EXPLANATORY MEMORANDUM TO THE SOCIAL SECURITY (DEFERRAL OF RETIREMENT PENSIONS) REGULATIONS 2005

2005 No. 453

1. This Explanatory Memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. **Description**

   2.1 The Pensions Act 2004 introduces a new option of a lump sum payment for people who defer claiming their State Pension for at least 12 months as an alternative to an increase ("increments") to the weekly pension. The Act also brings forward changes that were originally due to take effect in 2010 to increase the rate at which increments are calculated and remove the time limits for deferral. These provisions will come into force on 6th April 2005.

   2.2 These Regulations:

   (i) make provision relating to the accrual and calculation of lump sums; and
   (ii) amend existing regulations relating to the calculation of increments, time limits for deferral and the manner in which a person is allowed to stop claiming his State Pension in order to build up entitlement to increments or a lump sum payment.

3. **Matters of special interest to the Joint Committee on Statutory Instruments**

   3.1 None.

4. **Legislative Background**

   4.1 The legislation which allows for entitlement to the State Pension to be deferred and for the calculation of increments is to be found in sections 54 and 55 of, and Schedule 5 to, the Social Security Contributions and Benefits Act 1992 (c.4) ("the Contributions and Benefits Act"). Under these provisions, a person who defers his State Pension accrues increments according to a formula which earns an increase to the weekly pension, when finally claimed, equal to 1% extra for every seven weeks of deferral (approximately 7.5% extra, for each year deferred). The amount of increments a person may earn is capped by provisions which limit accrual to a maximum of five years. The Pensions Act 1995 amended these provisions with effect from April 2010 to increase the accrual rate to the equivalent of 1% for every five weeks (or 10.4% a year) and to remove the five-year time limit.

Section 297, of and Schedule 11 to, the Pensions Act 2004 (c.35) both substitutes section 55 and amends Schedule 5 to give effect to the changes summarised in paragraph 2.1 above.

4.2 Currently, regulations specify, among other things, how increments are to be calculated when the pension rate changes during deferment, which days within the deferment period are to be counted as days that earn increments and the circumstances in which a person may elect to give up his State Pension temporarily (or "de-retire") in order to be entitled to an increased weekly pension when he re-claims. [1] This Instrument amends these regulations to reflect the bringing forward the higher incremental accrual rate and the removal of the time limits. Amendments to these regulations also allow for a consistent approach to the calculation of increments where an increase of benefit is in payment to another person in respect of the deferrer and for the removal of the requirement that notice of "de-retirement" must be made in writing.

4.3 This Instrument also makes provision using new regulation-making powers in Schedule 5 to the Contributions and Benefits Act as amended by Schedule 11 to the Pensions Act 2004. This is the first use of these powers. The regulations specify what is to be treated as the "accrual period" for the lump sum calculation. They also ensure that common rules apply in determining what is to count as deferred pension for both lump sums and increments.

4.4 This Instrument is one of four sets of negative regulations that are required to underpin the new deferral arrangements with effect from April 2005. The other Instruments are:

(i) The Social Security (Claims and Payments) Amendment Regulations 2005;
(ii) The Social Security (Retirement Pensions etc.) (Transitional Provisions) Regulations 2005; and
(iii) The Social Security (Graduated Retirement Benefit) Regulations 2005.

5. Extent

5.1 This instrument applies to Great Britain. Equivalent provision will be made for Northern Ireland by statutory rules.

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[1] The Social Security (Widow's Benefit and Retirement Benefit) Regulations 1979 – referred to in this Memorandum as the "Widow's Benefit etc". regulations.

6. **European Convention on Human Rights**

6.1 Not applicable.

7. **Policy background**

7.1 Following the amendments made by the Pensions Act 2004, from April 2005, people who defer their State Pension for at least 12 months will have the choice of either a lump sum based on pension foregone plus interest or increments calculated at a higher rate, equivalent to 1% for every five weeks (10.4% for each year) a person defers. There will no longer be an upper limit on how long a person may defer to earn additional pension (either by way of increments, or a lump sum plus interest). These proposals were included in the Government December 2002 Green Paper "Simplicity, Security and Choice: Working and Saving for Retirement" (Cm 5677).

Regulations 2 and 3: accrual and calculation of the lump sum

7.2 The lump sum will be based on the amount of pension a person would have been entitled to for each week, or "accrual period", that he defers his claim. Once a person has claimed his pension, the day of the week that will be his State Pension payday is determined by regulations [2]. In order to ensure that the lump sum is calculated for exactly the same period as the weekly pension would have been calculated if the person had claimed his pension rather than deferred entitlement to it, regulation 2 of these Regulations provides, in effect, that the same day of the week is to be treated as a person's pension payday while his State Pension is deferred.

7.3 Regulation 3 provides that the pension deferred in a given "accrual period" or part-period is not included in the lump sum where particular circumstances apply. These are: i) where another benefit that overlaps with State Pension had been paid to the deferrer, or ii) an increase in such a benefit had been paid to another person for the deferrer, or iii) the deferrer would have been disqualified for payment of his State Pension because of imprisonment. These provisions correspond to those that apply to the calculation of increments and will ensure that deferred pension means the same for both the lump sum and increments (see paragraphs 7.5 and 7.6 below).

[2] Regulation 22(3) of, and Schedule 5 to, the Social Security (Claims and Payments) Regulations 1987 (S.I. 1987/1968)

Regulation 4: Amendments to the Widow's Benefit etc regulations

7.4 Under the current rules for calculating increments, a person does not accrue increments for any period for which he receives another benefit while he is deferring his State Pension, if that other benefit would have been reduced or extinguished under overlapping benefit rules had he been receiving his State Pension. The underlying principle is to prevent a person earning an enhancement to their pension while drawing another benefit that would otherwise have not been payable. [3]

7.5 Under the overlapping benefit rules, the same principle of preventing double provision applies where a person claims an increase to a benefit for another adult – that is, if the person for whom the increase is claimed is receiving State Pension, that increase is reduced by the amount of the State Pension. However, this principle is only partially reflected in the rules for calculating increments currently. Although a married woman who is deferring a pension based on her husband's National Insurance contributions (a "Category B" pension) is excluded from earning increments if her husband is claiming such an increase for her, the rules do not apply in relation to any other case where a dependency increase is in payment. This means that, for example a married woman deferring a pension based on her *own* contributions (a "Category A" pension) may earn increments while her husband is getting an increase for her. The amendment to these regulations is intended to rectify what now appears to be an anomalous position, by extending the current provision so as to prevent accrual in all cases where the dependency addition would have been abated had the deferrer been claiming his or her State Pension. This change will however only apply in relation to those who start to defer their State Pension on or after the date the regulations come into force – those already deferring will not be affected.

7.6 Other amendments made by regulation 4 are consequential changes to replace references to the current increment accrual rate with references to the new rate that applies from 6 April 2005 and to remove the time limits restricting how long entitlement to state pension can be deferred.

7.7 Regulation 4 of this Instrument also amends regulation 2 to the Widow's Benefit etc. regulations. Regulation 2 prescribes the circumstances and the manner in which a person may elect to stop claiming his State Pension to earn increments (or a lump sum). Among other conditions, it requires notice of such election to be given in writing, and, where the would-be deferrer is a married man whose wife

[3] The benefits which can overlap with State Pension under these rules – and hence affect entitlement to increments - are Carer's Allowance, short-term Incapacity Benefit, Severe Disablement Allowance, Widow's Pension, Widowed Mother's Allowance and Unemployability Supplement (payable under the Industrial Injuries or War Pensions schemes, to people who are severely disabled). A person who defers their State Pension while claiming Pension Credit is not precluded from accruing increments under these rules. However their Pension Credit is worked out taking into account the State Pension the person is not claiming.

is entitled to a Category B pension based on his contributions, her consent must also be given in writing (her consent is required because the effect of the husband cancelling his entitlement to his pension is that her Category B pension entitlement ceases as well.) These amendments will allow notice to be given orally as well as in writing. These changes are in line with other recent proposals designed to modernise the way in which the Department provides services to its customers by allowing benefit claims and reports of changes in circumstances to be made orally.

7.8 The proposals contained in these regulations were considered by the Social Security Advisory Committee on 2nd February 2005. The Committee was content with the proposals and agreed not to consult on them.

8. Impact

8.1 A Regulatory Impact assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.

8.2 The public sector impact comprises administration and programme costs. It is not possible to disaggregate the cost of the proposals contained in these Regulations from the overall costs of the new deferral arrangements introduced by the Pensions Act 2004. The set-up costs are estimated at around £7 million, and include the cost of new technology to support the calculation of the lump sum option. It is anticipated that the changes will not result in the need for additional staff. The overall programme costs in the first three years ending March 2008 are estimated at £10m/£25m/£60, peaking at £115m in 2010/11 and declining in the long term.

9. Contact

Helen Gadd at the Department for Work and Pensions can answer any queries regarding the instrument. Tel: 020 7712 2569 or e-mail: Helen.Gadd@dwp.gsi.gov.uk.