MAIN PROPOSALS FOR CHANGES IN THE NATIONAL INSURANCE SCHEME AND PRESERVATION OF OCCUPATIONAL PENSION RIGHTS

Memorandum by the Secretary of State for Social Services

This memorandum outlines my proposals for reconstructing the State basic national insurance scheme, for establishing a new State reserve scheme, and for ensuring the preservation of occupational pension rights on change of employment.

A. The Basic Scheme

Coverage

1. Employed and self-employed people over school-leaving age whose earnings are above a minimum level will be compulsorily insured in a comprehensive basic scheme, on which other provision is to be built—mainly through occupational schemes. Entitlement to benefit will be conditional on the payment of contributions, but contributions for employed persons, and their employers, will be put on a fully earnings-related basis. The benefit structure will remain broadly the same as at present.

2. Working wives and widows who have rights to benefit on their husband's contributions will continue to be allowed to choose not to pay the major part of the contributions for benefits on their own record, but they will have to pay for industrial injuries cover as they do now, and they will also pay for the first time the same small contribution as everyone else towards the cost of the National Health Service. Non-employed people will be able to contribute voluntarily, mainly for retirement and widowhood benefits.

Contributions

3. The new fully earnings-related contributions payable by employed persons and their employers will be a percentage of the earnings of the employee up to a ceiling set at about 1¾ times national average earnings. "National average earnings" is used, for convenience, to mean the average earnings of adult male manual workers in manufacturing industries and certain non-manufacturing industries and services, as obtained from the Department of Employment's half-yearly enquiries into earnings.
Employees with very low earnings (very broadly those whose earnings are too low to bring them within the PAYE system) will not be compelled to pay contributions under the new arrangements; nor will their employers. Contributions will be collected through the PAYE machinery and employers will no longer have to stamp cards for their employees.

4. A joint contribution of about 12\( \frac{1}{2} \) per cent (This includes an assumed 1 per cent for the Health Service, but does not make any assumption about the employer's contribution to the Redundancy Fund collected on behalf of the Department of Employment.) will be required assuming Treasury supplement in the same proportion as at present; it is proposed that the employee should pay 5\( \frac{1}{2} \) per cent with the balance payable by the employer. In addition, for those not in "recognised" occupational schemes, there will be a contribution of 4 per cent to the State reserve scheme; this will be collected along with the basic scheme contribution and split as to 1\( \frac{1}{2} \) per cent from the employee and 2\( \frac{1}{2} \) per cent from the employer.

5. The self-employed will pay a flat-rate contribution at a rate to be determined. The possibility that they may be required to pay some form of earnings-related contribution in addition is under examination.

5. Non-employed people will be able to pay flat-rate contributions voluntarily, at a level to be determined, mainly for retirement and widowhood benefits.

7. Annex 1 contains at Tables 1 and 2 examples of the present contributions for the various groups on different levels of earnings, compared with what the employee will pay on a 5\( \frac{1}{2} \) per cent share of the total basic scheme contribution of 12\( \frac{1}{2} \) per cent (plus the 1\( \frac{1}{2} \) per cent for the reserve scheme where appropriate). Two upratings of pension are due to occur before 1974 and these will provide opportunities to load more of the cost on to the higher-paid, so as substantially to mitigate the increase in their contribution in 1974. The proposals for the reconstruction of the national insurance scheme will be published after the first of these increases has been announced, and to that extent the longer-term increase for the higher-paid will look less steep.

Benefits

8. The scale and scope of benefit provision under the basic scheme will, with some selective improvements, be broadly as at present, but no new graduated pension will be earned after the new scheme comes into operation. Graduated pension earned up to April 1974 (when the new scheme is planned to start) will be paid with the basic pension on retirement. The question whether the purchasing power of graduated pensions is to be maintained is under consideration.
Retirement and widows' pensions

9. There will be a basic rate of benefit (£5 a week, in current terms) with a higher rate of pension - initially perhaps an extra 5s. a week - for pensioners over the age of 80. Entitlement will depend on a simplified contribution test based on the number of years in which the contributor achieves a minimum level of reckonable earnings. The level will be the minimum level of earnings at which contributions would normally be payable in that year for national insurance purposes. (Annex 1, table 4, compares the position of a man on national average earnings under the present basic and graduated schemes with the proposed new arrangements.)

10. Minimum pensionable age will remain at 65 for men and 60 for women subject, as now, to a retirement condition. Increments will be provided for deferred retirement and their rate will be improved. Those who retire and qualify for pension will have to have their pension adjusted in respect of subsequent earnings until age 70 (men) and 65 (women), but the operation of this earnings rule will be eased from time to time by preserving its relativity to national average earnings.

11. Widows' pensions will be payable under the same conditions as to widowhood as at present, including the new (reduced) pensions for women widowed between the ages of 40 and 50 which are due to start in April 1971. An earnings-related widow's allowance will be payable for the first six months of widowhood.

17. Unemployment and sickness benefit at present consist of a basic flat-rate benefit plus an earnings-related supplement for the first six months. This structure will need to be reviewed in the light of the change to fully earnings-related contributions. The staffing and other implications of this are under discussion with the Department of Employment and will be the subject of separate proposals.

13. For the purposes of future entitlement to flat-rate benefits earnings at the minimum qualifying level will be credited during weeks of unemployment or incapacity for work.

Invalidity pension for the chronic sick

14. For people who have been sick for 28 weeks, including those already sick when the change is introduced, sickness benefit will be replaced by a long-term benefit, to be called invalidity pension. The basic benefit will be the same as the standard rate of retirement pension, with an addition graded according to the age at which the beneficiary fell sick, the maximum addition to begin with being £1 a week for those who fell sick under age 35. It is also proposed to raise the increases paid in respect of the children of invalidity pensioners to the level of the substantially higher increases paid for the children of widow beneficiaries.
15. The condition governing the payment of a dependency increase for the wife of an invalidity pensioner will be made easier than the sickness benefit condition. At present a dependency increase is not payable if the wife's earnings exceed the amount of the benefit (currently £3.2s. a week). Under the new arrangements the level of earnings will be raised to that which applies under the retirement pensions earnings rule (currently £7.10s. a week) and earnings above that level will act to reduce the benefit, not to extinguish it immediately as now. This same relaxation will apply to the dependent wives of retirement pensioners.

Attendance allowance for the disabled

16. An attendance allowance for the very severely disabled, already enacted, will be introduced in 1971. It will be paid from the Consolidated Fund. Extension of the scope of this allowance to a wider range of less severely disabled will be considered in the light of experience of the initial stage of operation. Proposals will be brought forward in due course and it is hoped to be able to start this extended scheme in late 1973.

Review of benefit levels

17. All the main flat-rate benefits will be reviewed every two years and increased by at least the amount necessary to maintain their purchasing power.

Finance

18. The cost of the new basic scheme is unlikely to differ much from that of the present scheme if it continued but there will be some saving in due course because rights to graduated pensions will no longer build up. The new selective improvements can be financed within the agreed provision for general upratings. The cost of the present scheme would itself grow, even in terms of present benefit and earnings levels, by about 10 per cent (or £300 million a year) in the next thirty years mainly because of demographic changes.

19. The scheme will continue to be financed on a 'pay-as-you-go' basis. If the Treasury supplement continues at its present proportional level of about 18 per cent of contribution income, we shall need to fix the combined contribution at about 12 1/2 per cent when we announce the scheme. We shall need to look at the precise figure again nearer the time to take account of the effect of the uprating due in November and the forecast we feel able to make, for use in the Government Actuary's published report, of the movement of earnings between the Spring and the time of the uprating. In the longer term, after 1980, there is a prospect of reductions of the contribution even if benefits rise in line with earnings.
B. The Reserve Scheme

20. The reserve scheme will be an age-related money purchase scheme which, irrespective of the contributor's age and earnings level, will give him value for money and no more. The scheme will be fully funded and wholly free of Exchequer support. The aim will be to provide benefits on a profit sharing basis such that (though price dynamism will not be formally guaranteed) a reasonable expectation can be held out that their value will be maintained by regular "bonuses".

21. The scheme will be run by an independent Board of Management, though governmental machinery will be used (and paid for), for example, to collect and record the contributions. The Board will include members selected for their financial expertise and people of standing nominated, for example, by the Confederation of British Industry and the Trades Union Congress. Power of appointment will be vested in the Secretary of State. The Board will look to the Government Actuary for actuarial advice.

Scope

22. Contributions will be pitched at 4 per cent of PAYE earnings up to the same level as the basic scheme, shared as to 1 1/2 per cent for the employee and 2 1/2 per cent for the employer. (Table 1B of Annex 1 shows the combined basic and reserve scheme contributions.) Membership will be compulsory for employees between age 21 and 65 (60 for women) who are not members of an occupational scheme "recognised" as adequate for exemption purposes (see paragraphs 30-32 below); there will be no contribution option for married women, who will be brought in on the same basis as other employees. Contributions will be collected through the PAYE system along with the basic contributions and paid over to the Management Board for investment.

Funding

23. The reserve scheme fund or funds will be separate and self-contained, with no underwriting by the State and with freedom of investment extending to equities and property. The managers will have a statutory duty to maximise yields for the benefit of contributors. There will be safeguards to provide insulation against government interference and to remove any risk of "rigging the market". There will be a limit on the proportion of equity in any company that can be held.

Size

24. Estimates of the scale of the scheme can only be speculative. But it is reasonable to assume that membership at any one time might be of the order of 7 million, with perhaps 13 million in recognised occupational schemes. The immediate annual yield of contributions might be of the order of £200 million. (This may be compared with an annual income of the Prudential approaching £300 million, of which about £100 million is
available for investment. Even if the reserve scheme membership remained at the same level and it should diminish, the fund might build up by the end of the century to something of the order of £5,000 million with benefit expenditure then running at something of the order of £75 million a year, in terms of present earnings levels. (By comparison the funds of occupational schemes may on the same basis have by then built up to between £15,000 and £20,000 million.)

**Benefits**

25. The return on a given amount of contributions will vary according to the age when the contributions are paid: the younger the contributor the greater is the amount of pension secured for a given contribution. There will be no kind of accelerated maturity. A benefit scale will be laid down showing for each age and sex the amount of guaranteed pension secured on an actuarial basis for each unit of contribution.

25. Assumptions as to rates of interest, mortality etc. in working out the scale of benefit will be conservative ones, so that the investment of contributions can be expected to produce the surplus needed to provide "bonuses" both before and after award at a level at which they might reasonably be expected to be sufficient to maintain the purchasing power of the pension.

27. Widows' benefits will be paid amounting to half the rate of personal pension payable to the late husband, or if the husband dies below pension age to half the rate of pension which would have been payable to him at age 65 if he had not contributed further.

28. As under the basic scheme, pensions will be payable from age 65 (60 for women) but without a retirement condition. All pension rights will be fully preserved, with no refunds. Very small pensions may, however, be commuted.

29. Table 2 in Annex 1 shows for different ages of entry the rates of benefit which might be payable in practice to men, women and widows whose husbands die after retirement.

**Exemption from the reserve scheme**

30. Occupational schemes of a minimum standard, which will be fixed at a somewhat higher level than that of the reserve scheme, will be accorded a "recognised" status by virtue of which members of these schemes and their employers will be exempt from contributing to the reserve scheme.

31. Employers who wish to obtain a certificate of exemption in respect of their occupational schemes will be required to apply for this purpose to an Occupational Pensions Board. The Board will be an autonomous body of some standing, containing representatives of employers and employees as well as representatives of occupational pension interests.
It will be completely separate from the Board of Management of the reserve scheme. Its primary duty will be to deal with applications for exemption, but it will also be charged with a general oversight of the preservation of pension rights on change of employment and with the exercise of powers to approve the modification of schemes where this is necessary or desirable as a consequence of the legislation.

32. The precise nature of the tests which the Board will apply in considering applications for exemption will be the subject of technical discussions with occupational pensions interests. The nature of the reserve scheme rules out any test of precise equivalence of benefits and the aim will be to make the conditions as simple as possible.

Employees leaving occupational schemes without pension entitlement

33. Employees who leave a recognised occupational scheme before their service is sufficient to entitle them to a preserved pension will, subject to a de minimis rule, have to be brought back into the reserve scheme by payment of a sum equal to the contributions that would have been payable but for exemption.

C. Preservation of occupational pension rights

Qualifying conditions

34. The qualifying conditions for a preserved pension under the legislation will be the completion of 5 years' pensionable service (i.e. service as a member of an occupational scheme) and the attainment of age 26 on leaving.

Benefits to be protected

35. The preservation requirement will apply to all those benefits which would have been available to the member if he had reached the scheme's normal pension age at the date on which he left the employer's service e.g. the member's personal retirement benefit and widows' or other benefits payable on his death after retirement. Further consideration will be given to the question whether it is feasible to require the preservation of benefits payable on a member's death before pension age; in any event, a contributory scheme will be expected to provide the widow with benefits not less in amount than her late husband's contributions.

Preservation to be mandatory

36. The preservation of a leaving member's accrued pension rights in respect of service after the operative date will be mandatory where the member has 5 years' service after that date (provided, of course, that he has attained age 26); in such cases, contributory schemes will no longer be permitted to offer a refund of the leaving member's contributions as an alternative to preservation. Pension in respect of service before the operative date will also qualify for preservation but there will be no restriction on a scheme offering, and the member accepting, the alternative of a refund of contributions paid before that date.
Payable age

37. The payable age for a deferred pension will be the scheme's normal pension age; that is the age at which a member would become entitled to receive a full and immediate pension for his years of service, other than in special circumstances such as ill-health warranting earlier retirement. But special consideration will be given to the case of schemes with a particularly early pension age.

Calculation of preserved benefits

38. Benefits will be calculated in accordance with schemes' own accrual rules wherever this produces a reasonable equitable result, the amount of pension to be preserved being that to which the member would have been entitled if he had reached the scheme's normal pension age at the date on which he left the employer's service.

39. Where the application of the scheme's own rules would not produce an equitable result, schemes will be required to provide the leaving member with a deferred pension calculated on the basis of "uniform accrual", i.e., representing a fair proportion of the final pension to which he would have become entitled if he had stayed on in the scheme until normal pension age.

Pensions increases

40. Where the rules of a scheme contain contractual provision for periodic increases in full-term pensions, the scheme will be required to increase deferred pensions in payment by corresponding amounts.

41. A general requirement that deferred pension rights should similarly be increased during the period between withdrawal from the scheme and the payable age would plainly be unreasonable, since it would mean that, in many schemes, a leaving member would receive a higher pension for a particular period of service than if he had continued in the scheme. In the special case of final salary schemes, however, there seems a good case for requiring that the deferred pension (necessarily calculated on the salary at the time of leaving) should be at least partially inflation-proofed, either by linking with the retail prices index or at a predetermined rate to be prescribed. The practical implications of such a requirement will be discussed with the interested organisations.

Enforcement and adjudication

42. The Occupational Pensions Board (see paragraph 31) will have power to determine applications from scheme members and other interested parties as to whether a scheme's preservation rules comply with the legislation. The jurisdiction of the board in this respect will not extend to schemes for which a Minister of the Crown is responsible, i.e., schemes whose terms are in an Act or Regulations or are determined
by a Minister of the Crown (as distinct from schemes whose terms are merely approved by a Minister). Once schemes have incorporated suitable preservation provisions in their own rules, it will be up to members to enforce their own rights through the scheme's own arbitration machinery and (in the last resort) in the Courts.

Forfeiture of entitlement

43. Pension schemes will be permitted to provide for the forfeiture of a scheme member's rights to a deferred pension in cases of grave misconduct, subject to a right of appeal to an independent tribunal. In addition, subject to certain safeguards and the normal Inland Revenue rules, an employer will be permitted to have a lien on the deferred pension rights when he has suffered a quantifiable financial loss at the hands of an employee.

Staffing implications and cost

44. The staff requirement of the Occupational Pensions Board has been taken fully into account in the staff estimates given in CP(71) 12. The extra cost of providing deferred pensions for their leaving members will, of course, fall on occupational schemes themselves and has been provisionally estimated at about £25 million a year at the outset, rising to a total of about £40 million after 20 years. (The estimate assumes that about two-thirds of members leaving contributory schemes will take a refund of contributions paid before the operative date.)

Timetable

45. The intention is that provision for the preservation of occupational pension rights, as outlined above, should be phased in with the programme for reconstructing the national insurance scheme and should therefore come into effect from April 1974. Before reaching a firm decision there will of course be consultations with the employers' and occupational pension organisations.

K J

Department of Health and Social Security, SE1

28 January 1971
The following tables illustrate the levels of contributions at the percentages proposed under the new scheme if it had come into operation this year and compare them with the present scheme contributions and those that would have been payable under the Crossman scheme on the same assumption. The corresponding figures when the new scheme actually starts will of course depend on the levels of earnings and on present scheme contributions at that time. As indicated in paragraph 7 of CP(71)13 two warrantings are due to occur before 1974 and this will give the chance to load more of the cost on to the higher-earners so as to substantially to alter the increases in weekly contribution at the start of the new scheme.

Table 1A. Employees: 5½% of earnings up to £2,100 a year.

<table>
<thead>
<tr>
<th>Earnings</th>
<th>Contributions</th>
<th>Increase or Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>50</td>
<td>8 15 0</td>
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<td>700</td>
<td>13 9 0</td>
<td>1 4 1</td>
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<tr>
<td>1,400</td>
<td>26 18 0</td>
<td>1 8 3</td>
</tr>
<tr>
<td>2,100</td>
<td>40 7 0</td>
<td>2 2 4</td>
</tr>
</tbody>
</table>

*Contracted-out

Table 1B. Employees: As above, but paying 1½% extra up to £2,100 a year for the reserve scheme. The additional 1½% will of course earn extra pension.

<table>
<thead>
<tr>
<th>Earnings</th>
<th>Contributions</th>
<th>Increase or Decrease</th>
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<tbody>
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<tr>
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<td>1,400</td>
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<td>1 1 6</td>
</tr>
<tr>
<td>2,100</td>
<td>40 7 0</td>
<td>2 1 4 6</td>
</tr>
</tbody>
</table>

*Not contracted-out
Reserve scheme pensions in terms of 1970 earnings
(Assuming real earnings rising at 2½% per annum)

<table>
<thead>
<tr>
<th>Age (of husband where appropriate) at start of reserve scheme</th>
<th>Weekly pension for man earning half national average</th>
<th>Reserve scheme pension as % of earnings at retirement</th>
<th>Weekly pension for widow whose husband died in retirement and had earned half national average</th>
<th>Reserve scheme widow's pension as % of husband's earnings at retirement</th>
<th>Age at start of reserve scheme</th>
<th>Weekly pension for woman earning half national average</th>
<th>Reserve scheme pension as % of earnings at retirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>65</td>
<td>£10</td>
<td>£5</td>
<td>£6</td>
<td>£10</td>
<td>50</td>
<td>£8</td>
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<td>£2.10</td>
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<td>25</td>
<td>£1</td>
<td>£3</td>
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<tr>
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<td>£2.16</td>
<td>£5</td>
<td>£2.16</td>
<td>£2.16</td>
<td>21</td>
<td>£2</td>
<td>£3</td>
</tr>
</tbody>
</table>

NOTE: (1) "national average" means male national average earnings, i.e. £256 a week in 1970 terms.

(2) Cash figures are rounded to the nearest 2s.
### Table 3: Basic and Reserve Scheme Pensions (Men)

Single man's pension as percentage of earnings at retirement under the basic plus reserve scheme compared with Grossman scheme rates (with widow's pension of half husband's entitlement)

<table>
<thead>
<tr>
<th>Age at start of scheme</th>
<th>Reserve plus basic pensions</th>
<th>Grossman scheme Pensions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$\frac{1}{2}$ national average</td>
<td>national average</td>
</tr>
<tr>
<td>55</td>
<td>42</td>
<td>23</td>
</tr>
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<td>45</td>
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<td>25</td>
<td>58</td>
<td>38</td>
</tr>
<tr>
<td>21</td>
<td>60</td>
<td>41</td>
</tr>
</tbody>
</table>

The figures for the reserve plus basic pensions assume a rise in real earnings of 2% per cent a year (i.e., they are on the same basis as Table 2) and that basic pensions are increased in line with earnings.
Table 4: Comparison with present scheme

Pensions payable at age 65 on national average earnings for men under the present flat-rate plus graduated schemes compared with those payable under the basic plus reserve schemes under the proposed new arrangements.

<table>
<thead>
<tr>
<th>Age at entry to graduated/reserve schemes</th>
<th>Present Pension</th>
<th>New Pension</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Flat-rate £ s.</td>
<td>Graduated £ s.</td>
</tr>
<tr>
<td>25</td>
<td>5 0</td>
<td>4 17</td>
</tr>
<tr>
<td>35</td>
<td>5 0</td>
<td>3 13</td>
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<tr>
<td>45</td>
<td>5 0</td>
<td>2 8</td>
</tr>
<tr>
<td>55</td>
<td>5 0</td>
<td>1 4</td>
</tr>
</tbody>
</table>

The figures in this table, unlike those in Tables 2 and 3, are based on an assumption of constant prices and earnings, for ease of comparison with the graduated scheme. The amount of graduated pension is calculated on the basis of a person joining the graduated scheme in 1974 and contributing at the present contribution rate and on the present range of reckonable earnings.

It is to be noted, however, that the flat-rate and reserve scheme pensions may be expected to increase as prices and earnings rise, whereas the graduated pension would not.