



Department
for Work &
Pensions

Class 3A Voluntary National Insurance

Policy detail

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Summary

The Government's focus for this Parliament has been:

- protecting existing pensioners' core income by the triple lock uprating of basic State Pension and indexing Guarantee Credit by at least earnings; and
- introducing a new and sustainable settlement for tomorrow's pensioners delivered through the single tier and automatic enrolment.

The Government now wants to offer more to existing pensioners and people who reach State Pension age before 6 April 2016 when the single-tier pension is introduced:

- to give people in the pre single tier population, who may have lost out because of the structure of the legacy second pension system, the opportunity to increase their state pension in retirement;
- to give hard pressed pensioners, especially those who rely on their capital to supplement their income, an opportunity to top up their pension in a way that will protect them from inflation; and
- to give people with small amounts of pension saving a secure way of achieving an income.

To achieve these objectives the Government intends to introduce a new Voluntary National Insurance contribution – Class 3A – that will allow people to top up their additional State Pension.

Class 3A will be set at an actuarially fair rate that ensures that both individual contributors and the taxpayer get a fair deal.

The Government intends to introduce Class 3A in October 2015. The scheme will be open for a limited period – we expect most people who want to take-up Class 3A entitlement will do so in the first few months.

We will provide more information to the public closer to the date of introduction including factors individuals need to consider before taking up Class 3A.

The Government will work with stakeholders to ensure that the design of the scheme, and the way that pensioners can access it is as simple and clear as possible.

There will be two entitlement conditions – contributors must have entitlement to a UK State Pension (either basic State Pension or additional State Pension) and must reach State Pension age before 6 April 2016.

Background

The single-tier pension will provide a simple flat-rate state pension for people due to reach State Pension age from 6 April 2016 onwards. Transitional arrangements for the single-tier pension, which start in 2016, will uplift the incomes of groups who had a poor deal under State Earnings Related Pensions Scheme (SERPS) and may have been too old to benefit from the State Second Pension (which provides a boost for certain groups). The main gainers from the transitional arrangements are people with low earnings during their working life and carers, in the main these will be women. The self employed, who have always been excluded from SERPS and State Second Pension, will also gain through the single tier transition.

The boost from single tier for low earners, carers and the self employed will cost money. However, other changes in the single tier reforms save money with the overall result that the single-tier reforms are cost neutral in the early years of introduction.

Class 3A is designed to help exactly the same groups of people who have not been able to build much additional State Pension but who have reached State Pension age before single tier is introduced. It will also provide an opportunity for many other pensioners to boost their income in a period where they have seen their savings decline in the current low interest rate environment. The measure would also allow younger pensioners – people coming up to retirement now – with small amounts of pension saving, who could otherwise see little return for their efforts, to achieve a fair income.

We estimate that around 7 million pensioners will have enough savings to pay the new National Insurance contribution.

Class 3A will be set at an actuarially fair rate which means that over time the policy will be broadly cost neutral. This reflects the funding position of the single tier and means that today's workers will not have to fund the policy.

Examples of people who will gain:

A couple with savings where one has a good occupational pension and is paying tax but the other has little more income than the full basic State Pension. In particular, this could be beneficial to women who have an average weekly State Pension amount of £109 compared to the average amount for men which is £141. Around half of pensioners pay tax and many couples are expected to be in the position where one is paying tax and the other is not.

Self employed people who have sold their businesses at retirement but where their capital is not providing the pension they want, for example it is not inflation protected. Around 4 million people are currently self-employed. Typically while they have lower pension outcomes than employed earners they also tend to have higher assets/capital.

People approaching retirement now with Defined Contribution pension saving. They may want to use capital to supplement their income from annuities. Or people who drawdown on their capital to supplement their weekly income – or rely on their interest from savings to do the same.

Older pensioners who may welcome a simple offer from the state to increase their income. This could include women who paid the Married Woman's Reduced Rate Election who are not eligible to pay Class 3 NI contributions for years in which the Married Woman's Stamp was in force.

Key details about Class 3A

The price of Class 3A

The price of Class 3A will be based on an actuarially fair rate and will be calculated using the latest estimates of life expectancy from the Office of National Statistics (ONS). As Class 3A is National Insurance the final price of a unit will be determined by HMT but it will be informed by advice from the Government Actuary.

Prices will reflect the age an individual takes up Class 3A. This is a key component of an actuarially fair price. Prices will be lower for older pensioners simply because on average they will have a shorter life in retirement at the point they take up Class 3A. The Government intends to publish a list showing prices of a unit by age.

Gender neutral estimates of life expectancy will be used.

Class 3A will not replace the existing Class 3 Voluntary National Insurance Contributions, rather it will sit alongside. Class 3 contributions are used to cover gaps in people's basic State Pension and, to allow as many people as possible to achieve a full basic State Pension, the price of Class 3 has been set for many years at well below the actuarial rate. There are a number of restrictions on an individual paying Class 3 to top-up their basic State Pension. The Class 3A information products will make clear that individuals should consider making Class 3, contributions where that is possible, before taking up Class 3A. HMRC intend to identify applicants in that position and inform them of the option.

Each Class 3A contribution will result in the acquisition of a unit of extra pension which will increase the contributor's additional State Pension by £1 a week up to a cap of potentially £25. Some contributors may not have any additional State Pension in payment – they may have only basic State Pension and/or Graduated Retirement Benefit or Category D pensions (non-contributory pensions). They will still be entitled to take up Class 3A and to receive additional State Pension.

Additional State Pension

People who take up Class 3A will receive extra additional State Pension in return. (Additional State Pension is the pension earned from 1978 in SERPS and from 2002 in State Second Pension).

This extra additional State Pension will be added to people's existing pension payments. Entitlement will begin in the week following the day on which Class 3A contributions are paid. As with 'standard' additional State Pension, this extra additional State Pension will have the following characteristics:

- increased annually by any increase in prices (except if the person lives in a country where the UK State Pension is not uprated);
- inheritable on death – a surviving spouse is entitled to at least 50% of the additional State Pension;
- can be shared on divorce as part of a pension sharing order;
- can be deferred – it can be used to build up a lump sum or can be added to the pension, once claimed, through increments; and
- taxable and taken into account in the Income Related Benefits and certain other supplementary payments.

The value of Class 3A National Insurance

It is important that people think through all the options if considering paying Class 3A entitlement. For some people, who want the security of an increase in their regular pension income, with safeguards around inflation protection and inheritance and paid directly by Government, it may represent a good investment. But for other people, the security of having access to their capital – to meet living expenses, for a rainy day and for forming part of their estate – is more important. The following is an example of the value of Class 3A:

Using existing life expectancy projections Mr/Ms Average will live until 2039 if they reached age 65 in 2015 – around 24 years. If they wanted to guarantee they received £1 a week extra income during that period they would have to put £1,248 aside.

However by 2039 their £1 a week extra pension would be worth around 60p in terms of how much they could spend.

They could invest the money to see if it could keep pace with price inflation, but there is no certainty and before their money starts to make a return deductions may be made for administering the payments, for investment charges and for making a profit.

If Mr/Ms Average took up Class 3A the value of the £1,248 will be returned to them fully price protected and without charges. The extra income is also inheritable under the normal additional State Pension rules.

People will need to make their own judgements over the value of Class 3A compared to investing their money elsewhere. People also need to take account of the fact that extra additional State Pension will be included in an assessment of Income Related Benefits if appropriate – Pension Credit, Housing Benefit and help with Council Tax. People will need to consider this both at the time they are thinking of paying Class 3A and in the future, where a change of circumstances could mean they could fall onto the Income Related Benefits later on in retirement.

Administration

Class 3A will be introduced in October 2015. HMRC will handle applications and collect payments. DWP will pay the extra additional State Pension by simply revising the contributor's State Pension award. The intention is to deliver these changes as far as possible within the existing National Insurance and benefit framework so as to keep administrative costs to a minimum.

Primary legislation will be required to introduce the new arrangements and the Government has tabled an amendment to the current Pensions Bill, which is being scrutinised by the House of Lords.

Stakeholder engagement

In order to achieve our objectives for this policy the Government believes it is important to deliver a very simple offer to people and to remove any unintended barriers to take-up. For these reasons the Government intends to discuss the details of the policy with key stakeholders before finalising the secondary legislation that will cover pricing and maximum amounts. In particular these discussions will cover:

- what the level of the upper limit should be: The Government intends to place an upper limit on the amount of extra additional State Pension that people can acquire of £25 a week. This amount is around that of the boost that people could build up in State Second Pension from 2002 to 2016. This seems reasonable considering that our main target group are people with low Additional State Pension outcomes;
- how long the Class 3A scheme should run: The Government intends to limit the amount of time that people can take up Class 3A entitlement. The assumption is that most people interested in Class 3A would take up entitlement in the first few months after the scheme is introduced. The target audience – people who will have reached State Pension age before the single tier – are a static group and there will be no new customers so it therefore seems right to close the scheme after a period of time, perhaps after 18 months or 2 years;
- should there be a “cooling off period”: the amendment to the Pensions Bill makes provision for secondary legislation to define a “cooling off period” where contributors can reverse their decision to pay Class 3A. Class 3 has no cooling off period but is usually taken up by people of working age to cover gaps in their record as they arise. Class 3A is designed for people over State Pension age and the option to pay can be taken up by both new pensioners and pensioners into their 90s and beyond. The Government is concerned that pensioners may take up Class 3A where life expectancy is a key consideration and who may, on reflection, decide that access to capital is more important. The Government is interested in whether a cooling off period would reduce barriers to take-up and on the length of time that should be allowed for people to change their minds.

In due course we also intend to test our communications with stakeholders to ensure the public are given every opportunity to make a well-informed decision.

Impacts

Private sector

We believe that the limit on the amount of additional State Pension that people can acquire and time limiting the scheme will help to assure the private sector that Class 3A is a direct response to the needs of a particular group of pensioners and will not reduce their customer base.

Impact on Government finances

The Government have conducted some polling work on likely take-up which indicates that a small proportion of the 7 million eligible pensioners may pay Class 3A. The numbers taking up the policy will have a direct correlation with the revenue from National Insurance and the additional costs of extra additional State Pension. The Government will do further work on likely take-up and in particular will want to talk to stakeholders and other groups to gauge the level of interest once the final details of the scheme become settled. More details will be provided in due course.