

A simpler State Pension: A qualitative study to explore one option for State Pension reform

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Background

Demographic changes in the UK mean that life expectancy is increasing and the ratio of people eligible to claim the State Pension relative to the working population is rising. At the same time there has been a long-term decline in the level of private saving for later life. In response, the Government decided to introduce automatic enrolment, whereby eligible workers will be automatically placed into workplace pensions with an employer contribution unless they decide to opt out. To run alongside this initiative the Government announced its intention to reform the State Pension so that it provides a foundation of support whilst encouraging people to take greater personal responsibility for planning and saving for later life.

In April 2011 the Government published a consultation paper *A State Pension for the 21st century*¹, which set out two options for reform: accelerating existing reforms so that the State Pension would evolve into a two tier flat-rate structure more quickly; or more radical reform to a single tier flat-rate pension.

Against this context, we were asked to explore attitudes to the single tier option as a hypothetical alternative State Pension. The first option was not included as it is based closely on the current system which has already been the subject of much research.

The complexities of the current multi-element State Pension typically mean that people are unaware of how much they will receive, when or how it is calculated. The single tier option, as set out on page 25 of *A State Pension for the 21st century*², would simplify the system by combining the elements into a single amount with eligible future pensioners receiving a flat rate of around £140 per week. This

would be paid on an individual entitlement basis, and would be set above the current means-tested limit for the basic level of Pension Credit.

Research aims and objectives

As part of thinking about the optimal policy for a reformed State Pension and prior to taking any policy decisions the Department for Work and Pensions (DWP) commissioned this qualitative research to explore perceptions of whether the proposed single tier³ system was simpler and fairer than the current system and whether it offered certainty with regard to the amount that people will get that might impact financial planning for later life. The research also explored views and understanding around a number of individual concepts such as means-testing, qualifying years, automatic enrolment, contracting-out and the transition from one scheme to another, as well as language and communications testing.

Methodology

A series of focus groups and larger workshops were set up to facilitate the stated aims and to provide opportunities for people to respond to stimuli and debate potentially complex issues that they may not previously have engaged with in any depth.

Fieldwork took place between January and October 2011, and was conducted in four phases:

- Stage 1 – A pilot stage held in London to test research tools comprised of two focus groups, each comprised of six middle income respondents aged 35-50.

¹ www.dwp.gov.uk/docs/state-pension-21st-century.pdf

² *ibid.*

³ We have used the name ‘single tier’ in line with option 2 in *A State Pension for the 21st century*, although in Chapter 7 reference is made to potential alternative names for a reformed State Pension system.

- Stage 2 – Main-stage research incorporating 12 focus groups, each comprised of six to eight respondents in three locations (London, Birmingham and Manchester).
- Stage 3 – Follow-up research: i) two workshops, each comprised of 15 respondents, exploring transition issues arising from contracting-out of the additional State Pension, and ii) three focus groups with young people, each comprised of six respondents and split by age (20-25; 25-30; 30-35).
- Stage 4 – Follow-up research incorporating six focus groups, each comprised of six to eight participants. Respondents were recruited to reflect a broad spread of demographic characteristics. The groups explored respondents' views about the issue of transition and their understanding and reactions to alternative transition models. The purpose of the discussions was to explore how people trade off benefits of speed and length of transition, fairness, simplicity and certainty in light of the different models. In addition, any respondent reactions to transition were noted in order to help inform any future need to communicate the issue effectively.

Key findings

Consumer context

The four stages of research were conducted at a time of great economic instability, political change and a changing pension arena.

Consumers were generally facing increasing prices against a backdrop of rising unemployment and many people were facing job insecurity. The response for many consumers at a time like this was to rein in their expenditure and be more planned and considered in their household budgets. As a result of this, anything that seemed to offer people greater certainty and the ability to plan for the future was generally welcomed.

Throughout the research, there was also a narrative of cuts to public spending running in the background. Looking at any changes to State Pension policy, consumers were generally anticipating what was going to be cut or taken away, and how the Government was going to save money.

Finally, a lot of media attention was given during the fieldwork to the changes to State Pension age (and the changes in the decision about exactly when this would happen) and many of those employed in the public sector were facing changes to their occupational pensions. Furthermore, many of those with private pensions had recently seen the value of their investments drop sharply as a result of the global financial crisis and annuity rates were also declining. The consequence of all this was that respondents were generally cynical about the longevity of any changes announced. Many respondents believed that any changes to the State Pension would only be short-term, and that subsequent governments would probably change them again, thereby reducing any benefits in terms of the ability to plan ahead.

Perceptions of the current State Pension system

While approaches to retirement planning were very varied, the current State Pension system was generally found to be complex and confusing. There was very little idea about the current value of the State Pension, how it was calculated, or how much people might receive when they retire. The view that there may well not be a State Pension in the future, or if there is it will be at a much reduced level, was relatively widespread. For some, typically those further from retirement, this was a reason not to engage fully with the topic. Generally, it was felt that the State Pension alone would not be sufficient to provide a comfortable lifestyle in retirement, but would just cover the basics. This widespread view provoked a number of different responses: to ignore the issue and disengage; to plan for the future and make their own provision; or to conceive a vague plan to do something in the future.

As part of the research process, respondents were invited to suggest potential alternative structures for the State Pension. This was generally not an easy task as there were competing views about what and who it should be for. Generally, people felt that it should contain some combination of the following features:

- a safety net – enough to cover the basics (for everyone/deserving);
- some link to contributions/reward for working or effort;

- clarity about how much it will be worth to help people plan;
- those who have saved privately should not be penalised;
- those approaching retirement should not be denied what they are 'owed' – older generations should not be punished for the financial problems facing younger people.

There was little consensus about what an ideal State Pension system should look like or how the different elements could be traded off. However, respondents spontaneously started to weigh up the issues of fairness, simplicity, certainty, transparency and reward.

Introducing the single tier system

Respondents were introduced to an outline idea of a single tier – explaining that everyone who fully qualifies in this system would receive £140 a week; to qualify for this amount people would need to have 30 qualifying years of National Insurance contributions or credits. The amount of £140 was used for research purposes in order to test the policy proposition, no decisions have been made on the weekly amount of the single tier pension if it is implemented. A further assumption was that people would qualify for full level of State Pension at 30 qualifying years.

They were broadly positive about the idea as it seemed simple and easier to understand than the current State Pension. This was seen as benefiting the individual (easier to understand) and the Government (easier to communicate and administer). Additionally, the amount was viewed as being slightly more generous than many had anticipated, and was seen to be sufficient to cover the basics. However, there were mixed views about fairness. On the one hand, everybody who had 30 qualifying years would receive the same, making it fair for anyone who had taken time out of paid employment; on the other hand those who contributed beyond 30 years would not be rewarded.

From the point of view of being able to plan ahead, respondents felt that having a greater degree of certainty about the amount of State Pension they could expect to receive might help them plan better for the future, although it would not address other barriers, such as other financial pressures, lack of immediate imperative and uncertainty around the best way to save. However, knowing what State Pension to expect could help make planning a more concrete matter and act as an incentive to consider how much income they would need in retirement.

In addition to the overall concept of the alternative system, some specific related issues were discussed in the research:

Pension Credit/means testing

Introducing the topic of means testing made the concept of the single tier more complex, particularly in relation to fairness. The advantages of a reformed system would be that fewer pensioners would need to apply for Pension Credit and that it would save money for the Government by reducing administration. However, the concept of Pension Credit amplified the perceived unfairness of the single tier, whereby people who had made little or no National Insurance contributions would receive virtually the same income as the basic level of Pension Credit is currently only slightly lower than the proposed amount of pension under the single tier.

The link with automatic enrolment

Respondents were introduced to the idea of automatic enrolment, and the connection between that and the single tier pension was explored. The idea of being automatically enrolled into a pension scheme provoked a variety of responses, from relief and gratitude to confusion, anger and frustration.

The idea of the single tier and automatic enrolment was generally well received. To some extent, the combination was seen as making up for the perceived problem with the single tier system alone. The idea that the State Pension would cover the basics, with a workplace pension derived from automatic enrolment funding a more comfortable lifestyle in retirement, was seen as both logical and reasonable.

Contracting-out

In the event of moving from the current State Pension system to another, people who have previously contracted-out of the State Pension system will receive an amount made up of entitlement from the state plus an amount from the contracted-out element of their private or workplace pension. The third phase of this research explored understanding of contracting out. Although understanding was mixed, it was generally felt that the contracted-out element was completely separate from the State Pension. It was, therefore, felt that any attempt to explain that '£140 comes from the State Pension and part of your employer pension/private pension', undermined the simplicity, certainty and fairness of the single tier. Messages

that tried to combine state and employer/private pension pots were seen as potentially confusing or even misleading.

Transition

Respondents recognised that there would need to be some form of transition between the current and single tier State Pension. Overall, the complexities of transition undermine the simplicity and certainty of the single tier and people oscillate in their views between which simplicity, fairness and certainty are the more important. At root, however, particularly in times of economic uncertainty, people trade certainty for simplicity and fairness.

Conclusions and recommendations

In an area that is rife with confusion and uncertainty, simplicity intuitively appealed to respondents. Facilitating fairness, however, is far from straightforward and discussions around this generated polarised and changeable views. The perceived trade-off between fairness and simplicity was seen as difficult to make, but simplicity was generally seen to be more important than fairness as a means of ensuring transparency and, therefore, comprehension (although questions remained as to whether it could be this simple in reality).

The certainty associated with simplicity could prompt people to think more seriously about planning for retirement, as they would have a more concrete idea of how much they will need to save to fund the lifestyle they want. The proposed single tier system could therefore increase the level of personal

responsibility and empowerment for retirement planning, but other barriers remain in place that also impacts the actions people feel they can take. That said, considerable communications effort may be needed to ensure any real impact on people's planning – customers for whom State Pension age is a long way off are unlikely to pay much attention to it personally.

In discussing the various transition models it is clear that their underlying complexity and the varying amounts of pension that arise undermine the overall simplicity and certainty of the single tier. However, at root, people indicated that they are essentially individually focused and much less concerned about others – they want to avoid losing out themselves from reform; respondents are much less concerned about the simplicity and fairness of the single tier – certainty, particularly for themselves, is generally much more desirable.

Finally, it is important to remember that elements in the policy detail will also have a significant impact on how it is viewed by customers:

- the transition has the potential to obscure the benefits of simplicity and certainty;
- people that have contracted-out of the State Pension view their State and private pensions as separate entities;
- the benefits of certainty can easily be undermined by cynicism that it may all change again. Anything offering greater certainty (e.g. guarantee for a certain number of years, cross-party support) will be important in encouraging people to act.

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The full report of these research findings is published by the Department for Work and Pensions (ISBN 978 1 908523 46 4. Research Report 787. January 2012).

You can download the full report free from: <http://research.dwp.gov.uk/asd/asd5/rrs-index.asp>

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