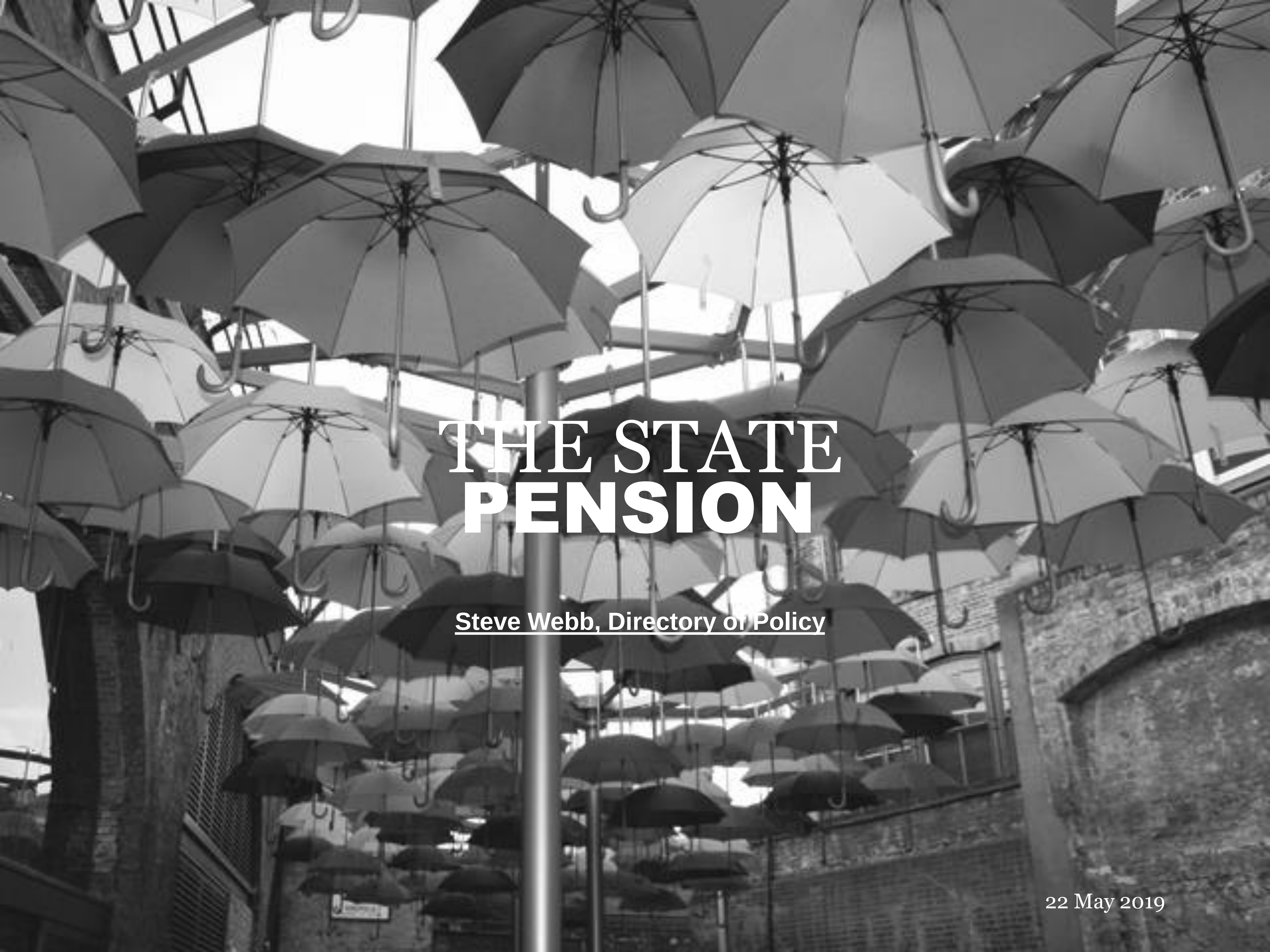

THE STATE PENSION

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LEARNING **OBJECTIVES**

- Topping up your state pension via voluntary National Insurance (NI).
  - who can do it, should they do it and how do they do it?
- The moving state pension age.
  - when will you get your state pension and how might this change?
- Deferring your state pension.
  - what do you get, when can you do it and is it a good idea?
- How to read a state pension statement.

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TOPPING UP YOUR STATE PENSION
PEOPLE ON THE OLD SYSTEM

- This section relates to those covered by the 'old' state pension system, that is, who reached state pension age (SPA) before 6th April 2016 - this is men born before 6th April 1951 and women born before 6th April 1953.

- These individuals may be able to pay voluntary National Insurance Contributions (NICs) if they have gaps in their NI record in the last six years but only where they were under SPA for the whole year – in effect this means 2013/14 and 2014/15 (assuming they reached SPA during 15/16).

- Voluntary NICs only count towards the basic state pension, for this group a full basic pension is payable for 30 qualifying years - only worth paying for those who have less than 30 qualifying years.

- Class 3 voluntary NICs cost £15 per week, but those who were self-employed during the year(s) in question may be able to fill the gap more cheaply by paying Class 2 NICs.

TOPPING UP YOUR STATE PENSION
PEOPLE ON THE NEW SYSTEM

- This section relates to those covered by the 'new' state pension system - who reached state pension age (SPA) after 5th April 2016. This is men born after 5th April 1951 and women born after 5th April 1953.

- The calculation of the new state pension is in two parts:
  - Evaluation of a 'starting amount' as at 6th April 2016.
  - The addition of years of contributions from 2016/17 onwards.

NEW STATE PENSION
STEP ONE

Calculating the 2016 'starting amount'

- As part of the transition to the new state pension, the 2016 starting amount is the *higher* of two figures:
  - The amount built up based on the client's own NI record under the old rules – a full basic pension for 30 years plus any SERPS pension, and
  - The amount built up under the new rules – a full 'flat rate' pension for 35 years minus a (potentially large) deduction for past 'contracting out'.

- People who were extensively contracted out will often find that their starting amount reflects the old rules - this will reduce the potential attractiveness of buying back years prior to April 2016.

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NEW STATE PENSION
STEP TWO

Taking account of years from 2016/17 onwards

- If the 2016 starting amount is *in excess of* the full flat rate, no further accrual is possible, (any excess is called a ‘protected payment’ and has its own rules for indexation and inheritance).

- If the 2016 starting amount is *less than* the full flat rate, any qualifying years from 2016/17 onwards add 1/35 of the full flat rate to the 2016 starting amount, this process continues until the full flat rate is reached.

TOPPING UP YEARS
BEFORE 2016/2017

Why the starting amount calculation matters

Freda has 32 qualifying years and a gap in her NI record for 2015/16 – should she top up?

Option 1

Suppose Freda’s 2016 starting amount is based on the old rules – a full basic pension for 30 years and any SERPS on top - in this case topping up for 2015/16 is of *no value* - she already has the maximum years needed for a full basic pension.

Option 2

Suppose her 2016 starting amount is based on the new rules – a flat rate pension for 35 years minus a deduction for contracting out - she can increase her starting amount to 33/35 of the full rate (minus contracting out deduction) by paying an extra year.

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IS TOPPING UP GOOD **VALUE FOR MONEY?**

- The normal rate for voluntary NICs is £15 per week or £780 for a year (the previous two financial years can be bought back at the 'going rate' for those years, but all other years are now charged at the current rate), years where the client has made some NI contributions may be cheaper to fill.
- In general one extra year will buy 1/35 of full flat rate pension – this is £168.60/35 or £4.82 per week or around £250 per year on the pension. Even allowing for basic rate income tax, this suggests that the £780 outlay will be recouped within four years.
- Need to check for interaction with any other benefits, particularly means-tested benefit such as pension credit, housing benefit, help with council tax etc.
- Worth maxing out on available NI credits first, especially for carers/grandparents etc.

Detailed Royal London guide (with flow-charts) can be found at www.royallondon.com/goodwithyourmoney

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WHEN WILL YOU GET **YOUR STATE PENSION?**

- State pension age for men and women has been equalised and is now being gradually increased. Individuals can check their state pension age at www.gov.uk/state-pension-age
- SPA due to reach 66 in Autumn 2020, remains at 66 until Spring 2026, then phased up from 66 to 67 between Spring 2026 and Spring 2028.
- Current legislation says age 68 will be reached in 2046, but government plans to bring forward. ‘Cridland’ review recommended moving to age 68 between 2037 and 2039, but latest longevity forecasts may imply slightly later.

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INCREASES BEYOND 68
MORE AGGRESSIVE TIMETABLES

- Current legislation does not give dates for increase to age 69 or beyond.
- Government goal is for adults to spend roughly two thirds of their adult life ‘in work’ and ‘up to one third’ in retirement (i.e. over state pension age).
- Cridland review suggested that age 69 could be implemented between 2053 and 2055 - those born after 1986 (who are now 33 or younger) would therefore have a pension age of at least 69.
- The Cridland review looks at a more aggressive schedule (no doubt recommended by HM Treasury!), where we spend 32% of our lives in retirement - this would produce an SPA of 68 by 2030, 69 by 2042 and 70 by 2056.
- Pension age schedule has to be reviewed every five years - policy is not to change SPA for those within ten years of pension age.

DEFERRING YOUR **STATE PENSION**

- There is no obligation to take state pension at state pension age – an active claim has to be made, and if no claim is made, pension is deferred.

- Those reaching SPA before 6th April 2016 benefited from generous deferral terms and more options:

  - Extra 10.4% on pension for each year of deferral.

  or

  - Take deferred pension as a lump sum (plus interest) when pension finally drawn.

- Under new state pension - no lump sum option. Deferral increase is 5.8% per year – designed to be 'actuarially neutral'.

- Those already receiving state pension can 'un-retire' – ask DWP to cease payment – and this will start to trigger increments for deferral.

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ISSUES FOR THOSE **CONSIDERING DEFERRAL**

- Those working past SPA and drawing state pension on top may pay unnecessary tax on their state pension, deferring one year and then drawing enhanced state pension can leave typical man more than £3,000 better off and typical woman more than £4,000 better off[1].

- Alternative would be to take state pension and invest in a private pension until ready to retire.

- Deferral less attractive for those with lower life expectancies/those further through retirement (increment rate does not increase with age).

- Need to check interaction with other benefits:

  - Cannot receive 'overlapping ' benefits (such as carers allowance) during deferral period.

  - Cannot claim extra means-tested benefits to make up for loss of state pension during deferral.

[1]See Royal London policy paper 33: www.royallondon.com/policy-papers

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HOW TO READ A **STATE PENSION STATEMENT**

Online state pension statements provide full details of NI record plus a state pension forecast on two bases:

- State pension accrued to date (though will not always reflect most recent year of NI contributions).
- Potential ‘maximum’ state pension with full record of qualifying years up to state pension age.

Those who were contracted out may see a COPE – a ‘contracted out pension equivalent’ figure – this is the government’s way of explaining why people who were contracted out may not be getting a full pension.

- The COPE figure is an ‘aide memoire’ – the pension forecast figure already takes account of contracting out, so no additional calculations are needed.
- The COPE figure may be much larger than the contracted out pension which someone expects to receive, particularly from a money purchase arrangement.

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LEARNING **OUTCOMES**

An understanding of:

- How the new state pension is calculated.
- Who can top up their state pension through voluntary NI and when this does and does not make sense.
- The government’s latest thinking on state pension age changes.
- How state pension deferral works under the new system.
- State pension statements.

IMPORTANT **INFORMATION**

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THANK YOU