on page 7 of the Consultation:
  - **personal responsibility** – enabling individuals to take responsibility for meeting their retirement aspirations in the context of increased longevity;
  - **fairness** – ensuring an adequate level of support for the most vulnerable, ensuring everyone with a full contribution record should be entitled to a state pension above the standard level of means-tested support, and ensuring all groups are treated fairly;
  - **simplicity** – simplifying the state pension so that it is easier for people to plan and save for their retirement;
22. However we have reservations about the fourth principle:
  - **affordability and sustainability** – given longer-term pressures on the public finances, any state pension reform must be affordable. Any options for reform must be cost neutral in each and every year to avoid placing an unsustainable burden on future taxpayers. Any proposals will be subject to confirmation, including on affordability, and will reflect the projections set out in the Office for Budget Responsibility’s forthcoming Fiscal Sustainability Report. In addition, changes to State Pension age should ensure the system is sustainable for future generations.
23. Whilst we accept that any pension system has to be affordable and sustainable, we cannot accept the principle of cost neutrality in each and every year. The clear inference of this is that, if there are to be gainers, there must also be losers. As a result, this immediately has the potential to breach the principle of fairness in that all groups may not be treated fairly.
24. If cost neutrality is to be part of the proposals, then there needs to be clarity on the meaning of this. N.F.O.P believes strongly that any estimate of cost must assume a full take up of means-tested benefits. In other words, the assumption must be that all those eligible for Pension Credit Guarantee credit plus any

---

<sup>4</sup> Resuscitating Retirement Saving , Dr Craig Berry, ILC, June 2011 page 2

unclaimed Savings Credit, Housing and Council Tax benefits, are receiving them and the costs calculated accordingly.

25. It is clear that any pension reform is directly affected by the promises made in the past, sometimes over 40 years ago. Individuals will have accrued contributory pension benefits in several State schemes with different contributory and accrual rules. This makes pension reform unique and particularly difficult.
26. The most important guiding principle should be that a fair and lasting system must be introduced, even if, in the short term, the cost is higher. Inevitably this will lead to an unpalatable political issue of increasing costs for one generation, but this should not be shirked. We do not want to return to the issue of pensioner poverty in future years because of the fiscal straitjacket imposed by the Treasury.

## Response to the Consultation

**Question 1** *Would the current state pension, if left unchanged, meet the Government's principles for reform and provide an effective foundation for saving?*

27. No. The current system is too complex to allow the average person to make reasoned and informed decisions about whether or not it is worth saving for retirement, particularly for those on median to lower pay rates. The interaction with means-tested Pension Credit makes the system particularly opaque.

**Question 2** *To what extent would faster flat rating meet the principles for reform and improve savings incentives?*

28. Faster flat-rating will not be understood by most people in work. Furthermore reducing the value of S2P over a seven year period will make it almost impossible for individuals approaching retirement to make up for any short-fall. This cannot be fair. The Government should heed the warning from the outcry over the patent unfairness of increasing the State Pension Age for women over a shorter time period.
29. Both flat-rating and faster flat-rating represent a massive re-distribution from the higher earners to the poorer, by removing the earnings link. It is presumed that, as the upper band is reduced the rate of NI contributions will remain the same. Therefore higher paid individuals will be paying the same level of NI for a significantly reduced benefit. This will be perceived as a stealth tax.
30. The real issue is contained in the sentence in the box at the bottom of page 27 of the Consultation Document:
- “However the level of a two tier system would need to be set so as to achieve cost neutrality.”
31. This implies an arbitrary Treasury calculation rather than one based on fairness. The value of the State pension should be dependent on - the level of tax (NI contributions) paid by individuals and on a level of pension which lifts all pensioners out of poverty and the means-test.

**Question 3** *What further reforms might be required to the State Second Pension, such as crediting arrangements and uprating of pensions in payment, to better meet the Government's principles, recognising that there is a trade-off between coverage and the potential level of any combined, two-tier flat-rate pension?*

32. The question will be asked as to why there are in effect two flat-rate State pensions, one under the triple lock uprating arrangements and the other subject to the CPI.
33. Removal of the earnings relation for S2P will inevitably lead to a smaller pension payment for very many people. Linked to this is the negative effect of switching from RPI to CPI for SERPS and S2P, the longer term effect will be

to increase the number of pensioners at or near the poverty line (if measured by 60 percent of median earnings) and therefore pulled into the means-tested Pension Credit.

34. If flat-rating is to be the chosen option then uprating of both elements of the pension must be on the same basis, namely the triple lock.
35. Likewise, the crediting arrangement for both elements must also be the same. It will not be understood why one flat rate pension is treated differently from the other.

**Question 4** *To what extent would a single-tier pension meet the Government's principles for reform and improve savings incentives?*

36. A single tier State pension will clearly be easy to understand and much simpler to administer. It will therefore allow people to make more sensible decisions about the need to make further savings to achieve a reasonable retirement income. Whether or not it will, in and of itself, improve savings is, however, questionable.
37. For young people just starting work with significant debt already to be paid back, the choice will be much more difficult. Financial advisors say that it is better to pay off existing debt, rather than save. However, for pension savings a very long term view has to be taken, in excess of 40 years. In general, it is the early years which will have the biggest impact on the size of a pension pot for those in DC schemes. So if an individual missed 10 or more contribution years early on in a career, they may never be able to make them up.
38. The ILC Report said that: "Debt and poor budget management are significant barriers for today's young people."<sup>5</sup>
39. It is clear that younger people do not think about pensions, and, in general, have little or no understanding of them. Furthermore, they have a very negative view of later life and so tend not to think about it and live for today. It is good to be young but bad to be old.
40. If a younger person is in a pension scheme it will normally be a DC scheme. Thus they are likely to be saving much less than is necessary and possibly be invested in "less risky" assets classes resulting in potentially lower long term returns.
41. The Scottish Widows UK Pensions Report June 2011 showed that 20 percent are not saving anything for their retirement and that this has not changed in the last five years. The Report also shows that, on average, people want about £24,000 for a comfortable retirement, but that current savings rates are inadequate to achieve this. The Report states:

---

<sup>5</sup> Resuscitating Retirement Saving , Dr Craig Berry, ILC, June 2011 page 7

“The percentage of people who are currently making adequate retirement provision has increased slightly this year (2011), but still only half of those who could and should be preparing financially for their old age are doing enough.”<sup>6</sup>

42. Furthermore, the Scottish Widows Report shows that, although more women are saving for a pension, they will have, on average, much lower salaries than men, resulting in significantly smaller pensions in retirement. A real concern is that 23 percent of women are not saving compared to 17 percent of men.
43. Data from the Scottish Widows Report suggest that a single tier State pension, although easier to understand, may not result in changed savings habits, with more than half saying that their savings habits would not change if they “were guaranteed to receive a State pension of £140 per week (in today’s money) when you reach state retirement age.”<sup>7</sup>
44. Clearly a simpler State pension system will make it easier to assess the level of income a person is likely to receive on retirement, but the lack of knowledge and understanding of pensions acts to depress the final pension income, particularly with the enormous pressures on family income. Much more needs to be done to educate younger people to provide them with the tools to understand better how to make financial decisions affecting their later lives.

**Question 5** *Which of these two options would act as the best complement for automatic enrolment?*

45. Automatic enrolment goes some way to addressing the point raised in the answer to Q4 above, about saving early in a career.
46. Since the interaction of any pension income derived from NEST with the Pension Credit cannot be forecast accurately, it is certainly a challenge under the current system to advise a person on median or lower earnings to save in NEST.
47. A shift to a single tier system, particularly under Option 2, will make it easier to forecast what the State pension provision will be and therefore easier to advise on the level of savings a person would need to achieve a particular income in retirement.

**Question 6** *Government would be interested in hearing views on other reform options that would meet the Government’s principles for reform.*

48. The Government’s proposals to accelerate the rate of increase in State Pension Age and to have a single tier State pension, which will for many be less generous, whilst maintaining the level of the individuals’ contributions, is

---

<sup>6</sup> The Scottish Widows UK Pensions Report – 7<sup>th</sup> Annual Report –June 2011 page 6

<sup>7</sup> The Scottish Widows UK Pensions Report – 7<sup>th</sup> Annual Report –June 2011 Table 7 page 19

in effect a significant tax increase, albeit by stealth. N.F.O.P is sure that, if the case is made clearly and strongly enough, then people will accept that, bearing in mind that longevity is still increasing, they will have to pay more to receive a good pension in the future. Therefore the Government should consider increases in NI to part fund the future provision and ameliorate some of the difficulties it will face if the aim of cost neutrality is to be adhered to.

**Question 7** *What would be the impact of ending contracting out, as implied by any single-tier model?*

&

**Question 8** *If the decision is taken to end contracting out, how could the process be best managed so as to minimise any adverse impacts on employers and individuals?*

49. Contracting out for DC will be abolished from 2012 as automatic enrolment begins. N.F.O.P believes that the Government should be leading a communications exercise together with employers and Trades Unions, to alert pension scheme members to this change. It will result in smaller contributions going into a DC scheme by removal of the Rebates and therefore a smaller ultimate pension pot unless the individual chooses to increase their contributions to compensate. The employee will also pay more in NI contributions (1.4 percent in 2012). Of course to balance this, the employee will be accruing years in S2P. This change adds to complexity because it will be very difficult to judge whether the increased NI contributions will provide more income from S2P, bearing in mind it is to be flat-rated, than the contracted out rebates would have provided in a contracted out DC scheme.
50. Employers can compensate for any adverse impact by reducing future accrual rates (which is arguably not unreasonable if the value of the state pension is being strengthened at the same time) and so it need not necessarily cause more DB schemes to close.
51. However, for those employers who are minded to close the scheme anyway, any excuse to blame closure on changes to Government regulations is likely to be seized upon and so government needs to recognise this as a "soft risk".
52. Abolishing contracting out for DB schemes is more complex. For scheme funding it may be beneficial, since the rebates do not fully cover the liabilities the scheme has to pay. Therefore removing this liability may assist schemes, but only if scheme benefits are reduced by a commensurate amount. However, if the same benefits in a DB scheme continue to be paid, the employer and/or employee will have to pay extra to make up the shortfall. This may well lead to very many more employers closing their DB schemes to future accruals.
53. Any adverse impact, or perceived adverse impact on an employer will be compensated for by them removing the liability of the DB scheme and thereby making significant savings for the shareholders in the future at the expense of the scheme members' future pension income.

54. Individuals will not have the opportunity of ameliorating any adverse impact without significant expense to them. We have already seen that when DB schemes close contribution rates into DC schemes are insufficient to provide a replacement rate approaching that of the DB scheme.
55. If contracting out of DB is to be abolished then sufficient lead in time must be given for individuals to adjust to the changed circumstances. The Turner Commission recommended that contracting out for DB should be introduced in 2030, which was the time that S2P was originally going to be flat rate. However, if the Government wished to introduce the single tier (Option 2) earlier, then communications will be key to making people understand how the changes will affect them. Meanwhile more must be done to ensure that employers do not renege on their current pension promises.

**Question 9** *In conjunction with the reforms outlined in Chapter 2 are there ways we can change the means-testing system for future pensioners to make it more simple, reduce disincentives and encourage personal responsibility while continuing to help pensioners avoid poverty?*

56. Setting the State pension at a level above the means-test for Pension Credit will be welcomed by many, including the N.F.O.P. It will be important that any indexation method chosen for the State pension and means-tested benefit does not ultimately mean that more and more pensioners are dragged into the means-test.
57. Encouraging personal responsibility will be largely an issue of financial awareness and education from an early age. Individuals should be aware of the consequences of not saving.
58. N.F.O.P accepts that it is very difficult to devise a simple scheme to get money to those who, through no fault of their own, have been unable to save, whilst avoiding paying benefits to those who have chosen not to save. This is the biggest source of bitterness amongst our members. There will always be those just above the means-test threshold who will perceive they have lost out despite having saved all their lives, whilst others who have not saved are better off than they are. This has echoes in the first UK State pension where individuals who were 'guilty of habitual failure to work', were deemed ineligible.

**Question 10** *What mechanism should be used to determine future increases in State Pension age?*

59. There should be no hard and fast rules for setting the State Pension Age. A simple link between future increase in longevity and the State Pension Age is far too crude to deliver fairness. The ability to continue to work past a certain age will be dependent on the nature of the job. Although we are living longer, the physical ability to carry out strenuous work diminishes rapidly for many

past the age of 65, whereas, people in sedentary work will in general be able to work longer.

60. Furthermore ailments associated with old age such as arthritis will strike at the same ages despite increased longevity, making it more difficult for many to continue to work.
61. People over the age of 50 already find it difficult to find work, if made redundant for example. Figures from the Office for National Statistics showed that, although the unemployment rate for the under 50s fell during February to April 2011, that for the over 50s increased. The chances of a person made redundant over 50 years of age of finding another job are small. For many, once out of work, that is it and they become dependent on State benefits. The result of making people wait until they are 70 to get their State pension may well be that more older people will be on a State benefit other than a pension, thus counteracting any saving from increasing the State Pension Age.
62. A balance will also have to be struck between keeping older people in work longer and giving younger people the opportunity to find work. What is worse, paying a pension to an older person or having many younger people unemployed?

**Question 11** *How should the Government respond to the frequent revisions in life expectancy projections while giving individuals sufficient time to prepare?*

63. N.F.O.P believes that 10 years notice of any significant change is the absolute minimum required and then frequent public announcements about any changes to keep the issue in the minds of those affected.