Simplifying the British national pension is complicated

By Editor Test *Thu, Jan 17, 2013*

Starting in 2017, Britain will switch from a double-tier national pension to a single-tier system. Workers must contribute for at least 10 years to get the minimum benefit. For the maximum benefit, they must contribute for 35 years, up from 30 years.

As Britain prepares to shift from a two-tier national pension system (basic and earnings-related) to a one-tier system in 2017, the government is trying to make the transition as smooth and transparent as possible—and without undermining the remaining private defined benefit plans, according to a report in IPE.com.

The switch to a one-tier system would end "contracting out," by which Britons were encouraged to stop all or part of their contributions to the earnings-related second-tier national pension and directed them into an employer-sponsored plan (DB or DC) or personal retirement plan instead.

In a new Department for Work & Pensions (DWP) white paper on national pension reform, the government acknowledged the financial and administrative impacts of ending "contracting out" and pledged not to undermine DB plans.

Pensions minister Steve Webb told the House of Commons that the current multi-tier system was "extraordinarily complex" and did not allow workers to predict their income in retirement, adding that "the overall cost of the new system will be the same as that of the one it replaces."

After 2017, the earnings-related tier will be gone and the basic national pension will be higher. "This is not a pensions giveaway for the next generation," said Webb. "A higher flat pension is affordable only because, in the long term, people will not become entitled to very large earnings-related pensions through the state system."

His department's accompanying White Paper, 'The single-tier pension: a simple foundation for saving', further outlined how the state second pension would be abolished after 2017 and confirmed a review of the state pension age every five years, starting the same year contracting out would end.

The British Chambers of Commerce said the reforms would simply matters for savers. It would also create a "much-needed incentive" for workers to save privately, said Adam Marshall, the Chamber's director of policy and external affairs.

Marshall said a proposal to allow defined benefit plan sponsors to amend fund accrual in a "limited" fashion to compensate for the loss of the rebates—the money the plans currently get from employees who have contracted out of the second-tier public pension—was "sensible and necessary."

But Zoe Lynch, a partner at the law firm Sackers, disagreed, saying that, "With the abolition of DB contracting out, the intention is to retain the contracted-out rights within the plan," she said. "Plans will therefore be required to retain records and remember the restrictions attached to DB contracted-out benefits."

The industry raised concerns about the end of contracting out ahead of the publication of the White Paper yesterday. Union Unite expressed concern about the override praised by Marshall, noting the "danger" of employers watering down pension provision to "claw back" the increased national insurance cost.

The DWP white paper also described proposals to review the state pension age every five years, with a 10-year notice period before any increase in the eligibility age.

"More frequent reviews would allow the government to respond quickly to changes in life expectancy projections, but would mean clarity for individuals would be reduced," the policy paper said. "In contrast, less frequent reviews could result in the need for large adjustments to State Pension age."

The reform will also introduce a minimum 10-year contribution period to draw the partial state pension and raise the threshold to receive the full state pension, under the reforms a flat-rate sum of £144 ($230) per week in current terms, to 35 years of contributions from the previous 30 years.