The new flat-rate state pension

March 2013

The government has announced details of its proposal to replace the basic state pension and all additional state pensions with a simplified flat-rate state pension.

The new flat rate pension of £144 a week (£7,488 a year) will be paid from 2016 and removes the complexity in today's means-tested state pension system. The change involves merging the state second pension with the basic state pension to create one flat-rate payment.

The proposed pension of £144 per week is an increase on the current full state pension of £107.45 per week. Although, it is worth noting that the state pension can be topped up to £142.70 with the means-tested pension credit and a state second pension, which is based on National Insurance (NI) contributions.

Under the new flat rate system, individuals who either work, have been claiming unemployment benefits, have been looking after children aged 12 or under, or caring for sick or disabled adults for 35 years will receive a fixed pension of £144 a week when they reach state pension age. The amount will be lower if they have fewer qualifying years. However, it will be updated each year in line with earnings, prices or 2.5%, whichever is higher.

The state pension age is rising to 66 for both men and women by 2020, with further plans for this to increase to 67 between 2026 and 2028. The government has stated that it would like to see a review of the state pension age every five years, starting in the next parliament.

Pension credits will continue, but only to provide those ineligible for the new pension with a safety net.

Anyone who qualifies for the state pension before April 2016 will continue to receive their entitlement under the current system.

People retiring after April 2016 will have to work longer by accruing 35 years' worth of NI contributions, rather than the current 30, to qualify for the full pension. Anyone who has not paid NI for at least seven, or possibly even ten years, will not qualify for the new state pension at all.

There will be winners and losers.

Winners include:

- Self-employed individuals, as they cannot currently build up a state second pension.
- Those who have spent time out of work, such as mothers and carers.

Losers include:

- Many starting work now, as they likely to receive less than they would have done under the old system.
- Those with less than seven, or possibly even ten, years of NI contributions will get no state pension under the new rules.

The changes remove the state second pension and therefore ‘contracting out’. Members of final-salary pension schemes in both the private and public sector pay lower NI contributions but receive no state second pension.

From April 2016, employees in these schemes will have to pay 1.4% more in NI contributions on relevant earnings on which NI is levied.

However, to reflect their lower NI contributions made prior to April 2016, these workers will initially be eligible only to receive a reduced version of the single-tier pension when they eventually retire. But between April 2016 and retirement, their new, higher, NI contributions will see them accrue more of the new flat rate pension, up to the maximum of £144.

Employers also pay lower NI contributions for pension schemes that are opted-out of the state second pension. From 2016, these employers will also have to pay higher NI, amounting to 3.4% of their employees' relevant earnings. To offset this, employers will be allowed to reduce their employees' pension benefits, or put up their members' contributions.

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