# EXPLANATORY MEMORANDUM TO THE SOCIAL SECURITY (GRADUATED RETIREMENT BENEFIT) REGULATIONS 2005

**2005 No. 454**

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

This memorandum contains information for the Joint Committee on Statutory Instruments.

## 2. Description

2.1 The Pensions Act 2004 (c.35)("the Pensions Act") introduces a new option of a lump sum payment for people who defer their entitlement to their State Pension for at least twelve months, as an alternative to an increased weekly pension (or "increments"). That 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.

2.2 These Regulations effectively replicate the new arrangements applying to those who are deferring entitlement to State Pension, including arrangements made in regulations[1], for those who are deferring entitlement to Graduated Retirement Benefit.

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

3.1 These Regulations replace and extend respectively sections 36(4) and 37 of the National Insurance Act 1965 (c.51)("the 1965 Act"), which continue in force by virtue of paragraph 7 of Part 1 of Schedule 3 to the Social Security (Consequential Provisions) Act 1975 (c.18) in order that rights to benefit under the 1965 Act are preserved. These Regulations are made under powers contained in section 62 of the Social Security Contributions and Benefits Act 1992 (c.4) ("the Benefits Act"), as amended by paragraph 17 of Schedule 11 to the Pensions Act 2004 (the "Pensions Act") which allow sections 36 and 37, so long as they continue in force, to be replaced and extended for certain purposes.The draft Regulations were therefore referred to Parliamentary Counsel and the drafting incorporates their comments.

## 4. Legislative Background

[1] The Social Security (Deferral of Retirement Pensions) Regulations 2005 and the Social Security (Retirement Pensions etc.) (Transitional Provisions) Regulations 2005

4.1 Graduated Retirement Benefit (GRB) is an increase in the weekly rate of a Category A or B retirement pension (payable under sections 44 to 51 of the Benefits Act). It is based on the amount of graduated contributions paid by an employee between 1961 and 1975 prior to the winding up of the scheme. Owing to its ‘preserved nature’ GRB continues to be payable by virtue of sections 36 and 37 of the 1965 Act as continued in force. The current form of sections 36 and 37 is to be found in the Social Security (Graduated Retirement Benefit) (No.2) Regulations 1978 (S.I.1978/393) (the “GRB No.2 Regulations”).

4.2 Since 1979, the arrangements under which entitlement to GRB can be deferred have mirrored those which apply to State Pension generally. Section 62 of the Benefits Act now allows for specific aspects of the provisions of sections 36 and 37 of the 1965 Act to be amended by regulations, in particular for replacing section 36(4) of the 1965 Act (increase of GRB in cases of deferred retirement) with provisions corresponding to those of Schedule 5 to the Benefits Act which relate to deferral of entitlement to retirement pension.

4.3 Section 36(7) of the 1965 Act as continued in force by Schedule 1 to the GRB No.2 Regulations provides that a person who is entitled to GRB but not entitled to a Category A or B retirement pension, is to be treated as receiving retirement pension at a nominal weekly rate in order that GRB can be paid.

4.4 The legislation which allows for entitlement to the State Pension to be deferred and for the calculation of increments is to be found in section 55 of, and Schedule 5 to, the Benefits Act. Section 297 of, and Schedule 11 to, the Pensions Act amend these provisions to give effect to the changes summarised in paragraph 2.1 above.

4.5 The new provisions take effect from 6 April 2005. Section 62 of the Benefits Act was amended by paragraphs 16 and 17 of Schedule 11 to the Pensions Act to extend the scope of the regulation making power in that section to allow changes to be made to the deferral arrangements for GRB which correspond to those made by that Act. This is the first use of the new powers.

4.6 In these Regulations-

a) Regulations 2 and 3 amend respectively section 36(4) of the 1965 Act as continued in force by Schedule 1 to the GRB No. 2 Regulations and Schedule 2 to those Regulations (provisions replacing section 36(4) of the National Insurance Act 1965).

b) Regulation 4 and Schedule 1 replace in part section 36(4) of the 1965 Act. Schedule 1 is divided into three parts:

Part 1 deals with cases where a person has underlying entitlement to both State Pension and GRB;

Part 2 deals with cases where a person has underlying entitlement to GRB only; and

Part 3 makes supplementary provision.

c) Regulation 5 and Schedule 2 make transitional provision in respect of cases where a person is deferring entitlement to his GRB and the period of deferment spans the date of the introduction of the new arrangements.

4.7 This Instrument is one of four sets of regulations to be passed by the negative resolution procedure that are required to underpin the new deferral arrangements with effect from April 2005. The other Instruments are:
(i) The Social Security (Deferral of Retirement Pensions) Regulations 2005;
(ii) The Social Security (Retirement Pensions etc.) (Transitional Provisions) Regulations 2005; and
(iii) The Social Security (Claims and Payments) Amendment Regulations 2005.

## 5. Extent

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

## 6. European Convention on Human Rights

6.1 The Minister of State for Pensions, Mr Malcolm Wicks, has made the following statement regarding Human Rights:

In my view, the provisions of the Social Security (Graduated Retirement Benefit) Regulations 2005 are compatible with the Convention rights.

## 7. Policy background

7.1 The GRB scheme was introduced in 1959 and provided the first earnings-related addition to State Pension. The scheme was wound up in 1975 and replaced by the State Earnings Related Pension Scheme (SERPS) from 1978. Entitlement to GRB is based on graduated National Insurance contributions paid between April 1961 and April 1975.

7.2 Since 1979, the arrangements for people who defer their GRB have mirrored those which apply to State Pension generally. These Regulations maintain that principle in relation to the changes to the arrangements made by the Pensions Act and underpinning secondary legislation.

7.3 A person's entitlement to GRB is claimed along with their State Pension. A person cannot claim GRB while deferring State Pension or vice versa. People who defer their GRB currently, whether by not claiming it on reaching State Pension age or by electing to stop claiming it, receive an increased benefit when they finally claim. This increase is calculated according to a formula that entitles the person to an increment of $1/7^{th}$% of his weekly rate of GRB for each "incremental period" (effectively a week) that he defers.

7.4 In line with the amendments made by the Pensions Act, these Regulations provide that from April 2005, people who defer their GRB entitlement will have the choice of either a lump sum or increments calculated under a more generous formula.

7.5 The choice of either a lump sum or increments will be available to those who defer entitlement for at least twelve months, from 6 April 2005. However, where a person has deferred both State Pension and GRB, paragraph 2 of Schedule 1 to these Regulations provides that their choice between a lump sum and increments for deferred State Pension will also apply to GRB because, although owing to its 'preserved rights' nature, GRB is legislated for separately, it is nevertheless part of a person's State Pension entitlement. In addition to providing for a choice between a lump sum and increments where only GRB is deferred, Paragraph 12 makes provision corresponding to that at paragraph A1(2) and (3) of Schedule 5 to the Benefits Act to deem a person to have chosen a lump sum if a choice is not made within a prescribed period and to provide for the original choice (including a deemed choice) to be reversed in prescribed circumstances. The relevant Regulations are required from April 2006 and will be brought forward in due course.

7.6 Paragraphs 4 and 14 of Schedule 1 to these Regulations provide for an increment of $1/5^{th}$% of the weekly rate of GRB each incremental period (equivalent to 10.4% for each year) in line with the provisions of Schedule 5 to the Benefits Act.

7.7 Paragraphs 6 and 16 of Schedule 1 to these Regulations mirror paragraph 3B of Schedule 5 to the Benefits Act by providing for the lump sum to be calculated on the basis of the GRB foregone plus compound weekly interest equivalent to an annual rate 2% above the Bank of England base rate.

7.8 In order to maintain parity with the deferral arrangements for State Pension, the calculation of either increments or a lump sum on deferred GRB is subject to the provisions of the Social Security (Widow's Benefit and Retirement Pensions) Regulations 1979 (S.I.1979/642) and to the Social Security (Deferral of Retirement Pensions) Regulations

2005. In essence the application of these provisions prevent increments or a lump sum from accruing in respect of periods for which, had GRB been claimed, it would not have been payable because the person was receiving another benefit or serving a term of imprisonment.

7.9 Paragraphs 7 to10 of Schedule 1(in relation to deferral of GRB along with State Pension) and paragraphs 17 to 20 of that Schedule (in relation to deferral of GRB only) make provision for a surviving spouse to ‘inherit’ a lump sum or increments where the deceased spouse had deferred GRB. These correspond to the provisions in Schedule 5 to the Benefits Act governing ‘inheritance’ where State Pension has been deferred. Under section 37 of the 1965 Act, ‘inheritance’ rights under the GRB scheme are restricted to one half of the deceased’s entitlement. This principle currently applies to increments and is carried forward into the calculation of an ‘inherited’ lump sum under paragraphs 10 and 20.

7.10 Paragraphs 8 and 18 of Schedule 1 make provision equivalent to that at paragraph 4 of Schedule 5 to the Benefits Act by providing that where a surviving spouse has chosen to ‘inherit’ GRB increments, or the deceased spouse was receiving GRB increments when he or she died, one-half of the increments to which the deceased was, or would have been, entitled may be ‘inherited’ by the surviving spouse in accordance with section 37 of the 1965 Act.

7.11 Paragraphs 9 and 10 and 19 and 20 of Schedule 1 make provision corresponding to that at paragraph 7B of Schedule 5 to the Benefits Act in relation to the calculation of a lump sum payable to a surviving spouse. In line with section 37 of the 1965 Act, the lump sum is calculated on the basis of half the GRB to which the deceased spouse would have been entitled up to the day before his or her death plus compound weekly interest equivalent to an annual rate 2% above the Bank of England base rate.

7.12 Schedule 2 makes transitional provisions in relation to cases where the period for which entitlement to GRB is deferred starts before 6 April 2005 and ends on or after that date. These correspond to provisions of the Social Security (Retirement Pensions etc.) (Transitional Provisions) Regulations 2005 which apply to people deferring State Pension as at the date of change. In particular Schedule 2 provides for:

- the choice between a lump sum and increments to be available only where the period of deferral from 6 April 2005 is 12 months or more (paragraph 6(a));
- an easement to the rule which normally means that increments amounting to less than 1% of the weekly pension rate are not payable. Under the pre-April 05 formula, deferral of 7 qualifying weeks will earn increments of 1%: with the new formula this reduces to 5 weeks. For transitional cases, the 1% rule is simplified so that a person will be awarded increments if they

defer for a minimum of 5 weeks where at least one week falls in the new period (paragraphs 2(b) and 7(b)), otherwise the normal rule applies (paragraphs 2(a) and 7(a)). However, for deferrers who choose a lump sum for the post-change period, no de minimis rule applies - so long as they have accrued any increment, it will be added to their weekly pension when it is finally claimed (paragraphs 2(c) and 7(c)); and

- if greater, the amount of the lump sum to be based on the amount that would be payable by way of arrears of GRB for 12 months to cater for cases where a person has accrued increments in respect of deferral pre-6 April 2005 and where the inclusion of pre-April 2005 increments in calculating a payment of up to 12 months backdated arrears could produce a higher amount than a lump sum payment calculated under normal rules (paragraphs 5 and 10).

7.13 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

Harry Cunniffe at the Department for Work and Pensions can answer any queries regarding the instrument. Tel: 020 7712 22491 or e-mail: Harry.Cunniffe@dwp.gsi.gov.uk.