Members of the House of Lords
House of Lords
London
SW1A 0PW

18 December 2013

Dear Colleague,

Pensions Bill 2013/14 - Grand Committee

During our first Grand Committee session of the Pensions Bill on Monday, I undertook to write to noble Lords on a number of more technical points. I have outlined the information requested below and hope that it is helpful.

Cost of paying single tier to current pensioners

Firstly, there was some discussion of the £10 billion cost of paying the full rate of single-tier pension to all current pensioners. Although I clarified at the time that this figure is a per annum cost in 2016, I thought I would be helpful to share some further information on this point.

DWP published some analysis in April 2011, which can be found here: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/223172/cost_140_a_week_state_pension.pdf. This shows that the costs fall fairly slowly over the first 5 years as the number of surviving pensioners who reached State Pension age before 2016 falls over time. The methodology is explained in the note but, briefly, the costing was done on the basis of increasing gross state pension (i.e. before a contracted-out deduction has been made) to the full single tier rate in 2016. Estimated savings from income related benefits are then netted off. An alternative method, to pay a net state pension equivalent to all current pensioners, would have a far higher cost as it would ignore past periods of contracting out. We have not repeated this analysis recently as the costs of this policy would be prohibitive.
Single tier Impact Assessment

I agreed to clarify that we use net state pension figures (i.e. the amount received after making the contracted-out deduction) in the Impact Assessment and why we have chosen to do so. As I said in Committee, the figures are net. In the Impact Assessment, we assess state pension outcomes in net terms because that is the amount of pension that individuals will receive from the DWP and is the basis on which their foundation amounts will be calculated. This is therefore the most relevant comparison when considering people’s state pension outcomes.

Savings Credit

There was also discussion of the way that Savings Credit element of Pension Credit is calculated, which was based on the assumption that the upper level of entitlement to the Savings Credit is uprated annually by price inflation, whereas the Guarantee Credit level is uprated by earnings, and therefore that the Savings Credit amount would be eroded over time.

However, I would like to clarify that the Savings Credit is an amount of benefit awarded on top of someone’s entitlement to the Guarantee Credit. It is this amount (£18.06 for an individual and £22.89 for a couple in 2013/14 rates), which is calculated with reference to 60% of the gap between the Savings Credit threshold and the Standard Minimum Guarantee, that is reviewed against and uprated in line with prices, regardless of the rate at which the level of the Guarantee Credit increases.

However, uprating policy is discretionary and forms part of the Secretary of State’s annual review. It is worth noting that, in order to protect the increase in the basic State Pension for the poorest pensioners and increase the Standard Minimum Guarantee by the same cash value as the basic State Pension, the Savings Credit maximum has not been increased in recent up-rating exercises. This has allowed us to target Pension Credit expenditure on the poorest pensioners, to ensure they benefit from the triple lock policy for the basic State Pension. Nevertheless, all pensioners have still seen an overall cash increase in their net income from uprating in each year of this Parliament as a result of the triple lock on the basic State Pension.

However, the longer term policy remains unchanged, and the Savings Credit maximum will be reviewed against the increase in CPI as part of the annual up-rating exercise.

Access to Guarantee Credit before men’s State Pension age

The fact that the qualifying age for the Guarantee Credit element of Pension Credit is rising in line with women’s State Pension age was also raised, with the suggestion that the savings from this measure could be recycled into funding the inclusion of the cohort of women born 6 April
1951 - 5 April 1953 into single tier. Currently, the number of men aged below 65 on Pension Credit represents approximately 18% of the entire male Pension Credit case load and just under 10% of the entire male population aged between 60 and 64.

The equalisation of State Pension Age and associated impacts on State Pension and means-tested benefits formed part of the Pensions Act 1995. Pension Credit was introduced at a later date but departmental forecasts of expenditure have always taken into account these impacts, so there are no new savings which can be used elsewhere. The numbers of men aged 60-64 receiving Guarantee Credit is falling as a result of these rules. We have not quantified the impact, but it should also be noted that a number of these men may be receiving working age benefits instead, which would offset some of the savings in Pension Credit.

Women born April 1951 – April 1953

I said that I would also write to clarify some of the analysis in our published paper, *The cohort of women born between 6 April 1951 and 5 April 1953*, which sets out much of the analysis of the state pension position of women born between these dates.¹

**Analysis**

90% will be better off over the course of their life, in comparison to if they had State Pension age 65 and a single-tier pension

Our analysis shows that approximately 90% of the women in this cohort² would receive more in lifetime state pension and other benefits under the current system than they would if they had a State Pension age of 65 and received a single-tier pension. This statistic includes state pension and other benefits, including Savings Credit.

This 90% statistic arises because the women in this group are able to draw a pension up to 4 years earlier than a man born the same day. The lifetime total as a result of drawing a pension under the current system at a State Pension age between 61 and 63, outweighs any higher state pension entitlement and other benefit that 90% of this cohort of women may be entitled to under the single tier system, if we were to give them a single-tier pension at age 65.

The analysis does not, as was suggested at Committee, factor in the differentials in longevity between men and women.³ Rather, the analysis is done on the basis of comparing an individual:

¹ Available on gov.uk: 
² i.e. women born between 6 April 1951 and 5 April 1953, who will reach pension age between 6 May 2012 and 6 March 2016
³ Although for illustration, in 2013 a woman reaching 65 is projected to live for another 24.0 years, compared to a man's 21.4 years. A woman towards the start of the 51/53 cohort, reaching State
- Drawing a state pension based on current system rules at legislated State Pension age (between 61 and 63) + other benefits received over the course of retirement; **versus**
- Drawing a state pension based on single-tier rules at age 65 + other benefits received over the course of retirement.

In both instances, the individual in question has the same National Insurance record.

**Women in this group can receive between £13,000 and £26,000, on average, between their SPa and their male twin’s SPa**

The women in this cohort can draw their pension between 2 and 4 years before their male twin, and their median state pension entitlement is projected to be £125 per week. The following calculations demonstrate how we have deduced the £13,000 - £26,000 range:

£125 per week x 52 weeks x 2 years = £13,000  
£125 per week x 52 weeks x 4 years = £26,000

Note that these calculations **do not** include other benefits which these individuals may be eligible for, including Savings Credit. Rather, they are purely on state pension terms.

**The median projected entitlement for this group is £125 per week in the current system, and £131 per week if we valued their National Insurance records under single-tier rules**

As outlined above, the median valuation under the existing system is about £125 per week. When valued under the single tier, the median valuation is about £131 per week. The median would rise by about £6 per week, but this does **not** mean that everybody would be about £6 better off per week. Indeed, around half of the people in the cohort would see no difference in their entitlement, compared to the current system.

The table below shows an illustration of how the median can change, despite many people seeing no change:

<table>
<thead>
<tr>
<th>Valuation</th>
<th>Person A</th>
<th>Person B</th>
<th>Person C</th>
<th>Person D</th>
<th>Person E</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current system</strong></td>
<td>£115</td>
<td>£123</td>
<td>£125</td>
<td>£134</td>
<td>£137</td>
</tr>
<tr>
<td><strong>Single tier</strong></td>
<td>£115</td>
<td>£118</td>
<td>£131</td>
<td>£134</td>
<td>£137</td>
</tr>
<tr>
<td><strong>difference</strong></td>
<td>+£0</td>
<td>-£5</td>
<td>+£6</td>
<td>+£0</td>
<td>+£0</td>
</tr>
</tbody>
</table>

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Pension age 61 in 2012, can expect to spend 27.7 years drawing a pension. It is also the case that, based on the latest data we have, women in the lowest socio-economic class are projected to live for about the same amount of time as men in the highest socio-economic class.
In this example, Person C has seen a change in +£6 and B a change of -£5, but the rest have seen no change when their National Insurance records are valued using single-tier rules.

As the Impact Assessment, Chart 3.1 shows, most people reaching pension age in 2016/17 are projected to receive the same in state pension that they would have received under the existing system.

**Differences between the 1953-1960 cohort, and the 1951-1953 cohort**
The question of how, if most women will be better off in the single tier, 90% of the women in this cohort are better off in the current system also came up in Committee. The answer lies in the differential in State Pension ages. The assertion that 90% of individuals would be better off rests on the basis that they would be better off compared to the counterfactual that they had a State Pension age of 65 and receive a single tier pension.

It is not that the 51/53 cohort are materially different from the 53/60 cohort in any terms other than their State Pension age. The benefit of having a relatively lower State Pension age outweighs, for the majority, the advantage of receiving a potentially slightly higher single-tier pension at a relatively higher age.

**Costs of including individuals in single tier**
Noble Lords also queried how much it would cost to put individuals in this group in single tier (without giving them a choice). We have not estimated the costs of such an option. However, if people were allowed to opt in to single tier, and were to make the optimal decision for them, then the cost would be:

- A total of £4.5bn over the first 20 years of single tier;
- Peak costs of £300m, in the mid-2030s.

Were we to undertake costings of including everyone, the total costs would be less than those shown above, because some people would receive lower pensions because, for example, they would not be able to make use of the derived entitlement provisions or draw Savings Credit. Including these people in single tier would also necessarily change the inherited additional State Pension provisions that are applicable for many people.5

Considering that almost half of the women in the 51/53 cohort have already reached pension age, and are likely to be drawing their pension, to transfer people onto the new system would entail changes to pensions already in payment. This would mean withdrawing pensions in their

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5 We have outlined the provisions for inherited additional State Pension in the Peer’s Information Pack. In summary, in cases where both parties to a marriage / civil partnership are in the single tier, only amounts above the full rate (i.e.: the Protected Payment) may be inherited by the surviving party. In a mixed age couple, the survivor may inherit the relevant proportion of SERPS/S2P which the deceased had built up in the current system up to 2016.
entirety for individuals with fewer qualifying years than required by the minimum qualifying period, and entirely or in part for those who are currently making use of the derived entitlement provisions, for example.

**Proportions of individuals in the 51/53 cohort making use of the derived entitlement provisions**

We have already published estimates of the proportion of individuals expected to receive less under single tier as a result of the removal of derived entitlement in a statistical paper. We estimate that about 3% of men and 6% of women reaching State Pension age in the first 4 years of the new system will receive less in state pension at some point in their lives, as a result of removing the derived entitlement provisions.

We expect the National Insurance records of people reaching pension age shortly before single tier to be roughly the same as those people reaching pension age shortly after single tier. We would therefore expect that about 6% of the women in the 51/53 cohort would receive less in state pension at some point in their life, if we were to include them in single tier, due to the removal of derived entitlement. Conversely, this implies that we would expect about 6% of this cohort are expected to make use of the derived entitlement provisions under the current system.

Yours sincerely,

[Signature]

Lord Freud

Minister for Welfare Reform

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