# State Pension top up

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People with gaps in their National Insurance record may be able to pay voluntary class 3 NICs. This can help protect entitlement to contributory benefits, including the basic State Pension. In general, they have to be paid within six years, but there are some exceptions.

In the 2013 Autumn Statement, the Government announced its intention to introduce class 3A NICs – to allow current pensioners (i.e. those who will not be eligible for the single-tier State Pension because they reach State Pension age before it is introduced on 6 April 2016) an option to top up their Additional State Pension record through a new class of voluntary National Insurance contributions (para 1.279). Provision for this "State Pension top up" was made in the *Pensions Act 2014,* with the details in regulations.

The offer is time-limited – to run between October 2015 and April 2017. The State Pension top up has been set at an "actuarially fair rate", which means they will cost more than the existing class 3 NICs, which are "heavily discounted**"** (DLC Deb 27 November 2014 c3). The rates vary by age. The contribution required for an extra £1 pension per week for a person aged 65 is £890. For a 70 year old the rate reduces to £779 and at age 75 the rate is £674. (HC Deb 2 April 2014 c85-7WS). The decision whether to pay will depend on individual circumstances. There is a State Pension top up calculator on Gov.UK.

This note provides an overview of the scheme and some of the issues that have been raised in connection with it. For more detail on the single-tier State Pension, see Library Note SN 6525.

# Contents



# 1 Background

Briefly, the current State Pension has two tiers:

- **The basic State Pension (BSP),** to which people build entitlement on the basis of their National Insurance (NI) contributions. People reaching State Pension age before 6 April 2010 needed 44 qualifying years (men) and 39 (women) for a full basic State Pension. People reaching State Pension age on or after 6 April 2010 need 30 qualifying years.

- The **additional State Pension**, which is partly earnings-related.

The Government legislated in Part 1 of the *Pensions Act 2014* for a single-tier State Pension for future pensioners from April 2016. For more detail, see Library Note SN 6525 Single-tier State Pension (September 2014).

In the current system, there is already provision for an individual with gaps in their NI record to protect their entitlement to the basic State Pension through payment of **class 3 voluntary** National Insurance Contributions (NICs). They cannot be paid in certain circumstances (for example, during a period in respect of which a woman paid the 'reduced married women's stamp') and they must generally be paid within certain time limits. In 2014/15, the cost of class 3 VNICs was £13.90 a week for an employee.[1] For more detail, see Gov.UK – Voluntary National Insurance and Library Note SN 3111 Basic State Pension – contribution conditions.

In the Autumn Statement on 5 December 2013, the Government announced its intention to introduce class 3A NICs – to enable current pensioners (who will not be eligible for the single-tier State Pension because they reach State Pension age before it is introduced) a way of increasing their additional State Pension entitlement:

> **1.279** As well as reforming the State Pension system for future pensioners, the government **will introduce a scheme to allow current pensioners, and those who reach State Pension age before the introduction of the new single tier pension, an option to top up their Additional State Pension record through a new class of voluntary National Insurance contributions.** The scheme will be introduced in October 2015 and will be time limited. The details of the scheme will be set out closer to the time of implementation, with the price of the new class of National Insurance being set at a broadly actuarially fair rate. The government will legislate for this scheme at the earliest available opportunity.[2]

[1] Gov.UK – Voluntary National Insurance
[2] HM Treasury, *Autumn Statement 2013*, Cm 8747, December 2013

The necessary legislation was introduced by means of an amendment to the *Pensions Bill 2013/14* when it was at Committee Stage in the House of Lords. The Government published a paper setting out the policy in more detail.[3] Lord Freud explained that the intention was to give people reaching State Pension age before 6 April 2016 the opportunity to increase their state pension entitlement. The scheme would start in October 2015 and run for a limited period:

> We have dealt with a great deal of complexity as we have discussed the transition provisions. These are intended to respect past contributions by giving people reaching state pension age on 6 April 2016 onwards the higher of the value of their national insurance record calculated under both single tier or old scheme rules. As a result of this calculation, many people retiring in the early years of the single tier will have their pension boosted using new-scheme rules. So a woman with 30 qualifying years and £10 of state earnings related pension scheme in 2016 would get £123.30 of single-tier pension, which is around £6.30 a week more than under the old scheme rules. As illustrated here, the groups who will benefit most are those who have only modest amounts of additional state pension, if any at all. These tend to be, in the main, women and the self-employed whose social and economic contributions were not captured in SERPS and are not fully reflected in the state second pension.
>
> As set out in these amendments, we now want to give existing pensioners and those reaching state pension age before 6 April 2016 the opportunity to boost their additional state pension by paying a new class of voluntary national insurance contribution: class 3A. The intention is that a unit of additional pension, obtained by paying the class 3A contribution, will provide £1 a week of extra pension. The extra pension itself will simply be added to people's state pension. The intention is for the scheme to start from October 2015 and run for a limited time of between 18 months to two years. There are just two entitlement conditions to class 3A—entitlement to a UK pension and that the person reaches state pension age on or before 5 April 2016.[4]

He said that some decisions had been left for regulations, including whether there should be a cap on the amount of additional State Pension that could be bought, how long the scheme should be open and whether people should have a cooling-off period after paying class 3A contributions. The cost of class 3A contributions would be set on "actuarially fair terms" (i.e. at a level which means the contributions paid should cover the cost of the additional pension benefits). This is in contrast to the position with class 3 NICs, which, as Lord Freud explained, are "relatively cheap":

> I turn now to costs. As noble Lords will know, covering basic state pension gaps through existing class 3 is relatively cheap. A person paying class 3 to acquire one qualifying year of basic state pension will get their money back within four years of reaching state pension age. A different approach is required for class 3A to ensure that the arrangements do not become a burden for today's national insurance contributors. So the costs of class 3A, which will be set by the Treasury, will be based on actuarially fair terms, in consultation with the Government Actuary's Department. In keeping with this, the cost will be adjusted to reflect the age of the pensioner at the time they pay class 3A.[5]

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[3] DWP, Class 3A Voluntary National Insurance – policy detail, December 2013; DEP 2013-2001
[4] HL Deb 13 January 2014 c12GC
[5] Ibid c13GC

For this reason, he said that individuals considering paying the new class 3A contributions should first check whether they are eligible to make class 3 contributions.[6]

Labour Peer Lord McKenzie described this as "effectively an annuity arrangement." He asked about the explanations and information people would be given to help make a decision on whether to pay.[7] Lord Freud responded that the Government would bring regulations back to the House and at that time would have the details required for a fully informed debate.[8]

The *Pensions Act 2014* (section 25 and Schedule 15) provided for a new section 14A to be included in the *Social Security Contributions and Benefits Act 1992.*

Details about the price, the maximum number of contributions that could be made and the increase in additional pension it would give were announced by Pensions Minister, Steve Webb, in a Written Ministerial Statement shortly after Budget 2014:

> **State Pension Top-up**
>
> **The Minister of State, Department for Work and Pensions (Steve Webb):** Following an announcement in the Budget, I am today providing further details on a new class of voluntary National Insurance contribution, Class 3A. We are calling this the State Pension top up and it is specifically designed to allow some of today's pensioners and those close to pension age to boost their retirement incomes.
>
> This change will allow existing pensioners and those reaching State Pension age before 6 April 2016 in the opportunity to gain additional State Pension by paying Class 3A voluntary National Insurance contributions. It will provide an opportunity for pensioners to improve their retirement income by obtaining inflation-proofed extra additional State Pension. This could be particularly beneficial to women and other groups such as self-employed people who have not done well under additional State Pensions and have not previously been able to top these up. Along with the newly announced Pensioner Bond that will be available from National Savings and Investments in 2015, it further demonstrates the Government's commitment to improving outcomes for those in retirement and providing increased flexibility for people to make the most of their savings.
>
> There are two entitlement conditions—contributors must have entitlement to a UK State Pension and must reach State Pension age before 6 April 2016.
>
> The rules on additional State Pension will apply to entitlements resulting from Class 3A contributions including inheritance—a surviving spouse or civil partner will be entitled to at least 50% of the additional State Pension.
>
> On 20 March 2014, the Department for Work and Pensions published the results of an online polling exercise conducted by Ipsos MORI, which was used to estimate potential take-up of the Class 3A voluntary contributions. The online poll was conducted in February 2014 and 2,000 people at or close to State Pension Age took part. We provided them with indications of the Class 3A contribution rates and what this would mean in terms of additional State Pension throughout their lifetime. We found that one in five (twenty percent) of those polled were either "very" or "fairly interested" in taking up this offer. The level of interest seems to differ by age group with those under age 70

[6] Ibid c13GC
[7] Ibid c14GC
[8] Ibid c21GC

> showing the highest level of interest. I have placed copies of the report in the House library and it is available on the Gov.uk website.
>
> These results have been used to make some assumptions about take-up rate: using a proportion of those who said they were "very interested" and "fairly interested". The Office for Budget Responsibility has agreed a conversion rate between levels of interest expressed through the polling and possible take up. Using these agreed assumptions we estimate that around 265,000 people may take up this offer.
>
> This new measure is in addition to the existing Class 3 voluntary National Insurance contributions which allow people to fill gaps in their contributions record for basic State Pension.
>
> I have established the facility for people to register their interest so that they can receive updates in advance of the State Pension top up becoming available from October 2015. This includes a personal calculator for people to work out the contribution needed to increase their pension by a weekly amount. This will be available at www.gov.uk/state-pension-topup or by searching for 'state pension top up'. A dedicated telephone line facility will also be available: 0845 600 4270 or 0345 600 4270 from mobile lines.
>
> Primary legislation for this measure has been introduced in the Pensions Bill 2013. We also intend to bring forward secondary legislation covering the prices and features of the State Pension top up.
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> The following features will be defined in regulations, that:
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> - £25 per week should be the maximum amount that contributions can provide;
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> - Class 3A VNICS will be available for 18 months from October 2015; and
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> - There will be a cooling off period of 90 elapsed days.
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> The State Pension top up has been set at an actuarially fair rate that ensures that both individual contributors and the taxpayer get a fair deal. The rates set out below show the contribution needed for £1 per week of additional State Pension, according to age. The rates are the same for males and females. As an illustration, the contribution required for an extra £1 pension per week for a person aged 65 is £890. This means that for £4,450, the individual could receive an additional £260 per year for life, increased in line with prices and inheritable on death in the same way as existing additional State Pension: with a minimum of 50% for the surviving spouse or civil partner. For a 70 year old the rate reduces to £779 and at age 75 the rate is £674.
>
> I will place a table in the House library of the rates at which pensioners can make Class 3A voluntary National Insurance contributions.[9]

As this explains, the maximum amount of additional State Pension an individual can buy is £25 per week. The level of contribution required varies by age. The cut-off date after which a person will no longer be able to pay Class 3A contributions is 5 April 2017.[10]

These details are provided for in the *Social Security Class 3A Contributions (Units of Additional Pension) Regulations 2014* (SI 2014/3240) and the *Pensions Act 2014 (Consequential Amendments) (Units of Additional Pension) Order 2014 (SI 2014/3213).* There is a State Pension top up calculator on Gov.UK.

[9] HC Deb 2 April 2014 c85-7WS
[10] *Social Security Class 3A Contributions (Amendment) Regulations 2014 (SI 2014/2746)*

## 2 Debate

The regulations were debated in Parliament on 27 November 2014.[11] Pensions Minister, Steve Webb, explained why the provision was being introduced:

> We are talking about a new class of voluntary national insurance contributions, which were created under the Pensions Act 2014 and are known as class 3A. Their genesis was as a result of one of my constituents contacting me and asking, "I am 75. I would like to top up my state pension. I would like to pay some extra national insurance. Can I do so?" I had to say, "No, I'm afraid not. Much as we would like you to give us your money, we cannot legally take it and give you a higher pension. We could do if you were at work or just retired, but we cannot now." The more I thought about it, the more I thought that there was no logical reason why people who are retired should not, in principle, have the opportunity to top up their pension through voluntary contributions if they so wished. Thus, class 3A national insurance was born.
>
> The new voluntary contributions are aimed at existing pensioners and at those who reach state pension age before the introduction of the new state pension on 6 April 2016 and who have an entitlement to a UK state pension. It allows them to make class 3A contributions in return for units of additional state pension, which will increase their weekly state pension. We have called the scheme as a whole "State Pension Top Up".[12]

### *Deciding whether to pay*

The Government expects some 265,000 people to take up the offer. It expects take-up to be highest among 65 to 70-year-olds.[13]

A decision as to whether it is worth paying class 3A NICs will depend on individual circumstances. In debate on the regulations, Pensions Minister Steve Webb explained that the offer might be particularly attractive to women in couples:

> State pension top-up will be particularly helpful to groups who have little or no additional state pension, such as women and the self-employed, whose social and economic contributions were not captured in SERPS, the state earnings-related pension scheme, and not fully respected in the second state pension. […] The offer is generally more attractive to women than to men because prices are gender neutral but women on average live longer. Other things being equal, it might be better for a woman in a couple to buy additional units than a man. The tax position is that they are SERPS payments so they are taxable, but an individual below the tax threshold would not pay tax and, again, on average, women tend to have lower incomes in retirement than men. If the woman in a couple is not a taxpayer, it may be more advantageous for her to pay. In a rational and logical sense, we think that that group would be more likely to take this up.[14]

Issues to take into account when making a decision about whether to pay would include likely life expectancy, whether the individual has a partner (since the state pension automatically includes partner's pension rights) and whether the individual might be entitled to means-tested benefits (as payments of the state pension count as income for Pension Credit purposes).

[11] Ninth Delegated Legislation Committee, Thursday 27 November 2014
[12] DLC Deb 27 November 2014 c3
[13] Ibid c4 and 7
[14] Ibid c4

The Minister explained that DWP would put in place measures to ensure that people who applied to make new class 3A contributions were made aware that they should first check their eligibility to pay class 3 contributions, which were "heavily discounted":

> In terms of cost, class 3A will be actuarially fair, and as a result will cost more than the heavily discounted class 3 national insurance. For example, a person paying £723 in class 3 contributions in 2014-15 would obtain £3.77 a week in basic state pension. On that basis, a person can effectively recoup their money within four years of reaching state pension age. A different approach was required to ensure that the arrangements for class 3A do not become a burden for today's national insurance contributors, hence our decision to base class 3A on actuarially fair rates, as advised by the Government Actuary. In keeping with that, the cost will be adjusted to reflect the age of the pensioner at the time they make their class 3A contributions.[15]

Furthermore, measures had been introduced to prevent newly-acquired additional pension being "clawed back by rules designed for other parts of the state pension system":

> The order therefore amends primary legislation to ensure that a person's state pension or disablement pension entitlement is not reduced by obtaining or inheriting units of additional pension acquired from class 3A. The order also applies the existing rules of inherited SERPS to the newly acquired additional state pension, meaning that people will be able to inherit the class 3A top-up in the same way as they can inherit SERPS: up to 100% if the deceased spouse or civil partner reached state pension age before October 2002, tapering down to 50% if they have reached state pension age since October 2010.[16]

### *Comparison with annuities*

Some commentators have noted that the cost of the scheme "looks generous compared to current annuity rates."[17] Pensions expert and Government Business Adviser for Older People, Ros Altmann said:

> Relative to the private annuity market, this seems a very good deal for many people. The price of buying these extra state pension rights has been set at about half the cost of buying an inflation-linked joint-life annuity in the open market. For a 65-year old, the annuity rate for an inflation-linked annuity is around 2.9%, so buying the equivalent of £25 a week pension would cost around £45,000, instead of £22,250 (although this does give rpi-linking, rather than cpi), whereas the cost of buying the extra state pension under Class 3A works out at an annuity rate of around 5.8%. About twice as good as the market rate. If you are 65 now and live beyond age 80 or so, assuming inflation is quite low, you will probably get a good deal and the higher inflation is, the better the deal. Of course, you could invest in the markets and do much better, but that entails risk.[18]

A report for Age UK found that:

> […] the current cost of paying additional Class 3A NI contributions to gain additional State Pension income is considerably cheaper than buying either a single-life or joint-life index-linked annuity.[19]

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[15] Ibid c5

[16] Ibid c5

[17] 'Top up your pension for half the price of an annuity', *Moneywise*, 16 July 2014

[18] Dr Ros Altmann, Government announces its terms for buying extra state pension – class 3A National Insurance, April 2014

[19] Dominic Lindley, *Dashboards and jam-jars,* December 2014

Age UK has called for "private pension decisions to be integrated with decision-making on state pensions and benefits to maximise income."[20]

In response to a question on the issue from Stephen Timms, Pensions Minister, Steve Webb said people were paying for additional state pension, not purchasing an annuity:

> I have been asked to stress that this is not an annuity; this is national insurance paying for additional state pension. Obviously, if people had this pot of money and bought an annuity, an insurance company has to make a profit whereas the Government have set the price of the national insurance for the additional state pension actuarially neutrally. One might expect a lower stream of income if someone bought an annuity but, in this case, that is not what they are doing.[21]

[20] Age UK launches 8-point plan to help savers make the most of pension reforms, 16 December 2014
[21] DLC Deb 27 November 2014 c7