Update number 2016/00151 – January 2016

PROSPECT MYTHBUSTER – THE NEW STATE PENSION

1 Is the state pension changing for existing pensioners in April 2016?

No, the state pension system is being reformed only for those who reach State Pension age from 6 April 2016 onwards. Anyone who reaches State Pension age prior to this date is unaffected and continues to receive state pension in line with the current system of Basic State Pension and Additional State Pension (SERPS and State Second Pension).

This means that the New State Pension will be relevant to men born on or after 6 April 1951 and women born on or after 6 April 1953. You have the right to defer taking your state pension until a later date, but this does not change the date on which you reach State Pension age.

2 Will everyone automatically be better off as a result of the New State Pension?

No. Government's own figures show that expenditure on state pensions is not set to rise or fall immediately due to the reforms. In fact over the longer term government expects expenditure on state pensions to have decreased as a result of the reforms.

3 So everyone will be worse off as a result of the reforms?

No, the mechanism for moving from the current scheme into the new scheme means that no-one should be any worse off straightaway. It all comes down to the transition from the current system into the new system.

4 Are Government taking anything away from me?

Government are not set to take any pension away that has been earned already (with the notable exception of increases to Guaranteed Minimum Pensions which will be affected – see Q11 for more details). A calculation will be carried out in April 2016 to work out your "Starting Amount". This is the amount of state pension you have built up through your National Insurance prior to that date. It will include a deduction if you have ever been contracted out. Your Starting Amount will not be any lower than what you would have built up had no changes been made.

5 But Government are moving the goalposts for what I might build up in the future?

Yes. The way New State Pension builds up from April 2016 is different, and so is the maximum level of New State Pension.

6 What is the maximum entitlement under the new system?

The full New State Pension is worth £155.65 per week. Every year's worth of National Insurance paid (or credited) under the new system adds 1/35th of this amount (i.e. £4.45). So 35 years of payments under the new system would result in a full New State Pension.

For those who are of working age prior to April 2016, these additions will build up on top of your Starting Amount (see Q4).

7 Will Government take pension away from me if my current earned entitlement exceeds the new maximum?

No – if your Starting Amount exceeds the maximum level of New State Pension then any excess will be honoured as a Protected Payment. You will get the higher level of earned state pension, but any National Insurance payments in future will not add any further pension entitlement.

Under the current system a long serving contracted out individual would expect Basic State Pension only, to a maximum of £119.30 per week (in 2016's figures). A long serving contracted-in individual could expect Basic State Pension and Additional State Pension of up to £270 per week.

Under the new system, the maximum entitlement of New State Pension is £155.65 per week.

8 Will all pension be increased in line with the Triple Lock?

The Triple Lock (under which pensions are increased by the best of 2.5%, price inflation and pay rises) is applied to some state pensions.

At present the Basic State Pension increases in line with the Triple Lock, but Additional State Pension is only increased in line with Consumer Price Inflation (CPI).

In the new system, the New State Pension will be increased in line with the Triple Lock; but if you have a Protected Payment in excess of the full amount of the New State Pension, this excess amount will only be increased in line with CPI.

Note that Government can change indexation arrangements, including application of the Triple Lock, at any time.

9 Aren't contracted out workers being unfairly penalised?

Anyone who has ever been contracted out will have a deduction made from their Starting Amount to reflect this. This takes account of the fact that they have paid lower National Insurance than a comparator who has never been contracted out. The deduction should also be offset by income from a private pension scheme (e.g. a workplace pension).

Anyone who is currently contracted out will see their National Insurance contributions rise when this facility ends in April 2016.

However it is important to recognise the new opportunities available to those who have been contracted out. National Insurance contributions in the future will help build towards a higher maximum amount, whereas this may not be the case for someone with a history of being contracted in (see the point on Protected Payments in Q7 above).

10 So there are winners and losers?

Potentially yes, although everyone will be contributing to the same system from April 2016, albeit with a different Starting Amount. The inclusion of transitional arrangements means that some people may have different outcomes to comparators. For example someone with a long contracted out history compared to an identical person who has been contracted in, will see a lower Starting Amount. This means that through future National Insurance payments they will be able to build upon their Starting Amount. Providing that they have the opportunity to make these payments, this is a better position than for someone whose Starting Amount exceeds the maximum level (whose pension entitlement would be frozen and whose future National Insurance payments would not be producing extra pension entitlement).

11 But they are fully protecting what I have already built up?

Not quite. There is a complex historical benefit called Guaranteed Minimum Pension which formed a part of your private/workplace pension if you were contracted out before April 1997. Your private pension scheme will have to follow strict rules on calculating and paying this Guaranteed Minimum Pension. Under these rules Government has been responsible for paying some of the annual increases to the Guaranteed Minimum Pension. They do this by making an adjustment to Additional State Pensions. For those who reach State Pension age from 6 Aril 2016 onwards, there will be no Additional State Pension and so no adjustment. This means that expected "increases" to this Guaranteed Minimum Pension will not be received. To many, this will seem like a removal of a right that has already been built up. Government is not currently inclined to agree with this point of view.

12 Can government change the rules like this?

Yes.

More information is available at
https://www.prospect.org.uk/advice_and_services/pensions_and_retirement/statepensions/index