Simplicity, security and choice:

Working and saving for retirement

DWP Department for Work and Pensions

HM TREASURY

Inland Revenue

Simplicity, security and choice: Working and saving for retirement

Presented to Parliament by
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Contents

Foreword by Rt Hon Andrew Smith MP, Secretary of State for Work and Pensions v

Summary 1

Chapter 1: Introduction 11

Chapter 2: The context 15

- 2.1 The demographic context 15
- 2.2 How are countries responding to the demographic challenges? 18
- 2.3 The UK pensions system – a partnership approach 19
- 2.4 Reforms to state support since 1997 19
- 2.5 Planning for retirement in the future 23
- 2.6 Provision for retirement by future pensioners 26
- 2.7 Ensuring progress 30

Chapter 3: Informed choice in pensions – choices for individuals 33

- 3.1 Introduction 33
- 3.2 The choices facing individuals 34
- 3.3 Barriers to saving 36
- 3.4 A simple framework 37
- 3.5 Financial education and awareness 39
- 3.6 Personalised information 42
- 3.7 A choice of suitable products 45

Chapter 4: Pensions and the workplace 47

- 4.1 Introduction 48
- 4.2 Trends in employer provision 50
- 4.3 Supporting occupational schemes and encouraging employer provision 53
- 4.4 Simplification 55
- 4.5 Protecting employees 62
- 4.6 Better information and promotion of pensions 70

Chapter 5: Financial services – building trust and improving understanding 77

- 5.1 Introduction 77
- 5.2 Helping people to save for their retirement 79
- 5.3 Turning savings into retirement income 87
- 5.4 Better investment by occupational pension schemes 91

Chapter 6: Extending opportunities for older workers 93

- 6.1 Introduction 94
- 6.2 Progress since 1997 95
- 6.3 The remaining challenges 97
- 6.4 Helping older people to remain in or return to work 99
- 6.5 Building on best practice among employers 104

Chapter 7: Women, work and pensions **109**

7.1 The position of current female pensioners 110
7.2 The labour market patterns of women compared to men 111
7.3 The effect of differential employment patterns on occupational pension coverage 112
7.4 The effect of differential employment patterns on earnings 113
7.5 The greater life expectancy of women in retirement 114
7.6 Government measures to help women who have already retired 115
7.7 Government measures to help working-age women build up better pensions 115
7.8 Conclusion 121

ANNEXES

Annex 1: Issues for consultation and the consultation arrangements 123
Annex 2: Partial Regulatory Impact Assessment 127
Annex 3: Public pension spending, the long-term sustainability of public finances and the challenges to economic growth 147
Annex 4: Retirement saving behaviour 151
Annex 5: Assumptions underlying the analysis 159
Annex 6: Contact details for organisations providing information on pensions 163
Annex 7: Consultation criteria 167

Foreword

Decisions on pensions are some of the most important of our lives.

Building on the foundation of our reforms to state provision and to financial services, this Green Paper sets out proposals to simplify occupational and private pensions saving and make flexible retirement easier. Our aim is to help people choose how they plan for retirement, how much they save and how long they keep working.

Our immediate priority on coming to office was to tackle pensioner poverty. Measures we have introduced, including the Pension Credit, mean the average pensioner household will be £1,150 a year better off in real terms, compared with 1997.

Today we face fresh challenges. Longer lives are good news, but if people are to get the retirement income that they want, they must be able to judge whether they need to save more, work longer, or both. But for too many people pension planning is an incomprehensible maze.

Employers' support for pensions also faces pressures of longevity, complex tax rules and red tape.

This Green Paper sets out a new more flexible approach making it easier for people to save and easier for employers to contribute. We propose radical simplification of tax rules, better information about pension choices and a range of options to strengthen protection for employees.

We want people to be able to choose between simple, quality products, assisted by trustworthy information tailored to their own circumstances.

We believe pensions saving should be based on partnership, with employees, employers, pensions providers and government all working together.

We believe our proposals will renew this partnership, improve saving through the workplace and enable people to extend their working lives if they choose.

It is important that the impact is independently monitored. So we will establish a pensions commission to assess trends in occupational and private pensions and long-term saving, and to advise whether there is a case for moving beyond the current voluntarist approach.

I look forward to comments on this Green Paper so that the action we take is fully informed by the views of the public and can deliver simplicity, security and choice in working and saving for retirement.

Rt Hon Andrew Smith MP
Secretary of State for Work and Pensions
December 2002

Summary

1. The Government is committed to building a fairer and more inclusive society to which everyone can contribute, and in which everyone can share in rising national prosperity.

2. We all want to be able to retire on an income that meets our expectations, and as we live longer and healthier lives, we need to save more or work longer so that we can make the most of our retirement.

Our proposals

3. This consultation builds on the 1998 Green Paper *A new contract for welfare: partnership in pensions* enabling future generations of pensioners to prepare for their retirement. It sets out the Government's proposals to renew the partnership between the Government, individuals, employers and the financial services industry which has long been a strength of the UK pensions system. The new proposals will:

    - help people make better informed choices about their retirement;
    - reaffirm the role and responsibilities of employers in the pensions partnership, improving saving through the workplace, and providing greater protection for members of occupational schemes;
    - encourage simple and flexible savings products, broadening access to the financial services industry; and
    - introduce measures to extend working lives.

Reforms since 1997

4. The immediate challenge when this Government came to office was pensioner poverty. So the Government introduced the Minimum Income Guarantee and above inflation increases in the basic State Pension. All pensioners are better off as a result.

5. From October 2003, the Pension Credit will build on these changes – guaranteeing a minimum income and rewarding pensioners who have done what successive Governments have asked and saved.

6. A key challenge was also to help today's employees – tomorrow's pensioners – provide for their retirement. At the time of the 1998 Green Paper, pensioner incomes for the better-off had been rising dramatically thanks to the maturing of the State Earnings-Related Pension Scheme (SERPS) and the growth of occupational pensions. But it was also clear that some people were not saving or working for long enough, particularly in light of rising longevity. So, to complement the Government's reforms to address pensioner poverty, the 1998 Green Paper also set out reforms directed at tomorrow's pensioners. These have now been implemented:

- we replaced SERPS with the State Second Pension to provide more generous pensions for those on low and moderate incomes and, for the first time, to give a second pension to many carers and people with disabilities;
- we introduced stakeholder pensions to provide a good value, simple and flexible vehicle for saving for retirement; and
- we reformed the regulatory framework for saving, replacing ten regulators with a single one – the Financial Services Authority (FSA) – enabling consumers to save with more confidence.

7. All this was built on a stable macro-economic foundation, providing a secure basis for long-term saving.

The challenges we face

8. To build on these reforms, simplify and broaden access to private pension provision, last year the Government announced three reviews of pensions and saving.

- *A Simpler Way to Better Pensions – An Independent Report*, by Alan Pickering, July 2002, put forward suggestions for simplifying the occupational pensions system.
- *Medium and Long-Term Retail Savings in the UK – A Review*, by Ron Sandler, July 2002, addressed the market for personal pensions and other personal investments.
- *Simplifying the taxation of pensions – increasing choice and flexibility for all*, Inland Revenue, to be published alongside this Green Paper, proposes a new simple system for taxing pensions.

9. In addition, the report of the *Quinquennial Review of the Occupational Pensions Regulatory Authority* is published concurrently with this Green Paper.

10. These reviews took place against a background of increasing concern over the adequacy and security of pension provision. Some of these concerns are legitimate but many have been overstated. Most people are being paid the pension they were promised. Most are saving for their retirement, either in pensions or in other forms. There has been a 40 per cent increase in pension contributions since 1997.

11. The main concerns are:

- longer life spans mean that people will have longer retirements – if people choose not to work longer, and do not wish to see a drop in living standards, they will need to save more;
- at the same time, there are signs of a decline in pension provision by some employers. While a shift from defined benefit to defined contribution pensions may not in itself be a cause for concern, the level of employer contributions does matter. Employee confidence has also suffered due to the action of a few companies, who have let their employees down when they have become insolvent with an under-funded pension scheme;

- the complexity of products, the cost of financial advice and the legacy of pensions mis-selling mean that too many people are excluded from the financial services industry; and
- many people are leaving employment too early.

12. Rising longevity is to be celebrated but it brings important challenges for all developed countries. Our analysis shows that the UK is better placed than most other developed countries to adapt to an ageing population. For example, the old-age dependency ratio is expected to increase by less in the UK than in the EU as a whole, and the employment rate for older workers has risen significantly following a steady decline during the 1980s and 1990s.

13. In addition, the level of private funded provision in the UK is high by international standards and the value of UK pensions assets is similar, relative to Gross Domestic Product (GDP), to that of the US. By contrast most other European countries have very few or no private pension funds.

14. This well-developed private pension provision, together with targeted State support, means that the UK is better able to cope with these demographic challenges.

15. The projections set out in HM Treasury's recent report on the long-term sustainability of public finances shows that public spending on pensions is likely to remain relatively stable over the next five decades – fluctuating around 5 per cent of GDP, in marked contrast to other EU countries.

16. But none of this can be a cause for complacency. There is still much to be done. The Government's analysis and reviews have identified clear areas where action is needed to enable people to control and plan their work and savings to give them the retirement they want.

17. This Green Paper sets out the Government's proposals to address these issues. Once the reforms are in place, we believe that people will take action to build their income for retirement.

Informed choice for individuals

18. The Government provides the foundation of pension income, but in a voluntary system the amount people should save in addition to the basic State Pension will depend on their own circumstances and preferences.

19. Assessing levels of under-saving is complex. Some methods used to quantify a 'savings gap' have serious shortcomings. They have failed to take account of alternative ways of saving and the various choices people may make at different stages of their lives.

20. Current estimates show that up to 3 million people are seriously under-saving for their retirement – or planning to retire too soon. In addition, a further group of between 5 and

10 million people may want to consider saving more, working longer, or a combination of both, depending on their expectations for retirement.

21. The Government believes this reflects the fact that choice is currently frustrated by complexity and confusing flows of information which do not relate clearly to an individual's circumstances, by hard-to-compare products and by expensive advice.

22. The Government wants to help people make better informed choices about their retirement and believes that those who seem to be saving too little will save more if:

- there is a simpler framework to help people understand their choices; and
- individuals are equipped to understand financial choices and receive clear information tailored to their own circumstances.

A simpler pensions framework

23. There are currently eight different tax regimes for pensions and within these regimes there are different rules concerning the levels of contributions and the levels of benefits. This proliferation of regimes and rules creates complexity which makes pensions difficult to understand and explain, constrains people's choices about when and how to save, and imposes unnecessary administrative burdens on employers, individuals and pension providers. **To reduce this complexity we will radically simplify the pensions tax regime.**

24. We will introduce a single regime with a lifetime limit on the amount of tax-privileged pension saving. This will increase individual choice and flexibility, helping to ensure that people make informed decisions on how, when, and how much to save for retirement.

25. The vast majority of people will be able to save more in a pension than existing rules allow.

Helping individuals to understand financial choices

26. The Government recognises the value of good information in helping people to make informed choices, and will continue to work with the FSA to improve basic financial literacy and make sure that individuals are equipped to understand financial choices.

27. But the Government also believes that providing tailored information based on an individual's circumstances will make the biggest difference and encourage people to save more. This approach will be developed by:

- **increasing the number of people receiving forecasts of their pension income**, by working with employers and scheme providers so that more people with private savings can receive combined pension forecasts, and begining to issue state pension forecasts to the self-employed, and to people who are not members of personal or occupational pension schemes; and
- **improving the range of services providing tailored information**, by offering an integrated telephone service and website, and by issuing information at key points in people's lives to encourage greater awareness and understanding of savings options.

Pensions and the workplace

28. Employers have a major role to play in the pensions partnership by providing access, information and contributions to pensions for their employees. The workplace is an effective place for people to save – administration is more effective and there are generous government incentives in the form of relief on National Insurance contributions.

29. Employers gain from the important benefits for recruitment, retention and staff motivation that good pension provision brings. Indeed, many employers contribute generously, and many give employees the good quality pension information they need to make choices for their retirement.

30. However, employers have expressed concerns about the burdens of administering pension schemes. There are also growing anxieties among employees and trade unions over scheme closures and reductions in pension contributions. Confidence has been undermined by a number of well-publicised cases where schemes have wound up, sometimes failing to meet the reasonable expectations of their employees.

31. The proposals will reaffirm the role and responsibilities of employers in the pensions partnership and encourage saving in the workplace.

Making pension provision easier for employers

32. The Government is determined to make it easier for employers to set up and run good pension schemes. The complexity in pensions legislation and tax rules will be reduced by:

- **radically simplifying the tax treatment of pensions** to reduce the costs of providing and administering a pension scheme by removing unnecessary burdens and introducing new, more flexible, rules;
- **replacing the Minimum Funding Requirement** with scheme-specific regulation to allow schemes greater flexibility. It will also make the funding position more transparent for scheme members;
- **simplifying the structure of contracted-out benefits** and reducing complexity for both past and future service. This will greatly simplify administration for schemes and could reduce funding pressures. It will also give schemes greater flexibility in the benefits they offer their employees and increase transparency for scheme members; and
- **consolidating existing pensions legislation** and simplifying legislation that relates directly to scheme administration and governance. We believe that the level of prescription should be based on the risk to scheme members. We want to give schemes greater flexibility to design and manage themselves in a more efficient and effective way that supports the business of the sponsoring employer.

33. Overall, the simplification proposals could save employers £150–200 million a year in administration.

Better protection for members

34. However, there is a balance to be struck. The Government is determined to ensure that reduced regulation and red tape around pensions is married with greater protection for consumers to give them the confidence they need to join schemes.

35. This is why the Government is proposing a **new pensions regulator** that will focus on protecting the benefits of scheme members. The new regulator will operate proactively to anticipate problems, concentrating its effort on schemes where it assesses that there is a high risk of fraud, bad governance or maladministration.

36. To reinforce this approach the Government is also looking at proposals to protect members when problems do arise, such as when employers become insolvent or when there is insufficient funding in the pension scheme to meet all the pension liabilities. These proposals would potentially:

    - provide members with **better protection** where schemes are wound-up;
    - make sure that schemes are **compensated for the full amount lost as a result of acts of dishonesty**; and
    - give employees the **right to be consulted** on changes to an employer's pension scheme to prevent firms changing or closing schemes without dialogue with employees.

Sharing best practice

37. The Government wants to encourage employers to ensure that their current and potential employees understand the value of any pension contributions made. We will set up an **employer task force** to draw on business experience and innovation in identifying and promoting good practice.

Using a good pension to help recruit and retain staff

38. The Government wants more employers and employees to see a good pension as a key part of a total remuneration package. We want to encourage employee awareness of pension benefits, so more firms learn about the benefits of pensions to help recruit and retain the best employees. We set out proposals to:

    - **encourage employers to adopt best practice in informing employees and prospective employees of the pensions offered** through total benefit statements, information on pay slips and in recruitment material; and
    - **help employers to provide information and guidance for employees**, through such initiatives as an FSA approved pension pack for employers to use to communicate with their employees.

39. The Government is also looking at what can be done to encourage better pension provision and help employers who do offer a good deal to their employees. For example,

the proposals will look at whether **employers could make joining their pension scheme a condition of employment for new recruits**.

40. We also want to **encourage immediate vesting** to ensure that all members enjoy the benefits of their employer's contribution as soon as they join the scheme. However, to avoid this becoming an administrative burden for schemes when a member leaves, trustees should be **able to transfer *de minimis* amounts to a stakeholder pension** unless the member objects or asks for the rights to be transferred elsewhere.

41. The Government believes that taken together these proposals will renew the role of employers in the pension partnership and improve individual choice to save through the workplace.

Informed choice in pensions: building trust and understanding in financial services

42. The financial services industry is a key player along with the Government, employers and individuals, in the provision of secure incomes in retirement. The industry provides investment and administrative services to occupational pension schemes provided by employers. It also provides personal pensions to individuals.

43. The Government's aim is to ensure that both of these markets work efficiently and effectively. Since 1997 we have taken action to clear up pensions mis-selling, re-build trust in the financial services industry and introduce new savings products, including ISAs and stakeholder pensions – these have opened up opportunities for more people to save.

44. The Government wants to build on this approach and encourage simple, flexible savings products to help more people save more for their retirement.

45. The proposals to achieve this include:

- **implementing Ron Sandler's recommendations** to make it easier to save through simple products and sales processes; to help develop generic advice products; and to make offering financial advice through the workplace easier;
- **introducing value protected and limited period annuities**; and
- ensuring that the **regulation of equity release and home reversion plans** protects consumers and allows the market to work effectively.

Extending opportunities for older workers

46. In planning for retirement, saving is only half of the equation. Enabling people to work a few years longer can make a huge difference to the income they can expect. This Green Paper sets out how we will make sure that our employment and pension policies work together so that there is flexibility in the system to give individuals the choice to extend their working lives.

47. We inherited relatively high inactivity rates amongst the over 50s – something we have already done much to tackle. But many people who are willing to, and capable of, work still do not have the opportunities they need.

48. The Government is determined to tackle these issues and to give more people a greater range of options to work for longer. We will do more to help over 50s into work and tackle age discrimination, by:

- providing **extra back-to-work help for those aged 50 and over** and piloting **measures to help recipients of incapacity benefits return to work**;
- treating **men and women between 60 and 64 as active labour market participants**, as women's State Pension age rises towards 65 from 2010; and
- **implementing by December 2006 age legislation covering employment and vocational training, in which compulsory retirement ages are likely to be unlawful** unless employers can show that they are objectively justified.

49. The Government is also determined to do more for those in employment who are prevented by tax rules from carrying on working. We will consult on **proposals to allow individuals to continue working for the sponsoring employer whilst drawing their occupational pension, and consult on best practice to ensure that occupational pension rules do not discourage flexible retirement**.

50. **For public service schemes, we intend to make an unreduced pension payable from age 65 rather than age 60, initially for new members.**

State Pension age

51. The State Pension age for women is already set to increase from 60 to 65 between 2010 and 2020 to match State Pension age for men. It has been suggested that we should go further after 2020, increasing the State Pension age for men and women to perhaps 67 or 70. **This Green Paper does not propose an increase in the State Pension age.**

52. Raising the State Pension age would impact most heavily on those most dependent on the State Pension. The first priority is to address the employment rates of those approaching 65.

53. The Government is also keen to encourage people to work past 65 where they want to, by developing further the concept of flexible retirement. At present, people who defer taking their State Pension until after they reach 65 (60 for women until 2010) get an increase in their pension. We want to improve these incentives.

54. From 2010 people will gain at least 10 per cent for each year they delay drawing their pension – compared to 7.5 per cent now. To encourage more people to consider later retirement, we will bring this forward so that people can benefit from it as soon as possible. We are also looking at the possibility, where people defer taking their pension, of offering **a choice of either increased regular State Pension or a taxable lump-sum payment**, comparable with the value of the pension increase.

55. The Government will also work with employers to help them play their part through encouraging good practice in employing older workers.

Pensions and women

56. The state and private pension systems have together delivered impressive improvements in the living standards of successive cohorts of pensioners. But the current generation of female pensioners are over-represented in those groups of pensioners with low incomes.

57. This reflects the historical gender gap in employment rates and pay that women faced over their working lives, which are partly driven by the different family roles of women and men. These trends adversely affect occupational pension coverage, and also feed through from lower pay into lower pensions.

58. The remaining gender gap in employment rates and pay, together with the prevalence of female part-time work, mean that it has been harder for women than it is for men to build up adequate National Insurance rights and private pensions. The pension they do accrue then has to last over a greater number of years in retirement due to the greater life expectancy of women.

59. We are also supporting women's labour market position. This includes additional investment in childcare, the introduction of the National Minimum Wage, and extra support for families from April 2003 with the introduction of new tax credits and changes to maternity and paternity provision.

60. We have already taken action to help women build up state pensions despite the various labour market disadvantages they face. We have also introduced stakeholder pensions which are designed to suit female employment patterns. Measures suggested in this Green Paper to promote the labour market participation of older workers will help more women work later in life, often when childcare responsibilities have ended.

61. The Government is committed to improving pensions information for everyone but awareness of pensions issues remains low among women. Proposals in this Green Paper to promote informed choice, such as individualised pension forecasting, will help. But **we will also look at the information we provide for women** to assess, for example, the best way of informing people not only of their expected pension position but of the rules of state and private pensions and the pensions implications of changing circumstances over the working life.

Ensuring progress

62. Pensions policy has to be for the long-term. If we want people to plan for the future, stability in the framework of pensions policy is a key component. There are currently obstacles in the way of an effective voluntary system. The measures outlined in this paper are designed to address this issue and to make the voluntary system work effectively.

63. It is vital that progress is closely and independently monitored. We need good information so that we can judge whether sufficient progress is being made and that employers, the financial services industry and individuals are responding to the challenge. But this will require all partners fully to play their part.

64. We will be establishing an independent **pensions commission** to report regularly to the Secretary of State for Work and Pensions on how effectively the current voluntarist approach is developing.

65. In view of concerns about the quality of information available to policy-makers, the commission's first task will be to look at this area and make recommendations to the Government.

Conclusion

66. These proposals for better information, simpler pensions, simplified tax treatment, better protection and more flexible retirement are designed to enable people to make their own choices for retirement. They build on the foundation of the State Pension.

67. The proposals are consultative. We look forward to comments from the public, employers, trade unions and the financial services industry so that future policy rebuilds and strengthens the contribution that the pensions partnership makes to security in retirement.

Chapter 1: Introduction

1. This Green Paper sets out the Government's proposals to renew the partnership between government, individuals, employers and the financial services industry that has long been a strength of the pension system in the UK. The aim of these proposals is to enable future generations of pensioners to plan more effectively for their retirement. They will help people to make better-informed choices. They recognise the important role that employers play within this partnership and reaffirm their responsibilities; and they help to increase the availability of simple and flexible savings products. In these ways, this Green Paper builds on the 1998 Green Paper, *A new contract for welfare: partnership in pensions*[1]. And it is complemented by the parallel radical simplification of the tax system for pensions set out in *Simplifying the taxation of pensions*[2].

2. The immediate challenge when this Government came to office was pensioner poverty. The Government therefore introduced the Minimum Income Guarantee, the Pension Credit and above inflation increases in the basic State Pension. All pensioners are better off as a result.

3. A key challenge was also to help today's employees – tomorrow's pensioners – provide for their retirement. At the time of the 1998 Green Paper, the incomes of better-off pensioners had been rising dramatically due to the maturing of the State Earnings-Related Pension Scheme (SERPS) and the growth of occupational pensions. But it was also clear that some people were not saving enough or working long enough, particularly in light of rising longevity. So, to complement the Government's reforms to tackle pensioner poverty, the 1998 Green Paper also set out reforms, now implemented, directed at tomorrow's pensioners.

   - We replaced SERPS with the new State Second Pension from April 2002 to provide more generous pensions for those on low and moderate incomes, many carers and people with disabilities.
   - We introduced stakeholder pensions to provide a secure, simple and flexible vehicle for saving for retirement.
   - We tackled pensions mis-selling and reformed the regulatory framework for saving, replacing ten regulators with one, the Financial Services Authority (FSA), enabling consumers to save with more confidence.

4. All this was built on a stable macro-economic foundation, providing a secure basis for long-term saving.

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1 Department of Social Security, December 1998.
2 *Simplifying the taxation of pensions*, HM Treasury and Inland Revenue, December 2002.

5. To build on these reforms, simplify and broaden access to private pension provision, the Government announced three reviews of pensions and saving in 2001.

   - *A simpler way to better pensions – An independent report by Alan Pickering*, July 2002.
   - *Medium and Long-Term Retail Savings in the UK – A Review*, Ron Sandler, July 2002.
   - *Simplifying the taxation of pensions*, Inland Revenue, a review of the tax rules for pensions.

6. In addition, the report of the *Quinquennial Review of the Occupational Pensions Regulatory Authority* was published concurrently with this Green Paper.

7. These reviews took place against a background of increasing concern over the adequacy and security of pension provision. Some of these concerns are legitimate, but many have been overstated. Most people are being paid the pensions they were promised. Most are saving for their retirement, either in pensions or in other forms. There has been a 40 per cent increase in pension contributions since 1997[3].

8. There are four main concerns.

   - Longer life spans mean many people will have longer periods of retirement. If people choose not to work longer, and do not wish to see a drop in living standards, they will need to save more.
   - At the same time, there are signs of a decline in pension provision by some employers. While a shift from defined benefit to defined contribution pensions may not in itself be a cause for concern, where such a shift is accompanied by a reduction in employer contributions, then it poses more serious problems. In a few cases, employees have seen dramatic reductions in their pension entitlements when their companies became insolvent.
   - The complexity of products, the cost of financial advice and the legacy of pensions mis-selling mean that too many people are excluded from the financial services industry.
   - Many older people are leaving employment unnecessarily early.

9. Plainly, rising longevity is welcome but it brings important challenges for all developed countries. In this Green Paper, we assess the scale of these concerns. Although not a cause for complacency, it is clear from this analysis that the UK is better placed than most other developed countries to adapt to an ageing population.

10. The Sandler and Pickering reviews have now reported and the Government's proposals flowing from the Inland Revenue review were published alongside this Green Paper. They re-affirm the Government's belief in the potential of the voluntarist approach.

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3 Office for National Statistics, data deflated by Retail Price Index.

They show how, with all partners playing their part, the voluntarist approach can work to the maximum effect.

11. This Green Paper sets out:

- an assessment of the challenges we face and the progress we have made so far **(Chapter 2)**;
- our proposals for helping people make informed choices **(Chapter 3)**;
- measures for improving planning and saving for retirement in the workplace **(Chapter 4)**;
- further proposals for providing simple and flexible products **(Chapter 5)**;
- measures to address the cliff-edge of retirement **(Chapter 6)**; and
- the particular challenges women face in accumulating sufficient pension income **(Chapter 7)**.

12. *Simplifying the taxation of pensions*, published alongside this Green Paper, sets out proposals for transforming pensions tax rules to increase individual choice and flexibility, and reduce administrative burdens on employers and pension providers alike.

13. These are all tasks that need to be addressed by the pensions partnership. This partnership has worked well in the past but needs to be renewed.

- The Government now provides a stable foundation of support for pensioners, and will continue to develop a framework that helps people to save more and to work longer if they so choose.
- Individuals need to decide how much income they want in retirement above the state foundation and plan their working lives and saving to match this, in partnership with their employers.
- Employers should play a key role as providers of and contributors to occupational pension schemes and as sources of information about pensions options.
- The financial services industry should facilitate these choices by developing a simpler, more transparent market in which trusted and trustworthy providers sell simple, good value products to increasing numbers of informed consumers.

Chapter 2: The context

Chapter summary

All developed countries face the challenges posed by an ageing population. The UK is better placed than most, but there is no room for complacency. As more people look forward to longer and healthier lives, it is all the more important that they plan their work and saving patterns so that they can attain their desired standard of living in retirement.

Today's pensioners are now much better off in real terms than they were five years ago. From October 2003, as a result of measures introduced by this Government, the poorest third of pensioners will be £1,500 better off a year in real terms than they were in 1997. The Government has also taken steps to increase saving for retirement among those of working age, by introducing the State Second Pension and stakeholder pensions and by helping people to work longer.

Any assessment of the adequacy of current saving for retirement is complex. It is impossible to make definitive statements on this issue. But our estimates suggest that there are likely to be around 3 million people who are seriously under-providing for their retirement. Depending on their expectations and circumstances, a further group of between 5 and 10 million people may wish to consider saving more or working longer.

The successful development of the voluntarist approach to pension saving requires a renewal of the partnership between the Government, individuals, employers and the financial services industry.

This Green Paper outlines what each of these partners need to do to ensure the continued success of pensions and how the Government can help them to meet their responsibilities.

2.1 The demographic context

1. People can look forward to a longer retirement than ever before. The average number of years spent in retirement has increased significantly: in 1960, a man aged 65 could expect to live for another 12 years. Today, he could expect to live for another 16 years, and by 2050 it is projected that this figure will increase to around 19 years. Similar increases apply to women.

2. Figure 2.1 shows past, current and expected future life expectancy at age 65 for men and women[1] in the UK. As we will see later in this chapter, widespread early retirement means that the average number of years spent in retirement is higher than suggested by Figure 2.1. The picture is similar across developed countries.

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1 State Pension age for women is currently 60 but will increase to 65 by 2020.

Figure 2.1: Life expectancy at age 65

Year	Men	Women
1928	11.5	13.3
1960	12.1	15.3
2002	16.0	19.0
2025	18.3	21.1
2050	19.0	21.7

Source: Government Actuary's Department (GAD), 2002.

3. Rising longevity, welcome as it is, underlies many of the long-term challenges to pension provision. People need to fund longer periods of retirement than ever before. Increasing longevity, coupled with the effects of lower birth rates, means that countries across the developed world are faced with ageing populations.

International comparison of the scale of demographic change

4. The ageing of the population is less marked in the UK compared to Japan and most EU countries. Over the next 50 years, EU countries as a whole are expected to see almost a doubling in the old-age dependency ratio (people aged 65 and over as a percentage of those aged 15 to 64) to nearly 55 per cent. Japan is likely to experience an even greater increase. By contrast, the old-age dependency ratio in the UK will rise by a relatively moderate 15 percentage points to almost 40 per cent between now and 2050.

Figure 2.2: Population aged 65 and over as a percentage of those aged 15 to 64, in selected developed countries

	1975	2000	2025	2050
France	21.5	24.5	36.2	46.7
Germany	23.3	24.1	39.0	54.7
Italy	18.9	26.7	40.6	68.1
The Netherlands	16.9	20.1	34.3	45.0
Spain	16.1	24.8	36.1	73.8
Sweden	23.5	27.1	41.5	54.5
UK	**22.6***	**24.4**	**32.8**	**39.2**
Weighted average of EU Member States	**20.7**	**24.5**	**37.1**	**54.7**
Australia	13.6	18.2	29.2	37.5
Canada	12.9	18.5	32.6	40.9
Japan	11.6	25.2	49.0	71.3
US	16.3	18.6	29.3	34.9

Sources: *World Population Ageing 1950–2050*, United Nations, 2001. The UK figures are updated based on GAD historical data and 2001-based interim principal population projections.

* Figures for 1976.

Early retirement

5. The trend towards rising life expectancy is compounded by a tendency towards early retirement across the industrialised world. Figure 2.3 shows that, in a range of Organisation for Economic Co-operation and Development (OECD) countries, on average, people currently tend to retire before age 65 (the State Pension age for men in the UK).

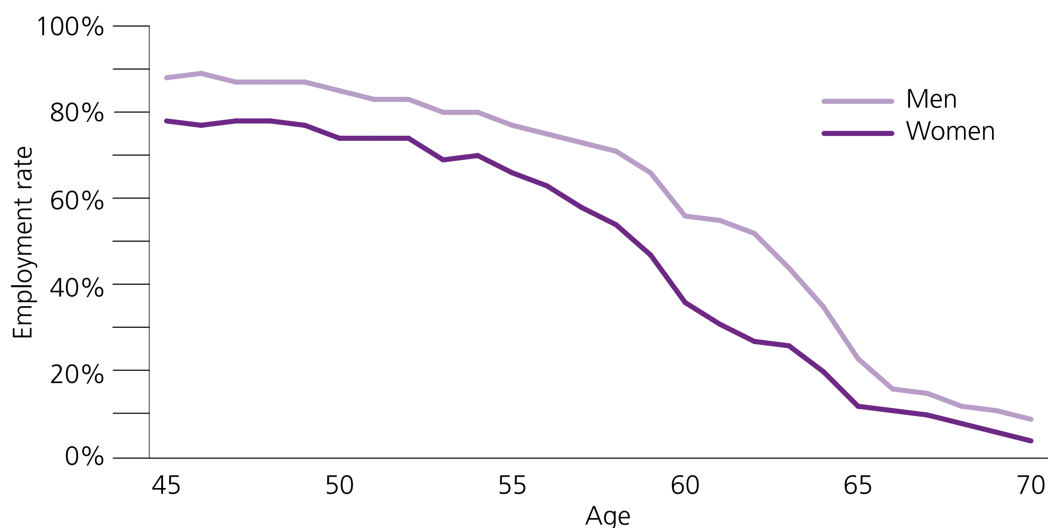
Figure 2.3: Average age of withdrawal from the labour force in selected OECD countries in 1999

Year	Men	Women
Canada	62.4	60.8
Germany	60.3	60.1
Italy	58.8	57.9
Japan	68.5	64.7
The Netherlands	60.4	59.8
Sweden	63.7	62.7
UK	**62.6**	**60.4**
US	64.6	63.4
Average	**62.3**	**61.1**

Source: *Ageing and Income*, OECD, 1999 (1998 data for Germany and the Netherlands).
Note: Figures refer to median age of withdrawal.

6. In the UK, employment rates for men and women start to decline quite sharply after age 55. This is shown in Figure 2.4. By State Pension age (currently 60 for women and 65 for men) around two-thirds of men and half of women have left the labour market. In total, a third of people between 50 and State Pension age – almost 3 million people – are outside the labour market.

Figure 2.4: Employment rates of older workers by age in 2002 (UK)



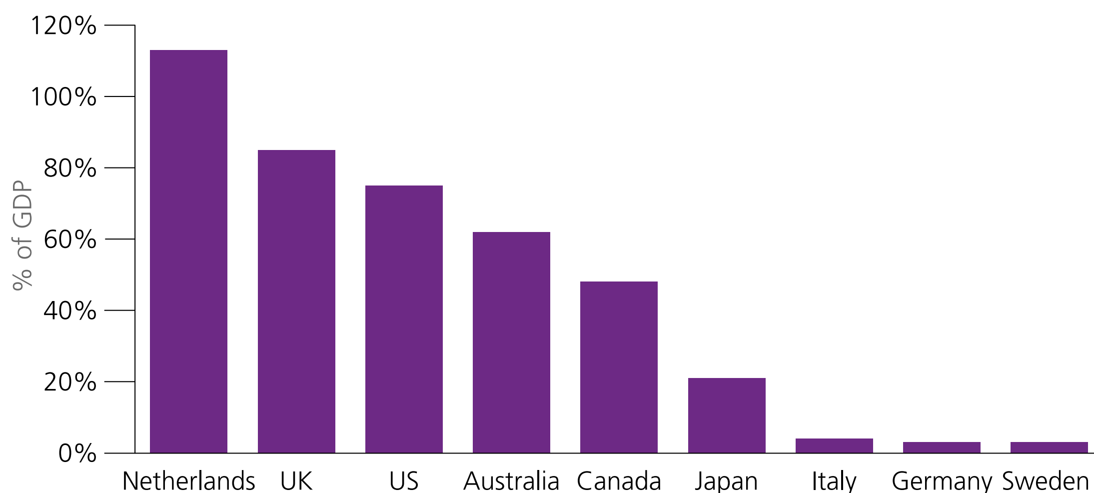
Source: *Labour Force Survey*, 2002.

2.2 How are countries responding to the demographic challenges?

7. Increasing life expectancy and the trend towards earlier retirement mean that societies need to fund longer periods of retirement than ever before. As people look forward to longer and healthier lives, it is all the more important that they plan their work and saving patterns so that they can attain their desired standard of living in retirement. These demographic pressures are already being felt in countries with large unfunded state pay-as-you-go pension systems, in which the current working-age population pays for the pensions of current pensioners.

8. The level of privately-funded pension provision in the UK is high by international standards. Figure 2.5 compares pension funds as a proportion of Gross Domestic Product (GDP) in a range of OECD countries. It shows that the value of UK pensions assets is similar, relative to GDP, to that in the US – well over 75 per cent. Most other EU countries have little or no private pension provision. The Netherlands is a notable exception.

Figure 2.5: Financial assets of pension funds as a percentage of GDP



Source: *Institutional Investors Statistical Yearbook*, OECD, 2001.
Note: Figures refer to 1999.

9. On the assumption of unchanged policies, public spending on pensions in the EU is projected to increase substantially from around 10 per cent to around 13 per cent of GDP. This raises questions about the long-term fiscal sustainability of their pensions arrangements. Reducing the long-term costs of pensions will be a key challenge in many EU Member States in the next few years.

10. By contrast, the relatively high level of privately-funded pension provision places the UK in a much better fiscal position to face the demographic challenges. **Annex 3** contains projections of state spending on pensions. These projections show this spending, as

a proportion of GDP, continuing at broadly its current level of around 5 per cent in future years.

2.3 The UK pensions system – a partnership approach

11. The UK is much better placed to meet the demographic challenges because of its system of targeted state support coupled with a well-developed, funded private pensions system. This system provides individuals with greater choice and flexibility over how much to save and the timing of their retirement. The continued success of the UK approach to pension provision relies on the renewal of the partnership between the Government, individuals and employers, underpinned by a competitive and accessible financial services industry.

12. The Government wants to ensure that no pensioner lives in poverty, while providing a clear and stable framework so people can plan for their future, and ensuring the system remains affordable. To achieve this, the Government's role is to:

- provide a minimum income for less well-off pensioners;
- provide a stable and coherent foundation of state support for all pensioners;
- encourage and support individuals and employers to make private provision for retirement;
- oversee an efficient, effective and transparent private pensions market, where consumers are adequately protected and informed of the choices available to them, and complexity is kept to a minimum;
- remove barriers that working people may face if they wish to work in later life; and
- enable those older individuals who are out of work to find employment.

13. Above the foundation of support provided by the State, individuals, where possible supported by their employers, are responsible for deciding the level of income on which they wish to retire. They need to choose the appropriate combination of saving and working to achieve this, making use of the choices offered to them by the Government, employers and the financial services industry.

2.4 Reforms to state support since 1997

14. The Government's immediate priority in 1997 was to tackle poverty among today's pensioners. While average pensioner incomes had risen over the previous few decades, improvements in incomes had not been evenly distributed. Real median incomes of the poorest fifth of pensioner couples grew by 34 per cent between 1979 and 1996/97, compared with over 80 per cent for the richest fifth. The poorest single pensioners in 1997/98 had to live on incomes as low as £68.80 a week.

The Minimum Income Guarantee

15. The Government reformed Income Support for pensioners by introducing the Minimum Income Guarantee (MIG). This reform included an increase in the amount available to pensioners and a relaxation of the capital rules, ensuring that fewer pensioners saw their entitlement reduced by their savings. From April 2003, no single pensioner need live on less than £102.10 a week and no couple on less than £155.80 a week. These are real increases of over a third since 1997 for the poorest pensioners. The Government will continue to increase the MIG in line with average earnings for the rest of this Parliament, benefiting over 2 million pensioners.

The Pension Credit

16. The introduction of the Pension Credit from October 2003 will build on the success of the MIG. The Government believes that the efforts pensioners have made to provide for themselves should be rewarded by the system of state support. Like the MIG, the Pension Credit will bring pensioners' incomes up to a guaranteed minimum entitlement. It will then give extra support to those with modest incomes over and above the basic State Pension.

17. At an additional cost of £2 billion in the first full year, the Pension Credit will entitle nearly half of all pensioner households to an average of £400 more a year. Through the Pension Credit, we are abolishing the intrusive weekly means test and rules which exclude pensioners with savings of more than £12,000 from government support. The Pension Credit will ensure that pensioners benefit from their thrift and effort in providing for their retirement. The new Pension Service, part of the Department for Work and Pensions, will deliver this fundamental reform, providing a modern, dedicated service to improve take-up of pensioner entitlements. This will be responsive to the needs of individuals, such as black and minority ethnic pensioners, who might face extra barriers to claiming their entitlements.

Supporting today's black and minority ethnic pensioners

Black and minority ethnic groups are over-represented among Britain's poorest pensioners.

The Department for Work and Pensions produces comprehensive guidance for staff on providing a service for black and minority ethnic pensioners. This includes guidance on cultural awareness, ethnic naming systems, and partnership organisations that work with black and minority ethnic communities. The Department also provides information in a range of languages and holds its annual Ethnic Minority forum at which issues affecting black and minority ethnic pensioners are discussed. But there is more to be done.

The new Pension Service faces a particular challenge in the delivery of services to black and minority ethnic pensioners. Perceptions of state entitlements are strongly influenced by cultural and religious factors and negative perceptions have led to non-claiming, under-claiming and delayed claiming. The Pension Service is determined to rise to this challenge.

The Partnerships Against Poverty initiative was established in 2001 to enable organisations with a shared aim of reducing poverty and tackling social exclusion among pensioners to work together. A sub-group of this forum focuses on black and minority ethnic pensioner groups. One of the first tasks of the group was to commission research into the particular barriers faced by black and minority ethnic elder communities. This research will help inform the provision of services to black and minority ethnic pensioners. The report is due to be published in summer 2003.

Providing more support for all pensioners

18. In addition to extra help for the poorest pensioners, the Government is committed to providing support for all pensioners throughout retirement. The basic State Pension will continue to be the foundation for income in retirement. From April 2003, the full basic State Pension will increase to £77.45 a week for single pensioners – an increase of 7 per cent in real terms since 1997. For future years, the Government has announced that it will increase the basic State Pension by at least 2.5 per cent a year, even if the Retail Price Index (RPI) is below this.

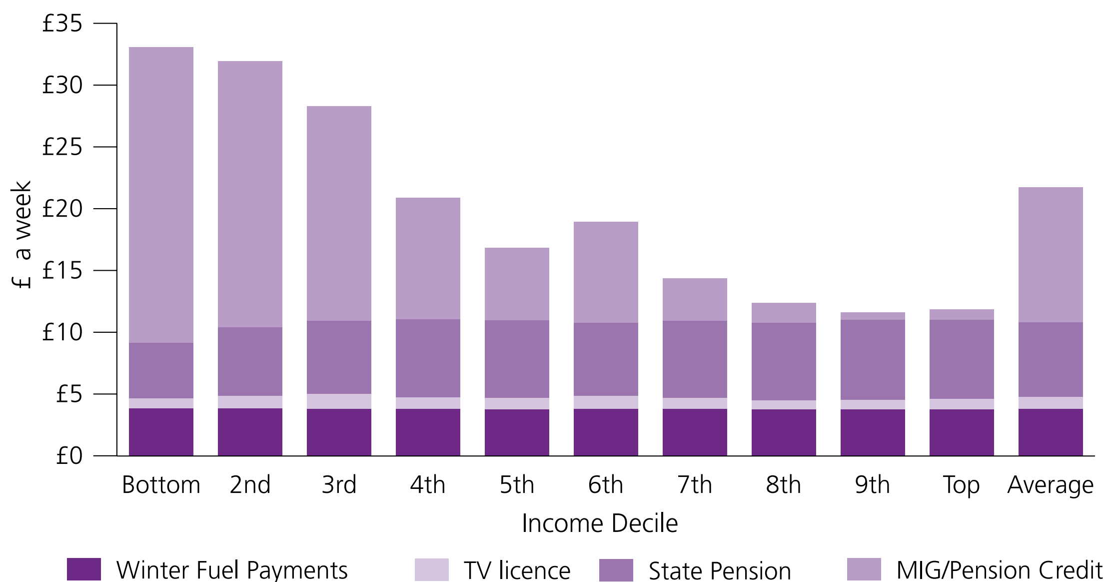
19. The Government has introduced various other payments to meet the particular needs of pensioners, helping them regardless of their income. These include Winter Fuel Payments – at £200 for the remainder of this Parliament – and free TV licences for households with someone aged 75 or over. Many pensioners will also benefit from the increase in age-related personal tax allowances, which will ensure that no pensioner over the age of 65 will pay tax on income of less than £127 a week from April 2003. The allowances will be raised at least in line with earnings, rather than prices, for the rest of this Parliament.

Increasing pensioners' incomes

20. Together, these measures offer considerable extra financial support for all pensioners while channelling most additional help to households with lower incomes or extra needs. As a result of measures introduced since 1997, the Government is spending around £6 billion extra in real terms on pensioners in 2002/03. The poorest third of pensioners will receive an additional £2.5 billion – three times more than an earnings link in the basic State Pension would have provided. **Chapter 7** sets out the particular challenges faced by female pensioners and how these measures have helped to address them.

21. Figure 2.6 shows the distributional impact, in 2003/04 prices, of the Government's pensioner policies. From October 2003, pensioner households will be over £1,150 a year better off on average in real terms than in 1997 – around £22.50 extra a week – as a result of the reforms introduced by this Government. The poorest third of pensioner households will have gained over £1,500 a year in real terms, helping poorer households catch up with the rest of the population.

Figure 2.6: Overall gains for pensioner households from Government pensions policy since 1997



Source: Department for Work and Pensions' simulations based on 2001/02 *Family Resources Survey*, projected forward to 2003/04.

2.5 Planning for retirement in the future

22. In addition to tackling pensioner poverty and providing a solid foundation for retirement income through the basic State Pension, the Government also sets the framework for individuals to make their own retirement provision. In the UK, the majority of working-age individuals are compelled to contribute towards their State Pension through the National Insurance system. Contributions entitle individuals to the basic State Pension and, in many cases, to the State Second Pension.

23. In 1998, the Government's Green Paper, *A new contract for welfare: partnership in pensions*, set out major reforms to broaden the pensions partnership, building on the existing elements of compulsion and voluntarism.

The State Second Pension

24. The Government reformed the State's second-tier provision, the State Earnings-Related Pension Scheme (SERPS), to give extra help to the low paid and those with caring responsibilities. The State Second Pension was introduced in April 2002. It provides employees with a pension in addition to the flat-rate basic State Pension, based on the level of their earnings throughout their working lives.

25. The State Second Pension boosts the pension rights of low and moderate earners and brings in groups of non-workers for the first time. Under the State Second Pension, around 4.5 million low earners[2] will build up an additional State Pension worth at least twice as much as that which SERPS would have provided. Around 2 million people with substantial caring responsibilities – including those caring for children below school age – and an additional 2 million people who become ill after a period of work will, for the first time, build up the same substantial rights as low earners.

26. People wishing to contract out of the State Second Pension can do so. For members of contracted-out defined benefit schemes, the occupational pension replaces the pension they would earn in the state second-tier pension, and in return for this they pay lower National Insurance contributions. For those contracted out through an appropriate personal or stakeholder pension, full-rate National Insurance contributions are payable but the State then makes a contribution directly into the individual's private pension.

27. The 1998 Green Paper envisaged a second stage of reform for the State Second Pension, moving towards a flat-rate State Second Pension. It recognised that it would be prudent to take time to evaluate the impact of the new pensions framework, and to consider the public cost and impact on savers before going ahead with such a reform. It is clear that the Government would need to ensure that it was able to make those affected aware of the change, because if a person did not act they could lose out. The Government will keep the position under review, taking account also of progress on stakeholder pensions and the wider developments in pensions and savings as set out elsewhere in this Green Paper.

2 People earning between £3,900 and £10,800, 2002/03.

28. Some have suggested more fundamental changes in this area, such as the complete abolition of contracting out, primarily on the grounds of its complexity. Under this proposal, there would no longer be a National Insurance rebate, removing around £11 billion a year from private pension funds.

29. Such a reduction in funding to pension schemes would be likely to lead to lower private pensions. It would mean an increase in National Insurance contributions for those contracted out into defined benefit schemes (because they currently pay a lower rate of National Insurance contributions) and it would directly reduce private pensions for those in defined contribution schemes. For these reasons, the Government is not attracted to the abolition of contracting out. The Government is, however, committed to simplifying the arrangements. Details of the Government's simplification proposals can be found in **Chapter 4**.

Stakeholder pensions

30. Personal pensions provide a retirement savings option for those who do not belong to occupational pension schemes, including the self-employed. They can be expensive, however, with high charges up front that deter people who may not be able to make substantial contributions or sustain them for a long time.

31. The Government responded to these issues in the 1998 Green Paper by announcing legislation for a low-charge, simple new product. Stakeholder pensions were introduced in April 2001 and are now available through the workplace to the majority of those employees who currently do not have access to an employer-sponsored pension and to the self-employed and non-earners.

32. Stakeholder pension charges are transparent and low, with a cap of 1 per cent of the fund. This allows individuals to contribute intermittently, if they cannot maintain regular contributions, without fear that the bulk of their contributions will be lost in charges. More than one million people have taken up stakeholder pensions so far. Stakeholder pensions are discussed further in **Chapter 5**.

The state structure in the longer term

33. Some argue that the state structure should be reformed to make support less targeted in favour of a single payment to all pensioners. The Government could not provide such a pension system without substantially reducing the support for poorer pensioners or greatly increasing state spending (which would mean higher taxes or undermine the long-term sustainability of the public finances).

34. For example, if all our spending on the MIG were re-directed into the basic State Pension, maximum basic entitlement would only increase from £75.50 to £85.50 a week. Even this increase would be possible only on the generous assumption that consequent savings from other benefits were channelled back into the basic State Pension. Given that from April 2003 the MIG will stand at £102.10 a week, this policy would mean imposing big cuts on the incomes of the poorest pensioners.

35. Even with such a dramatic reform, Housing Benefit and Council Tax Benefit would have to continue to be paid if extreme hardship were not to be imposed on the poorest. Thus many pensioners would continue to depend on income-related benefits.

36. Others argue that additional resources should simply be spent on a universal payment to older pensioners. It is true that older pensioners tend to be poorer on average. However, inequality is far more pronounced across the whole pensioner population than between pensioners of different ages. For example, the median net income of the richest fifth of pensioner couples is around four times that of the poorest fifth. Recently retired pensioner couples[3], on the other hand, have incomes around 25 per cent higher than couples aged 75 and over. The poorest third of pensioners will gain on average twice as much from the Pension Credit than if the equivalent amount were spent on a higher basic State Pension for those aged 75 and over.

37. The Government's approach strikes a careful balance between providing a solid foundation of support for all pensioners while targeting support at those who need it most.

38. Others have argued for an increase in the age (perhaps to 70) at which people can first claim their State Pension, for example to fund a more generous flat-rate State Pension. This issue is discussed more fully in **Chapter 6**. The Government does not propose to increase State Pension age but, in moving to a more flexible view of retirement, we do want to ensure that people are rewarded through the state system if they choose to work beyond this point.

39. Some commentators have also argued that we should introduce compulsory private pension saving on top of the existing compulsion in the National Insurance system. In Australia, for example, employers are required to contribute a set proportion (9 per cent) of their employees' salary to a private pension. Mandatory employer contributions in Australia were introduced at the expense of wage increases as part of a collective bargaining process. We believe it is preferable to build on the UK's voluntary partnership. The successful development of the voluntarist approach does, however, require all the partners – individuals, employers and the financial services industry, as well as the Government – to play their full part in the process.

Improving the activity rates of older workers

40. The Government has also taken steps to increase the employment rates of older workers. We have introduced the New Deal 50 plus, Work-Based Learning for Adults and Jobcentre Plus, and provided extra resources to help people return to work in areas of high unemployment.

41. Alongside the measures to help people find work, the Government has improved the financial attractiveness of work through the Working Tax Credit. This builds on the success of Working Families' Tax Credit and Disabled Person's Tax Credit. The Government is also working with employers to tackle age discrimination. Since 1997, the employment rate for those aged between 50 and State Pension age has increased from just over 64 per cent to 68 per cent. Progress made, and further measures to encourage older people to find and remain in work, are discussed in **Chapter 6**.

3 Within five years of State Pension age.

2.6 Provision for retirement by future pensioners

Overall saving levels

42. The Government provides the foundation of support for retirement income through the basic State Pension and the State Second Pension. The amount that individuals should save in addition will depend on their circumstances and preferences. There has been some discussion as to whether, in light of the demographic trends highlighted earlier, today's workers are working for long enough or saving enough to ensure sufficient income in retirement.

43. Concerns about whether overall levels of current saving are sufficient have focused on two aggregate measures of savings behaviour. The first is the aggregate household saving ratio – broadly the ratio of household saving to household income. The relatively low level of this ratio since 1997 has been interpreted by some as evidence of households not saving enough to ensure a comfortable retirement. However, this interpretation is open to doubt.

    - Movements in the saving ratio tend to be highly cyclical. A high saving ratio is often associated with economic weakness – households retrenching in the face of uncertainty about factors such as employment prospects and inflation. On the other hand, a low saving ratio may reflect greater economic stability and consumer confidence, reducing the need for households to save for precautionary purposes.

    - When considering retirement, a much more relevant measure is the trend in long-term saving. Economic stability since 1997 has provided an environment conducive to longer-term saving. Overall contributions to pension funds increased by nearly 40 per cent in real terms between 1997 and 2001 (the latest full year)[4].

44. The second focus of concern about overall saving relates to a quantifiable 'savings gap' representing the difference between aggregate levels of actual and desired savings. This type of analysis has been used to suggest that there is a large discrepancy between what the UK as a society is currently saving and what it will need to save to ensure against a substantial fall in income during retirement. Such aggregate 'snapshot' measures suffer from serious shortcomings that call into question their usefulness as a guide for policy-making because:

    - individuals' preferences concerning incomes in retirement may vary. For example, many individuals find that their living costs are lower in later life as they may no longer face the costs of raising children or paying off a mortgage;

    - patterns of consumption and saving will also vary over an individual's lifetime, based on changing commitments, circumstances and expectations; and

    - an exclusive focus on the level of individual pension savings ignores the wider range of assets that individuals may use to generate income for retirement, and the pensions and other assets that individuals might share with a partner.

4 Office for National Statistics (ONS) data, deflated by RPI. Note that the ONS has conducted a review of aggregate contributions data. This has led to 30 recommendations to improve data in this area. There is a working group with representatives in government and outside considering how best to implement these recommendations. As a result, better data on total contributions will become available over time.

Individual patterns of working and saving

45. Recognising these complexities, and in order to inform policy-making, we have looked at disaggregated data such as household surveys to try to estimate the number of individuals who may be under-saving. This methodology looks beyond a 'snapshot' of current employment and savings behaviour to projected levels of working and saving over a person's lifetime. It also takes into account forms of retirement provision other than pensions, as well as the assets of partners.

46. **Annex 4** sets out the issues and methodology in detail but the main conclusions are summarised in this chapter.

What income might individuals want in retirement?

47. In planning for their retirement, most people will compare their projected living standard in retirement to that enjoyed during their working life. The ratio of retirement income to income when in work is called the replacement rate.

48. Current pensioners have, on average, an income that is equal to around two-thirds of the average earnings of working-age people just before retirement. This suggests that their own replacement rates in retirement might be close to around two-thirds of their own earnings.

49. This rate is high by historical standards. Pensioners' incomes have outstripped average earnings consistently over the past 20 years due to growth in the coverage of private (especially occupational) pensions, the maturing of SERPS and strong returns on investments. Twenty years ago, the replacement rate was lower – around 60 per cent.

Levels of support provided by the State

50. The Government has no specific objective on earnings replacement. The state system, through the MIG and the Pension Credit, guarantees a level of income rather than a specific replacement rate. It is the responsibility of individuals, where possible supported by their employers, to determine the level of income in retirement they want over and above that provided by the state system. But in order to assess the potential scale of under-saving, two benchmarks have been considered: two-thirds of earnings (close to the replacement rates of current pensioners); and half of earnings.

51. The Government's strategy is to focus resources on those pensioners who need them the most. As a result, for those on the lowest incomes, the foundation of support provided by the State will take them close to or beyond these benchmark levels. As illustrated in Figure 2.7, for those with low lifetime incomes, replacement rates provided by the State on retirement are more than 100 per cent.

Figure 2.7: Retirement income from the State in 2050 as a percentage of weekly average earnings

Source: Department for Work and Pensions calculations.

Private provision needed to ensure adequacy

52. However, those on incomes of more than around £11,000 a year (£300 a week) need to make some private provision if they wish to ensure that their retirement income falls within the half to two-thirds range. Given their state income, Figure 2.8 below estimates the weekly contributions individuals and their employers would need to make to achieve either half or two-thirds of final earnings in retirement. These are shown for a 2050 retiree who starts saving 35 years before retirement. The contribution rates need to increase with the individual's earnings.

Figure 2.8: Savings rates required to retire on half and two-thirds of final salary in 2050, taking account of both state and private income

Gross replacement rate		Gross weekly earnings over working life			
		£300	£400	£500	£600
Half	Savings amount	£5	£30	£55	£70
	Savings rate	1%	7%	11%	12%
Two-thirds	Savings amount	£30	£60	£85	£110
	Savings rate	10%	15%	17%	18%

Source: Department for Work and Pensions' calculations.

Note: Savings amounts have been rounded to the nearest £5.

53. Someone earning £300 a week would need a total contribution of around 10 per cent of earnings to achieve a two-thirds replacement rate, and someone earning £400 a week would need to put in 15 per cent. For most people saving in a private pension, part of the total contribution will be made by the employer.

54. These figures are illustrative only. If the individuals above chose to work and save for longer, then the contribution levels required to generate the chosen target levels of income in retirement would be lower.

Lifetime saving patterns

55. There are currently around 25.6 million people of working age in work. Of these, 22.7 million are employees and around 3 million are self-employed. Many people not making private pension contributions at a particular point in time will have saved in the past. Over time, people move in and out of private pension saving and between different types of pension products. For example, when people were surveyed over a nine-year period, almost 9 out of 10 of those earning more than £10,000 a year had saved in a pension for at least four of those years. Those not saving at all or only occasionally tend to be younger (and therefore will probably go on to save more in the future), at the lower end of the earnings range (and therefore likely to be adequately covered by state provision), or in less secure jobs.

Non-pension saving

56. In assessing whether people might be saving 'enough' for retirement, it is important not only to look at savings patterns over the lifetime but also to recognise that people have other assets apart from pensions, some of which may be used in retirement.

57. Although people with good private pension provision also tend to hold more than the average in terms of other assets, non-pension wealth can be important for other groups, too. Around 20 per cent of employees (and around 30 per cent of the self-employed) have liquid financial assets of more than £10,000.

58. The level of liquid financial wealth among households is usually much lower than their housing wealth. Of employees not contributing to a private pension, 17 per cent own their own home outright, while the equivalent proportion of self-employed is around 30 per cent. A further half of employees and the self-employed have a mortgage – and are therefore likely to own their home by retirement[5]. This reduces housing-related spending in retirement.

59. Few people will want to use all or even most of their housing 'equity' to boost their retirement incomes. But given that many people move to smaller properties when they retire, 'trading down' or equity release – discussed in more detail in **Chapter 5** – are possible means of supplementing income in retirement.

5 *Family Resources Survey*, 2001/02.

Partners

60. Some households may choose to have one person saving in a pension on behalf of a couple. Around half of those with little or no private pension saving have a partner who is saving. Once account is taken of partners, fewer households are likely to be seriously under-saving. However, many partnerships do not survive until retirement and therefore individual retirement saving is more secure than relying on joint savings.

An overall assessment of 'under-provision'

61. As explained more fully in **Annex 4**, we have taken account of the various factors affecting retirement saving – earnings, private pension saving over time, partnerships and other assets – and have estimated lifetime saving of moderate and higher earners. Our estimates suggest that there are likely to be around 3 million people who over time are seriously under-providing for their retirement – that is, their income in retirement is likely to be less than half that during their working life.

62. Depending on their expectations of retirement and their circumstances, a larger group of perhaps 5 to 10 million people may also want to consider saving more or working longer. This group have replacement rates at the lower end of the benchmark range set out in Figure 2.8. If they increase their savings rates by around 1 per cent to 2 per cent, and this is matched by their employers, many would move towards the upper end of the range.

Why are people not saving or working long enough?

63. The barriers to saving more or retiring later are discussed in detail in **Chapters 3** and **6** respectively. The rest of the Green Paper sets out how individuals, employers and the financial services industry, working in partnership with the Government, can overcome those barriers and help people to plan more effectively for their retirement.

2.7 Ensuring progress

64. Pensions policy has to be for the long term. If we want people to plan for the future, stability in the framework of pensions policy is a key component. There are currently obstacles in the way of an effective voluntary system. The measures outlined in this Green Paper are designed to address this issue and to make the voluntary system work effectively.

65. It is vital that progress is closely and independently monitored. We need good information so that we can judge whether sufficient progress is being made and whether employers, the financial services industry and individuals are responding to the challenge. But this will require all partners to play their full part.

66. **We will be establishing an independent pensions commission to report regularly to the Secretary of State for Work and Pensions on how effectively the current voluntarist approach is developing.**

67. In view of concerns about the quality of information available to policy-makers, the commission's first task will be to look at this area and make recommendations to the Government.

68. The terms of reference of the commission will be:

    To keep under review the regime for UK private pensions and long-term savings, taking into account the proposals in the Green Paper, assessing the information needed to monitor progress and looking in particular at current and projected trends in:

    - the level of occupational pension provision:
      - trends in employer and employee contributions;
      - trends in coverage of occupational pensions;
    - the level of personal pension savings, including:
      - take-up of stakeholder and personal pensions;
      - contributions to stakeholder and personal pensions; and
    - the level of other saving:
      - financial assets, for example Individual Savings Accounts, housing, businesses, savings, and other assets of partners.

    On the basis of this assessment of how effectively the current voluntarist approach is developing over time, to make recommendations to the Secretary of State for Work and Pensions on whether there is a case for moving beyond the current voluntarist approach.

Chapter 3: Informed choice in pensions – choices for individuals

Chapter summary

There are a range of barriers to pension saving which need to be addressed. The Government believes those who are saving too little will save more if:

- there is a simple framework that helps them understand their choices – this chapter sets out the Government's plans to **simplify the taxation of pension schemes radically** so that all pension schemes are covered by **a single set of simple rules**;
- they are equipped to understand financial choices – so the Government proposes to improve financial education and awareness by, in particular, continuing its **publicity campaign**, sending **targeted information** to people at key points in their lives, and **re-branding tax relief** on individuals' contributions to demonstrate the generous incentives that tax reliefs provide;
- they receive clear information tailored to their own circumstances – so the Government plans to broaden the provision of **combined pension forecasts** by employers and pension providers and extend the **automatic** issue of **state pension forecasts** to people who are not members of private pension schemes; and
- they are offered a choice of suitable products – and so the Government plans to **simplify savings products** and asks for views on offering the **self-employed** the right to opt in to the **State Second Pension**.

3.1 Introduction

1. The Government believes that, given the right opportunities, people will plan ahead sensibly. If informed and empowered, many would choose to save more than they do. But, at the moment, there remain significant barriers to saving.

2. Information about pensions is widely available, but people do not know which sources to trust, or how the information relates to their circumstances. People find it hard to judge which of the many products available will provide them with good value and a suitable level of risk. Financial advice can help, but can also eat heavily into funds intended for retirement.

3. In this chapter and the next we explain how we propose to tackle these barriers to pension saving. We propose to empower people by putting tailored information about the outlook for their own retirement into their hands, to give them clarity about the choices they face for the future and enable them to take control. We propose to build on our track record in Kitemarking financial products, so people can be sure that they are buying good-value, secure products that suit their circumstances without having to pay for financial advice.

4. This chapter sets out the role of individuals in the pensions partnership.

- Section 3.2 examines the choices facing individuals in planning for their retirement.
- Section 3.3 sets out the barriers to saving and identifies four areas for government action to enable people to overcome these barriers.
- Sections 3.4 to 3.7 set out the Government's proposals to help individuals to overcome each of these barriers.

3.2 The choices facing individuals

5. People save at different times over their lifetime for different reasons. Most financial advisers would suggest that, in the short term, individuals should focus on their immediate security by paying off debt and putting aside some money for a rainy day. But in due course, and looking to the longer term, individuals will also want to build up assets for their future security, which will often include saving in a pension and buying a house. Most people will want to do both at the same time.

6. With respect to pensions, some countries, such as Australia, make saving in a private pension mandatory. But in the UK, people choose whether to save in a private pension. So people who want to live on more than their income from the State in retirement will want to choose how much to work and save to secure their preferred retirement income.

7. As choices of career and lifestyle become clearer, people will be better placed to consider their choices for retirement. Decisions such as the age at which they retire and their desired retirement income will be difficult and uncertain. But between them, they help to indicate broadly how much individuals need to save over the remainder of their working lives. If they are not on track, they will need to adjust their savings, the expected timing of their retirement or their income in retirement. This chapter focuses on additional saving. **Chapter 6** explores the impact of earlier and later retirement.

How much to save

8. Each person needs to decide where the balance between current and future needs lies for them. There will be times in many people's lives when they cannot afford both to contribute to a pension and meet their current needs, but it is important that people save when they can afford to do so.

9. Many people find that their living costs are lower in retirement than during their working life. For example, they may no longer face the costs of bringing up children or paying off a mortgage, so they can maintain their working-age lifestyle on a lower income in later life. But the income they are seeking in retirement may well exceed the State Pension, in which case they will need to consider additional saving.

10. Because these decisions reflect individual preferences and circumstances, it is not possible for the Government to stipulate the level of income that any particular person will need in retirement, and therefore the additional saving any one individual should make.

11. It is possible, however, to make broad projections of the amounts people would need to save to achieve a certain level of private pension income. Figure 3.1 shows the amount a man who begins saving at 20, 30 or 40 years of age must save each week in order to retire at the age of 65 with the target private pension income shown (in addition to any State Pension entitlement). It brings out a clear message: by saving from an earlier age someone need save significantly less a week in order to reach a given 'target' private pension income. Figure 3.1 shows the net contributions individuals should make. This means that both the tax relief they receive on their contributions, and the income tax they must pay on their pension, have been taken into account.

Figure 3.1: The impact of starting to save as soon as possible: the amount people need to save each week for different target incomes (net)

Target weekly income	Age saving starts		
	20	30	40
£50	£10	£15	£20
£100	£20	£30	£45
£200	£45	£60	£85
£300	£65	£90	£130

Source: Department for Work and Pensions calculations.

Notes: Full modelling assumptions are set out in Annex 5. All figures rounded to nearest £5.
Assumes tax relief is paid at basic rate.

12. The assumptions used in Figure 3.1 are outlined in **Annex 5**. The results are sensitive to the particular assumptions made and, because of this, the projections[1] should not be taken as 'guarantees'. However, they do give a broad indication of how to link savings behaviour today with resulting retirement income tomorrow.

1 The figures in the tables do not include projected income from the basic State Pension, the State Second Pension or the Pension Credit. The target income shown in 2002/03 earnings terms is for the year of retirement, which is assumed to be 2050.

Choosing a savings vehicle

13. As people move into work, most should have the opportunity to join a pension scheme provided through their employer. If the employer contributes to the scheme, this is likely to be a very good option. The workplace should provide an opportunity to learn more about pensions. It is in employers' interests to play their full part and thus maximise recruitment and retention of skilled and motivated staff.

14. As well as, or instead of, a pension, individuals might save through an Individual Savings Account (ISA), through their house or, in the case of the self-employed, their own business. But in most cases, a pension will be at least part of the answer.

15. If people use a pension to save for retirement, they benefit from the more generous tax treatment that pensions enjoy in comparison to other forms of investment. In the UK, contributions into approved pensions benefit from upfront tax relief and, in addition, pension fund growth is mostly tax free. The income resulting from pensions is taxable, but the Government offers an incentive to save in a pension by allowing pensioners to take a significant proportion of their savings as a tax-free lump sum. The Government's proposals to simplify pensions tax will allow for even more generous tax-free lump sums to be paid by many occupational pension schemes.

3.3 Barriers to saving

16. Perhaps 3 million people are seriously under-saving (or planning to retire too soon). Depending on their expectations of retirement and their circumstances, a further group of between 5 and 10 million people may want to consider saving more or working longer. There are several reasons why people may not save enough for their retirement.

17. The Sandler review[2] confirmed the Government's view that the complexity of the current tax rules acts as a barrier to saving, confusing individuals and imposing burdens on employers and providers alike. This complexity drives product proliferation, and makes pensions inflexible and hard to understand, tending to reduce how much people save, and indeed to prevent some people, especially the less well off, from saving at all.

18. Evidence suggests that most people have only a limited understanding and awareness of pensions and the pensions system.[3,4] The Government's own qualitative research[5] suggests that both public and private pensions are poorly understood and seen as complex. Many people lack the knowledge and understanding to plan for and decide on pensions options and products.

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2 Ron Sandler, *Medium and Long-Term Retail Savings in the UK*, July 2002.
3 Office of Fair Trading, 1997, Report of the Director General's Inquiry into Pensions, London.
4 Schagen, S and Lines, A, 1996, *Financial literacy in adult life*, National Foundation for Educational Research, Slough.
5 Hedges, A, 1998, *Pensions and Retirement Planning*, Department of Social Security Research Report No. 83, Corporate Data Services, Leeds (qualitative research – 16 group discussions among 97 members of the public).

19. Alongside a generally low awareness of pensions issues, the evidence also indicates that most people are not sure of their own pension position or of the pension income they can expect[6]. They may overestimate how well off they can expect to be in retirement and therefore not fully understand the consequences of the decision not to save. Even if they do understand their situation, they may not have the expertise to appreciate how much they need to save and the best way to do so.

20. Research by the Financial Services Authority (FSA)[7] has also identified problems for individuals trying to navigate their way around the pensions products offered by the financial services industry. People choosing financial products are unaware of what is available to them, lack access to comparative information when they choose products and find the jargon confusing.

21. Of course, some people are not saving in a pension at a point in time for good reasons. They may have low incomes or have substantial other financial demands.

22. Taken together, the evidence suggests that there are four areas where action by the Government, employers and the financial services industry can make informed choice a reality for more people in future. In partnership we need to provide:

- a simple framework to help people understand their choices;
- financial education and awareness to navigate the system, including access to generic financial advice for the mass market;
- personalised information tailored to individual circumstances, so people can make rational choices; and
- a choice of suitable products.

3.4 A simple framework

Tax simplification

23. All savings products operate within a framework of government regulation, including tax law, which means that simplifying their taxation can lead to real benefits for consumers, by stripping out similar products and so reducing confusion, as well as providing greater scope for individual choice and flexibility.

24. The complexity of tax rules not only acts as a barrier to saving: it also biases advice on saving because advisers seek to maximise tax advantages; and it increases costs, because pension providers have to comply with numerous cumbersome rules. All in all, the tax system weakens competitive forces by discouraging potential pension providers from entering the marketplace and clouding the information that savers need in order to make informed decisions.

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6 Hedges, A, 1998, *Pensions and Retirement Planning*, Department of Social Security Research Report No. 83, Corporate Data Services, Leeds (qualitative research – 16 group discussions among 97 members of the public).

7 Financial Services Authority, 2000, *Better Informed Consumers*, survey and qualitative work exploring the use of information and advice by consumers when choosing financial products.

25. This complexity has developed as the tax system has grown to reflect changing and ever more diverse demands for pension provision. There are now eight different tax regimes that apply to pensions. These are largely dictated by the type of pension scheme a person is using and the date when they first joined the scheme. Figure 3.2 illustrates the complexity of the current arrangements for taxing pensions. The differences in tax treatment of the various pension options means that people often face constraints on how and when they should save. So all too often, they need tax-based advice on the most appropriate form of pension.

26. Having considered evidence from the Sandler review and elsewhere, the Government firmly believes that radically simplifying the existing pensions tax regimes is an essential feature of its strategy to encourage people to save in pensions.

Figure 3.2: Current pension tax system

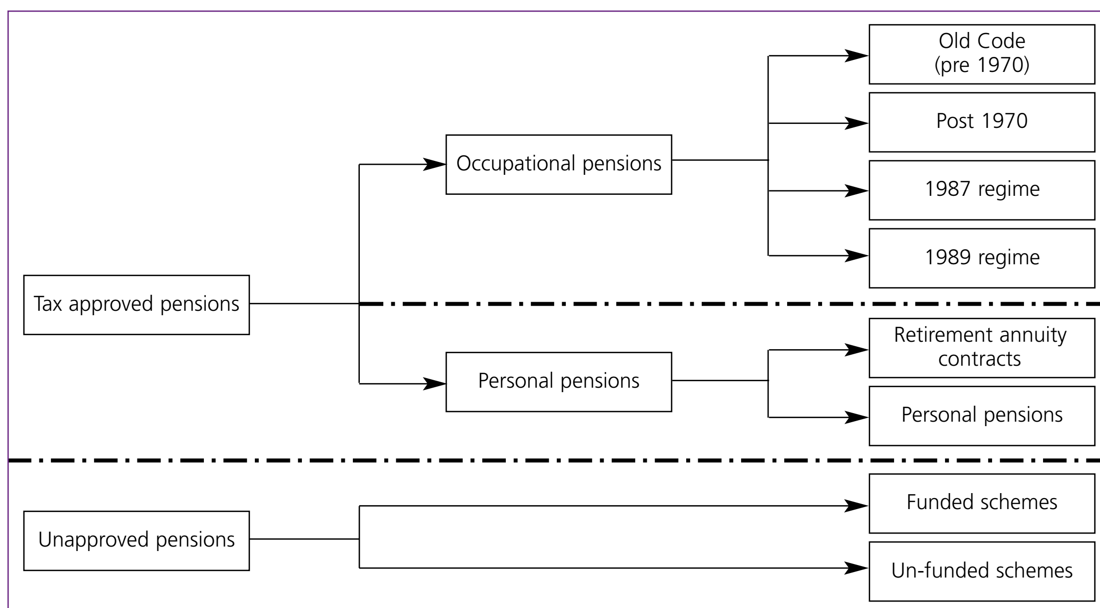
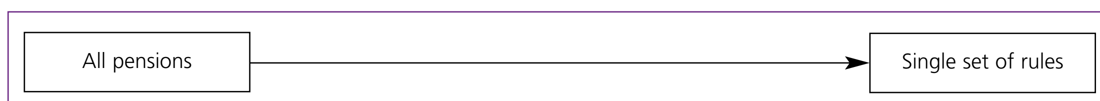


Figure 3.3: Proposed pension tax system



27. Alongside this Green Paper, the Government is launching the consultation document *Simplifying the taxation of pensions* which sets out radical proposals to deliver a single tax regime for all pensions. **The main features of the Government's proposed new, single regime are:**

- **a single, lifetime limit on how much someone can save in a tax-privileged pension.** The Government proposes that £1.4 million is the appropriate level at which to set this limit, because this would be broadly equivalent to the amount someone could accrue in a pension by saving up to the current maximum limits over a working career;

- **each year, the great majority of savers could contribute sums to their pension scheme equivalent to their annual earnings**, thus for example increasing the scope for savers to roll savings from ISAs into pensions;
- **a light-touch compliance regime of an annual limit on increments of value to an individual's pension fund. The proposed limit at introduction is £200,000**. In almost all cases, this will not restrict an individual's pension saving; but it provides a solid foundation for the lifetime limit; and
- **increased flexibility on how people move from work to retirement.** The Government proposes to allow schemes to offer full, flexible retirement, enabling people approaching retirement to reduce their working hours later in life and supplement their income with benefits accrued in their pension. In recognition of increasing life expectancy, the Government also intends, **by 2010, to increase the minimum age at which an individual can draw a pension from 50 to 55 years old**.

28. These proposals will remove much of the complexity in the current pensions tax, reducing compliance costs by at least £80 million each year and ensuring flexibility so that over 99 per cent of people saving in pensions would be able to save more in a tax-relieved pension.

29. The proposals will deliver significant benefits to existing and potential savers in pensions from April 2004. In particular:

- **transparency** – these proposals will help individuals understand the contribution the Government makes to their pension via the tax system. This is important to help them reach informed decisions on what to save in a pension in order to achieve a secure and sufficient income in retirement;
- **flexibility** – simplifying pensions tax in this way will remove most of the tax controls on how much a person can save in a tax-relieved pension. This will mean that people have far greater choice on when, and how much, to save in a pension; and
- **consistency** – delivering a single set of rules that govern all pensions will ensure that everybody has equivalent rights and opportunities. In principle, the tax system will not distinguish between different types of pensions and the date at which an individual first joined the pension scheme. This will reduce the need for people to get financial advice on the tax issues and will ensure that people do not arbitrarily benefit or lose out due to personal financial decisions.

3.5 Financial education and awareness

Financial literacy

30. Improving basic financial literacy is a key element of the Government's strategy. There is a wide variety of activity across government and regulators to inform consumers about financial services and products such as pensions, including the following initiatives.

- In September 2000, the Government introduced personal financial education as a non-statutory part of the national curriculum in England. Scotland, Wales and Northern Ireland are taking measures to improve personal financial education.

- The Department for Work and Pensions is working in conjunction with the Pre-Retirement Association and other partners, including large employers, to develop a web-based financial education package, due to be launched in 2003.

- The Department for Education and Skills has been working with the National Institute for Adult Continuing Education (NIACE) to better understand the financial literacy needs of older people.

Awareness campaign

31. The current government awareness campaign, supported by a series of pensions information guides, has been running since January 2001. More than 2 million copies of the guides have been distributed. The campaign so far has focused on making people aware of the need to save for retirement whilst also providing simple and impartial information on pension options.

32. The Department for Work and Pensions' research suggests that it is having the desired effect on public attitudes: more people agree that it is better to start saving sooner rather than later for retirement than did before the campaign began. However, similar campaigns (such as those on drink-driving or wearing seat belts) have historically taken a significant length of time to change public attitudes in a major way. The campaign must therefore be sustained over the long term.

33. **We intend to build on the work that has already been done, by moving the emphasis of the campaign away from promoting simple awareness of the need to save, and towards information that will prompt people to take action. We will also ensure that the publicity campaign is linked into other initiatives, such as life events marketing (see paragraph 39), that might be developed as part of this Green Paper.**

Tax reliefs on pension saving

34. The Government provides generous tax reliefs on pension saving in order to encourage and help people to save for a secure income in retirement. These reliefs are a critical component of the pensions framework. They are worth around £19 billion to private pensions each year. Even after taking into account income tax paid on pensions in payment, tax reliefs are worth around £13 billion net each year.

35. If tax reliefs are to remain an effective tool to encourage people to save for a secure retirement income, it is crucial that the incentives they provide are clear, transparent and straightforward.

36. The tax simplification proposals provide a unique opportunity to encourage people to save more in pensions by reshaping the way we deliver pension tax reliefs and communicating the benefits they provide more clearly. These reforms will not mean changes to the rates

at which tax relief is delivered – this will continue to be set at the person's marginal rate – but they will mean a simpler system, easy to explain and easy to understand.

37. Building on international evidence on how to encourage saving, **the Government will rebrand tax relief on individual contributions to personal and stakeholder pensions, to illustrate more fully the generous matching top-up that these reliefs provide. The change will deliver the matching message that:**

> ***for every £1 an individual contributes to a personal or stakeholder pension, the Government provides an additional 28p.***

38. **Chapter 4** outlines how the Government will build on this message, by encouraging all personal and stakeholder pensions to show individuals whether their employer contributes to their pension and, if so, how much. It also sets out the Government's plans to complement tax simplification with radical reforms to the regulation of pensions, facilitated by employers.

Access to information

39. Before making decisions, people need to know the sort of issues they need to consider and what their options are. The Government has four further proposals to help ensure that people can access or receive this information in a way and at a time that meets their needs.

- **Telephone and website information service.** A number of organisations provide an information service on pensions. **Annex 6** contains a list of some of the key contact points. Employers can also play an important role; this is discussed in **Chapter 4**. All of these services are valuable. However, following a successful pilot[8], **the Government believes that consumers would find it helpful to have a clearer first port of call for answers to basic questions, access to general information and help in navigating their way through to more specialist help and advice.** Such a service would not replace specialist sources of help and advice or direct routes into them where people know where they need to go. Impartiality would be essential, so there is an important role for government, but there would be value in involving the pensions industry and other interests and in joint funding. A similar approach could be adopted for an internet service, integrated with the telephone service. **We will discuss with the other organisations providing services in this area how this proposal might be taken forward.**

- **Generic financial advice.** The perception of advice as available free of charge in the commercial sector (when it is actually paid for through commissions) has inhibited the development of a market for advice as a stand-alone service. There is still a gap in the market for those on moderate incomes who would like help in assessing their financial services. The FSA is exploring how a new interactive financial planning tool might be used as a stand-alone service by community or voluntary organisations to

8 The then Department of Social Security operated a pilot helpline for six weeks in 1999 in conjunction with partner organisations. 80 per cent of callers found it helpful, and the majority of callers intended to take action after calling the helpline.

help consumers assess their financial position. Financial 'healthcheck' products on these lines are already being offered by some providers, both in the high street and online. This is discussed further in **Chapter 5**.

- **Interactive Digital Television.** The Department for Work and Pensions has launched a digital television pilot with a number of providers in stages over the last few months[9]. This provides impartial information on pensions to customers who are approaching or planning for retirement, as well as customers who are already in retirement. **The service is being evaluated to determine how the Department could use digital television as a communication channel in the future.**

- **Life events.** Research by the Department for Work and Pensions[10] has shown that people are particularly likely to think seriously about planning for their future at certain key points in their life – for example, when they start a new job, pay off their student loan or have a child. **The Government proposes to look further at these and other life events and the information and messages that people would find useful to accompany them. We will also look at the relevant data requirements and data protection issues.**

- **An online retirement planner.** The Association of British Insurers and the FSA have recently launched a 'ready reckoner' at www.pensioncalculator.org.uk to enable people to estimate the total state and private pension they might receive in retirement. We would like to build on this to create a web-based retirement planning tool that could enable people to view their total projected pension income, estimate the income they might need in retirement and calculate any savings shortfall. The planner could then be used to illustrate options for addressing any shortfall. This service could also offer a facility to enable people to trace old pensions. **We aim to introduce a retirement planner in 2004.** Such a planner could be run by the Government, by the pensions industry or the two in partnership.

3.6 Personalised information

40. Information specific to the individual's circumstances is likely to be even more influential than general information.

41. We are committed to ensuring that people of working age have such information to help them take personal responsibility and plan for their financial future – and that they receive that information on a regular basis. The 1998 Green Paper set out the Government's intention to build on the existing state pension forecasts by developing 'combined pension forecasts' which combine state and private pension rights. We now want to take this strategy much further, so that the majority of the working-age population will receive a pension forecast within the next five years.

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9 The pilot was launched on cable via ntl and Telewest in May 2002, on satellite via Sky Active in October 2002, and via UK online in November 2002.

10 Thomas A Pettigrew and N Tovey, *Increasing Compulsory Pensions Provision – Attitudes of the general public and the self-employed,* In-house Report No. 48, Department of Social Security Qualitative Research.

42. The Pension Service, part of the Department for Work and Pensions, provides pension forecasts showing people in today's prices how much they are likely to receive in retirement from a pension.

- A **state pension forecast** shows someone the State Pension already earned, and what they can expect to have earned by State Pension age. People can get a forecast by contacting the Retirement Pension Forecasting Team on 0845 3000 168 (textphone 0845 3000 169).

- A **combined pension forecast** adds state pension information to the forecast of an individual's current occupational or private pension scheme, and is delivered through the employer or provider.

- From April 2003, a **Statutory Money Purchase Illustration** must be issued annually by providers of money purchase (that is, defined contribution) pensions, and gives an illustration of the amount of pension that might be payable from retirement, at today's prices. This was introduced following consultation in the 1998 Green Paper, so that members of these pensions receive information broadly equivalent to that issued in statements from occupational pension schemes.

State pension forecasts

43. The Government has offered state pension forecasts on request for a number of years, but savers have tended not to ask for them until later in their working life, by which time they find it more difficult to save enough to increase their retirement income. We made clear in the 1998 Green Paper that we planned to examine ways of providing state pension forecasts automatically. **We now plan to roll out automatic state pension forecasts, starting with the self-employed, with a view to extending this service across the rest of the working-age population over the next five years. The Government will issue forecasts at regular intervals after that.**

44. **Self-employed** people who have private pension savings can get a combined pension forecast from their pension provider if the provider participates in the forecasting scheme. However, around half the approximately 3 million self-employed people of working age have no current private pension saving. **From May 2003 we will automatically issue state pension forecasts and supporting information to self-employed people who have not had a combined pension forecast from their pension provider.**

Combined pension forecasts

45. During 1999, the Government ran pilots of combined pension forecasts with a number of major employers and pension providers. In the case of Emap plc, employees who had not joined the occupational pension scheme were given a forecast of their State Pension, which meant that all employees were sent either a state pension forecast or a combined pension forecast unless they had specifically opted out. An example of the combined pension forecasts issued by Emap is shown overleaf.

Example of a combined pension forecast

Name: **E Sample**
Sex: **Male**
NI number: **AB123456C**
Joined Company: **20/09/1985**
Joined Flexiplan: **01/04/1996**
Lifestyle investment choice: **B**

Date of Birth: **06/08/1963**
Normal Retirement Date: **06/08/2028**
Basic annual salary: **£35,654**
Your current contribution rate: **7.00%**
Company current contribution rate: **7.00%**

Your Flexiplan Account

Balance at 6 October 2002 (see note 3):	**£23,677.30**

On Retirement Age 60/65	**Age 60**	**Age 65**
At retirement, the money in your account is used to buy a pension. The amount of the pension will depend on the investment returns achieved and interest rates when you retire. As an illustration, based on the assumptions described opposite (see note 5), the estimated pension payable from age 60/65 as a percentage of plan pay is (see note 1):	**13.6%**	**22.3%**
Based on your current salary, this is equivalent to an annual pension of:	**£4,850.00**	**£7,940.00**
with a partner's pension payable on your death of:	**£2,425.00**	**£3,970.00**

At retirement, you may take part of your account as a tax-free lump sum. Your pension can be tailored to your needs. For example, you might want to provide extra pension for your partner on your death or a higher rate of increases once in payment.

In addition, you will also receive any State pensions to which you are entitled.

On Your Death In Employment

Flexiplan will pay a lump sum death benefit of (see note 7):	**£142,616.00**
In addition, your partner or dependants will receive an annual pension of at least:	**£7,131.00**

On Leaving Employment
The full balance in your account can be transferred to your new employer's pension scheme or to a personal pension.

Protected Rights

Balance at 6 October 2001 (see note 4)	**£1,066.03**

Total state retirement pension earned up to 5 April 2002:	**£4,178.05 a year**
When you reach state pension age (65) your total state retirement pension is expected to be:	**£5,596.31 a year**
If you stay in Flexiplan until your retirement age (65) your pension is forecast to be:	**£7,940.00 a year**

Your combined pension from Flexiplan and the state when you are 65 is forecast to be:	**£13,536.31 a year**

46. The pilots clearly demonstrated the value of the service. 98 per cent of those who received a forecast found it useful, while 31 per cent sought further information about increasing their pension provision.

47. For part of the Emap[11] pilot, employees automatically received a pension forecast unless they chose to opt out. During that stage of the pilot 8 per cent of the workforce either joined the company scheme or increased the level of their contribution after receiving their forecast. These results are early signs that combined pension forecasting will make a difference. To illustrate, if the Emap results could be replicated across the whole of the UK then around 2 million people might join or contribute more to occupational pension schemes.

48. Following these successful pilots, the combined pension forecasting service was formally launched in October 2001. We are expanding the programme on the basis of voluntary participation from employers and schemes, and aim to have issued more than 1 million combined pension forecasts by summer 2003.

49. However, there is a risk that some of those who need the information most might not receive it because their employer or pension provider chooses not to join the programme. **Chapter 4** discusses the Government's desire to extend the coverage of the combined pension forecasting programme, whether on a voluntary or compulsory basis, through employers and pension providers.

3.7 A choice of suitable products

Simple products

50. People need simple savings choices. With stakeholder pensions, the Government developed the idea of simple, easy-to-understand products by legislating to produce a pension product free from many of the features that had traditionally disadvantaged many savers, such as high charges. **Chapter 5** describes how the Government is working with the financial services industry to empower consumers to make the right savings choices, by providing simpler products.

The self-employed

51. The measures described in this chapter generally apply to people whether they are employed or self-employed. However, unlike employees, the self-employed cannot build up rights to the State Second Pension. As discussed in **Chapter 2**, self-employed people tend not to have large private pension savings, and so there may be a case for increasing their retirement incomes through the state pension system.

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11 The characteristics of Emap and its employees will have contributed to the particular result they obtained. Emap operates a policy of matching employees' pension contributions up to 5 per cent or 7 per cent of salary depending on the length of service. Forecasts were issued to 3,300 employees. Some employees may have joined the pension scheme or increased their contributions in the absence of pension forecasting, but Emap believe this number to be small.

52. One option would be to **allow the self-employed to opt to pay higher National Insurance contributions and accrue rights to the State Second Pension on a voluntary basis.** There are many possible designs for such a scheme. For example, those who choose to opt in could do so on a yearly basis with age-related contributions based on profits. This could be of particular benefit to those self-employed with lower profits, who would accrue State Second Pension rights equivalent to those built up by someone earning almost £11,000 a year. **We would welcome views.**

Chapter 4: Pensions and the workplace

Chapter summary

The workplace plays a vital part in pension provision. Employers provide information on, access to and, in many cases, contributions to pensions. The Government supports workplace pension saving with generous tax and National Insurance reliefs on contributions made by employers. Workplace pensions and employer contributions have been one of the main drivers of the rapid growth in pensioners' incomes over the last 20 years.

Many employers recognise the important benefits of recruitment, retention and staff motivation that good pension provision brings. These benefits can only become more significant. It is clear that employees, unions and potential recruits are attaching ever greater importance to the pension support offered by companies.

But, elsewhere, some employers have been reducing their financial commitment and contribution to workplace pensions. And there are growing anxieties among employees and unions over scheme closures and reductions in pension contributions.

The Government wants to help the many employers who provide good pensions, while at the same time ensuring proper protection for pension scheme members. This chapter sets out proposals to achieve this balance, including:

- **major simplification of tax and private pensions regulations**; and
- **extra security and protection for scheme members** through a new pensions regulator and changes to procedures when a scheme winds up.

The Government will be guided in its consideration of these issues by the aim of avoiding increases in the overall burden of employers who stand behind their responsibilities.

Employers providing schemes could often do more to highlight the value of their pensions to employees. And employers who do not provide pension contributions should help to ensure that their employees have the information they need to make proper provision for themselves. This chapter therefore sets out a number of proposals for **improving the provision of pensions information by employers, and the setting up of an employer task force** to promote best practice and innovation on pensions issues in the workplace.

4.1 Introduction

1. Employers have a crucial role in the pensions partnership, as providers of, and contributors to, occupational pension schemes, and as a source of information about pensions options. We need to renew and build on this, to strengthen the commitment of employers and ensure that the value of good employer provision is recognised by employees.

2. Employers choose to provide pensions to help them recruit and retain the best employees. Employers also have a responsibility to help their employees to provide for their retirement. Employees and unions have made it clear that they believe a good pension to be a key part of any attractive remuneration package. To compete in the labour market today and in the future employers will need to offer pensions that meet their employees' needs.

3. The Government wants to make it easier for employers to provide pensions. Administrative and financial burdens faced by employers should be minimised in order to support their commitment and encourage greater provision. Employees also want to have confidence in their pension. In some rare instances, this has not been the case, creating great hardship for those affected. The Government is determined to strengthen protection offered to scheme members to maintain confidence in pensions. We also want to help employers to provide their employees with the information they need to make the right choices.

4. We are very aware, however, that we must balance simplification to support employers against the need to provide protection for scheme members. Our aim is that the package we take forward in the light of consultation will reduce the overall costs and burdens on those employers providing pensions.

5. Many employers:

   - provide access to pension schemes and encourage employees to join;
   - contribute to these schemes as part of the overall benefits package; and
   - provide information to aid retirement planning.

6. Employers are well placed to fulfil this role. They can take advantage of economies of scale and efficiencies in running pensions and providing pensions information, for example through the use of payroll deductions and internal communication systems. They can also design schemes so that employees can get maximum benefit from the employer's total payment and contribution.

7. Trade unions and workplace representatives also have a key role to play, particularly in promoting awareness of the importance of pensions and making information about options more readily available in the workplace. The Trades Union Congress (TUC) and its member unions represent almost 7 million working people. Both at national level, and in the workplace, they can raise awareness about the need to save for retirement and the value to employees of good pensions.

8 For example, the TUC campaigns actively to maintain existing high-quality pension schemes and for more work-based pensions, promoting stakeholder pensions for individuals who do not have access to occupational schemes.

9. The Government promotes workplace provision, in particular by providing employers with generous tax incentives to contribute to pensions. This recognises the importance of employer pension contributions to a firm's ability to recruit and retain staff and to help employees to save for their retirement. In addition to upfront income tax relief, employer contributions are exempt from both employer and employee National Insurance contributions. This makes tax relief on employer contributions the most generous form of pensions tax relief. For example, if an employer contributes £1 to a pension, this will be worth 21p more to an employee than if the employee contributed from their pay.

10. The Government looks forward to continuing a constructive dialogue on pensions issues over the coming months with employers, employees and their representatives. We are keen to discuss with trade unions and employers what more can be done, building on best practice, to enhance pension provision in the workplace. Later in this chapter we set out our proposal for an employer task force. We want the TUC to be represented on this group.

11. This chapter sets out the Government's strategy and proposals for promoting pension provision and information in the workplace, addressing the concerns expressed by employers, scheme members and their representatives. It covers trends in employer pension provision (section 4.2) before setting out the Government's proposals to address the key challenges we face.

- The complexity of pensions regulations can be a barrier to provision – section 4.4 sets out the Government's proposals for **radical simplification**.
- Employees and unions are rightly concerned about security – section 4.5 contains the Government's proposals to **enhance pension protection**.
- Employers want their workers to recognise the value of the pensions they provide and employees want information on which to base sound choices – section 4.6 outlines proposals to **improve pensions information** in the workplace.

Pension provision in the workplace

There are two main types of occupational pension scheme.

In a **defined benefit** scheme the level of benefits is determined by the scheme rules. Pensions are generally linked to the length of time an employee is in the scheme and their salary at a set point in time or averaged over a set period. Final salary schemes provide a proportion (such as 1/80th a year of membership of the scheme) of final salary at retirement. Other common variants are based on lifetime average earnings or the best earnings in, say, the last five years of work.

In a **defined contribution** scheme (often called a money purchase scheme), set periodic contributions are invested. The resulting pension depends on the amount paid into the scheme, the investment return over time, and annuity rates at retirement.

Employers also often contribute or provide access to **personal pensions**. These are defined contribution arrangements between the individual and a pension provider such as an insurance company. In some cases personal pensions are grouped together – a **group personal pension** – to make provision more cost efficient. **Stakeholder pensions**, introduced in April 2001, are personal pensions with limits set by the Government on, among other things, the level of charges.

4.2 Trends in employer provision

Current employer provision in the UK

Figure 4.1: Pension provision by size of organisation, 2000 (private sector only)

Source: *Employers' Pension Provision Report*, 2000 (GB).

Notes: Small employer defined as fewer than 20 employees; large employer is 20 or more employees. Employers can offer more than one type of provision, hence the totals exceed the total for any provision.

12. As Figure 4.1 illustrates, different types of employers tend to provide different types of scheme. Smaller employers often offer pension schemes that involve less administration for the employer, such as group personal pensions. Larger employers who can take advantage of economies of scale often run their own occupational pension scheme and are more likely than smaller employers to provide defined benefit schemes.

13. In 2001/02, more than half of all employees were contributing to a private pension (see Figure 4.2). Most – nearly 11 million people – were in occupational pension schemes.

Figure 4.2: Private pension coverage for those in work

Source: *Family Resources Survey* 2001/02.
Notes: Personal pensions include stakeholder pensions.
People may contribute to both an occupational and a personal pension.

Changes in scheme type

14. There has been considerable attention paid in recent months to moves by some employers from defined benefit to defined contribution provision. These switches tend to apply to new employees only and therefore do not generally affect existing scheme members.

15. Movement between pension scheme types is not new. In the 1950s, over half of all members of private sector occupational pension schemes were in average salary schemes or schemes providing fixed monetary amounts for each year of service. During the 1960s and 1970s, as the overall number of schemes grew, these schemes gave way to provision based on final salary and service. Over this period, the percentage of private sector members in defined contribution occupational schemes remained fairly constant at around 5 per cent.

16. From the late 1980s, however, there has been a shift towards defined contribution occupational schemes. By 2000, around 16 per cent of private sector occupational scheme members, and nearly 70 per cent of all private sector occupational schemes, were based on defined contributions. The late 1980s also saw the launch of personal pensions.

17. The trend towards defined contribution schemes has accelerated. It has been reported that around a third of FTSE100 companies have recently moved away from defined benefit provision. But this trend should not be overstated. The latest figures available from the Pension Schemes Registry suggest that, in the calendar year 2001, only just over 1 per cent of defined benefit schemes reported as having closed to new members. And only 0.5 per cent closed to existing members.

18. Different scheme types will suit employees with different characteristics. Long-serving employees with high salary progression tend to do well from final salary schemes, while average salary schemes will often be better for those whose salaries peak in mid career, rather than at the end. Defined contribution schemes tend to be better for employees who move jobs more frequently, although the employee rather than the employer bears the investment risk. Overall, therefore, none of the different scheme types is invariably better than the others.

Contribution rates

19. Average contribution rates tend to be higher in defined benefit schemes. Preliminary results from the Government Actuary's Department (GAD) Occupational Pension Scheme Survey 2000 indicate that, as a percentage of earnings, the average employer contribution rate in defined benefit schemes is 9.9 per cent compared to 4.3 per cent in defined contribution schemes.

20 To a large degree this reflects differences between the types of companies that offer the different types of scheme. In particular, larger and more established companies are more likely to have defined benefit schemes, whereas smaller, newer companies tend to offer defined contribution schemes. This is reflected in figures from the Pension Schemes Registry showing that only 3 per cent of all defined contribution schemes have 100 or more members compared to over a third of defined benefit schemes.

21. The shift of individual employers from defined benefit to defined contribution pensions may not in itself be a cause for concern. A key factor in determining people's future pension income will be the level of contributions, and in particular, the contribution the employer makes. If a reduction in employer contributions were to accompany the shift away from defined benefit schemes, this would pose more serious problems. Those employers who want to recruit and retain the best workers will need to show continuing commitment to their employees' pensions. Employers contribute approximately twice as much as employees on average[1] in private sector occupational schemes. Their contributions play an important role in encouraging employees to join pension schemes. The Association of British Insurers report, *Stakeholder Pensions – Closing the savings gap?*, cited research showing that take up is around 70 per cent where an employer contributes, but only 13 per cent if there is no employer contribution. Of the total contributions to employer designated stakeholder schemes, employer contributions accounted for 57 per cent.

1 Government Actuary's Department (GAD) Survey of Occupational Pension Schemes 2000, preliminary results for private sector schemes.

4.3 Supporting occupational schemes and encouraging employer provision

The key issues

22. In the UK, there is greater membership of occupational pension schemes and these provide a larger proportion of pensioners' incomes than in the majority of EU Member States. The Government wants to reinforce this, building on the wealth of good employer practice.

23. The key workplace pensions challenge is to build on the existing level of employer commitment and employee confidence. Employer pension provision has come under pressure in recent years. Government, employers and employees and their representatives must address this together.

24. A key issue is **complexity**, which imposes regulatory burdens and administrative costs on employers who provide occupational pensions. The Government is determined to simplify pensions. The proposals set out later in this chapter are designed to alleviate administrative costs on employers who provide schemes while ensuring that scheme members' rights are properly protected. In addition to the administrative costs of running pensions, employers also face **funding costs and risk**, particularly those providing defined benefit schemes. This cost has increased over recent decades, partly as a result of increases in longevity. For employers who provide defined benefit pension schemes, longer life expectancy increases the length of retirement and hence increases the cost of providing a pension. Stock market falls have been cited by some as a cause of increased costs. Stock market movements are cyclical, however, and while poor equity markets inevitably bring higher costs for a time, many employers benefited from contribution holidays when the stock market was rising. Pensions are a long-term investment.

25. There are, however, major benefits to set against the direct costs. A good pension package helps the employer to recruit and retain staff and hence furthers the long-term success of the business. In the changing climate, with employees becoming ever more aware of the value of pensions, employers will continue to find that pension contributions represent money well spent. The Government's proposals later in this chapter will help to ensure that employees value their pension provision. They will also help to reduce financing costs for employers.

26. The primary concern for employees is to have an occupational pension scheme that will give them a good income in retirement. However, **this pension must be secure**. If it is not then employees in defined benefit schemes may not get the pension they were expecting, and if employees are not confident of this they will not join the scheme. Secondly, employees need **good information**. They need to be kept informed about the position of the scheme so that they can be confident that their pension is safe. They also need to know what their options are and how large their pension is likely to be so that they can plan effectively for their retirement. Lastly, employees should recognise the commitment their employer is making to their pension and how valuable it is. Only then will the employer realise the full business benefits.

The Government's strategy

27. The Government will provide a regulatory framework that encourages and supports employers in providing and contributing to good quality pension schemes. To achieve this we must simplify the legislation surrounding private pensions. Overall, our intention is that the package we take forward in the light of consultation responses should significantly reduce the burdens placed on those employers providing pensions. But legislation is there for a reason – to protect the pension rights of members. We need to ensure that while simplifying the regulatory regime, we maintain consumer protection, trust and confidence. Much of current legislation was introduced in response to the Maxwell affair a decade ago. The pendulum must not swing back too far.

28. We have three linked sets of proposals.

    (i) **A major simplification of private pensions regulation and tax rules (section 4.4)** to ease burdens on employers and promote private provision.

    (ii) **Greater protection** for scheme members **(section 4.5)** to increase confidence and help to ensure that people get the pensions they expect.

    (iii) **Helping employers to provide better information for employees (section 4.6)** to help employees to understand the value of their pension scheme and to facilitate informed choice.

4.4 Simplification

Summary

We propose to simplify radically the regulatory regime for pensions. In total, this could save employers £150–200 million a year in administration. We want more employees to enjoy the benefits of a good employer-sponsored pension scheme. Simplification and deregulation are necessary, not only to encourage employers to provide and contribute to existing schemes, but also to encourage more employers to include pension provision in the overall package of remuneration and benefits to their employees. We have looked particularly closely at the extra burden of regulation and complexity for defined benefit schemes, which is putting considerable pressure on employers providing such schemes.

This significant deregulation is part of our commitment to strengthening our partnership with employers for the provision of pensions. It builds on the approach we set out in the 1998 Green Paper *A new contract for welfare: partnership in pensions*, and reflects the proposals for simplifying many areas of pensions legislation contained in *A simpler way to better pensions*. This independent report from Alan Pickering, a former Chairman of the National Association of Pension Funds, addressed continuing employer concerns about regulations. This chapter also draws out the important implications for employers of the Government's review of the tax treatment of pensions, which are set out in the consultation document, *Simplifying the taxation of pensions*, and which complement the other proposals in this section.

Our simplification proposals will reduce employer administrative and funding costs, and include:

- **radical simplification of the tax rules** for private pensions;
- **more flexible rules for scheme funding** to reduce the short-term burdens on employers;
- a **major simplification and restructuring of the contracting-out regulations;** and
- a range of proposals to give schemes **much greater flexibility** in how they comply with the regulations.

Tax simplification

29. The proposals to simplify radically the taxation of pensions are set out in **Chapter 3**. These proposals will transform the tax environment within which pension providers operate, providing greater choice and flexibility for individuals and reductions in administrative costs for employers and pension scheme providers.

30. The proposals will remove almost all the existing compliance burdens on pension scheme administrators. Most notably, data requirements will be dramatically reduced, calculating benefits and payments will be far simpler, and complying with tax limits will, in many cases, comprise a one-off valuation. And by applying the same tax rules to defined benefit and defined contribution pensions, the artificial distinctions created by the tax system will vanish, leaving employers sponsoring pensions free to decide which best suits their circumstances and the needs of their workforce. Overall, we estimate that the annual savings in administrative costs will be at least £80 million a year.

A new framework for scheme funding

The Minimum Funding Requirement

31. The existing Minimum Funding Requirement (MFR) sets out the minimum level to which employers must fund their defined benefit pension scheme and the timescales for addressing any shortfall. It also forms the basis for minimum transfer values. The MFR was introduced following the Maxwell affair to help improve the funding of defined benefit schemes. In practice the MFR has proved to be too inflexible – it does not take account of the specific circumstances of individual schemes. It has also encouraged some schemes to focus on short-term market conditions instead of the most appropriate longer-term investment strategy for meeting their specific pension commitments. As a result, the MFR leads to unnecessary administrative costs for schemes and has adversely influenced the investment decisions of some schemes.

32. The Government has listened to the concerns that have been expressed about the MFR. As a result, we propose **to replace the MFR with scheme-specific funding requirements**. We originally announced our intention to replace the MFR in March 2001. This major deregulatory change demonstrates our determination to eradicate unnecessary red tape, and it could save companies up to £80 million a year.

33. We have developed our proposals with the key stakeholders: the pensions industry, employers, trade unions and consumer organisations. The key elements of the proposals are:

- employers, trustees and the scheme actuary will have to work together to develop an appropriate funding strategy for their scheme. This will give them more flexibility – allowing them to determine a contributions plan which best meets their and members' particular needs;

- reducing from three to one the number of actuarial valuations schemes generally have to make in a three-year period;

- funding arrangements that will introduce greater flexibility in the investment decision-making process, benefiting both scheme members and employers; and

- providing more effective communication with scheme members to raise their awareness and understanding of the funding of their scheme and increase accountability.

34. After the replacement of the MFR with scheme-specific funding requirements, it will be for schemes to determine their own transfer values on a basis that is fair to all. As the MFR has provided a minimum measure of funding, we might expect that in many cases, transfer values would be higher than they were under the MFR.

35. We believe that replacing the MFR, together with the other proposals in this Green Paper, strikes the right balance between our objectives of additional flexibility and affordability for employers, and protection for scheme members.

Other issues

36. The FRS17 accounting standard sets out how pension assets, liabilities and costs should be reflected in company accounts. FRS17 has been cited by some employers as a reason for reducing their role in defined benefit pension provision. This standard is the responsibility of the Accounting Standards Board which is independent of government. FRS17 does not in itself create pension liabilities, it merely seeks to make them clear in company balance sheets. This objective is more important than ever given recent concerns over accounting practice. The corresponding international standard, IAS 19, is being reviewed by the International Accounting Standards Board and it hopes to have an agreed revised standard by 2004. Consequently, mandatory full implementation of FRS17 has been deferred until 2005. The Accounting Standards Board is planning to consult on the early adoption in the UK of a standard based on the outcome of the International Board's work.

37. A related issue, raised in the Myners report, is the ownership of scheme surplus. The Government has obtained Law Commission advice. This indicates that, from a legal perspective, the relevant issue in an ongoing scheme is not 'ownership' of a surplus but rather how the trustees are permitted or obliged by the trust deed and scheme rules to deal with any surplus. We believe that legislative intervention in this area would result in more, rather than less, complexity. In view of this, we are not proposing to legislate further.

Contracting out

38. Contracting out was introduced with the State Earnings-Related Pension Scheme (SERPS) in 1978. The legislation sets a minimum benchmark that defined benefit occupational pension schemes have to meet to contract out of the earnings-related part of the state pension scheme. Many schemes can and do provide benefits in excess of this level. Individuals forego their earnings-related state benefit rights and in return pay less National Insurance contributions. Similarly, employers sponsoring defined benefit occupational pensions pay a reduced rate of National Insurance contributions. Similarly, employers sponsoring defined benefit occupational pensions pay a reduced rate of National Insurance contributions. Individuals can also contract out through personal and stakeholder pensions and have a rebate of their National Insurance contributions paid into their pension fund.

39. This is one of the most complex areas of pensions legislation. As discussed in **Chapter 2**, some commentators have suggested that contracting out should be abolished altogether. While we believe that contracting out should remain, the arrangements for doing so should

be simplified. The proposals set out in this section would ease administration and could reduce financing costs for employers. They would also give employers much greater flexibility in how they run their schemes and in the package of benefits they offer their employees.

40. All the options for change to the contracting-out requirements are discussed in more detail in the accompanying document *Simplicity, security and choice: technical paper*.

Contracting out: survivors' benefits and indexation

41. In his report, Alan Pickering asked the Government to consider removing the requirements for contracted-out schemes to provide survivors' benefits. He also proposed removing the requirement, which also applies to occupational schemes which are not contracted out, to index-link (up to a maximum of 5 per cent) pensions in payment. If these requirements were removed, employers would be free to continue to offer these benefits, and we would expect most to do so.

42. The suggested changes would simplify administration considerably for schemes. They would also reduce the funding pressure on employers running defined benefit schemes, making future pensions cheaper to provide. In so doing, however, there would be a corresponding negative effect on the value of future pensions for those affected.

43. Removing the requirement to provide **survivors' benefits** would have a disproportionate impact on women, who are less likely to have access to other substantial sources of retirement income.

44. Women could also be expected to lose out more than men if the **indexation** requirement were removed, as they have greater life expectancy and tend to have lower pensions. In the case of indexation, however, there might be an approach that would give schemes greater flexibility while also maintaining protection for those with smaller pensions. For example, we could maintain compulsory indexation of pensions below a certain level to protect those who most need it, while **removing compulsory indexation for those with large pensions. This would mean retaining compulsory indexation for that portion of the pension up to, say, £30,000 a year, but not for the pension above that level.**

45. **We would not introduce these changes unless we had good reason to believe that the coverage of and contributions to occupational pensions would be higher than would otherwise be the case. We would, however, welcome views on the proposal to limit compulsory indexation to pensions up to £30,000 a year.**

Contracting out: the Reference Scheme Test

46. Under the contracting-out legislation, the minimum benchmark that defined benefit schemes must satisfy to contract out of the State Second Pension is set by the Reference Scheme Test (RST). The resulting benefits are generally significantly more generous than the state benefit that the individual gives up. Since the National Insurance rebate that employers and employees receive relates to the cost of the State Second Pension benefit given up, employers and employees have to make additional contributions to bring the benefit up to the RST level.

47. Alan Pickering recommended that we make the RST benchmark easier to meet. He believes that the level of the current test acts as a disincentive to providing defined benefit pensions for some employers. We think that employers currently offering benefits at or above the level of the RST will want to continue to do so. But we also want to make it possible for employers offering other kinds of benefit structures to contract out and to help other employers to set up new defined benefit schemes. The objective of the change would be to give schemes greater flexibility and to encourage employers to continue to offer contracted-out provision.

48. We are proposing a package of changes to the RST, including:

- **changing the minimum accrual rate from 1/80th to 1/100th**, equivalent to 1 per cent of pensionable salary. The objective would be to allow schemes which provide a lower pension than is required by the current RST to contract out. They would still have to provide a pension broadly equivalent to the State Second Pension that people in such schemes would be giving up, but this would reduce funding pressures. It should be noted, however, that this would correspondingly reduce members' potential benefits for future service;

- allowing contracted-out schemes to choose whether to calculate pensionable salary on a **career average or final salary** basis. This could provide a fairer reflection of earnings throughout an individual's whole working life and could benefit people whose earnings peak mid-career. However, those with strong earnings growth throughout their working life could lose out. Whether this would increase or reduce funding pressures on schemes would depend on the make-up of their workforce; and

- **requiring all earnings to be included in pensionable salary**. This would simplify administration for schemes as they would not have to keep separate records under different definitions of earnings. It could result in higher pensions for members but add commensurately to scheme funding costs.

49. We would welcome views on how the individual measures would work together in a package. We would be attracted to simplification in this area if it would lead to more pension provision overall. It will be important to balance the needs of members, employers already providing occupational schemes and potential future providers. Even under the proposed new RST, the benefits provided would generally be more generous than the State Second Pension given up, so employees contracted out in defined benefit schemes would generally still accrue more pension than those who stayed in the state scheme. However, if employers decided to reduce the pension they provide to the new RST level, in future people in contracted-out schemes could build up less pension than they do now. We would hope, however, that the package would lead to more pension provision than would otherwise be the case. This would depend on the behavioural response of employers so we will want to gather as much evidence as possible as to the likely actual effect if this proposal were to be introduced. The proposals are discussed in detail in *Simplicity, security and choice: technical paper*. **We would welcome views on this proposal, particularly on whether it is likely to encourage more contracted-out provision.**

Contracting out: simplification of Guaranteed Minimum Pensions

50. Prior to 1997, when defined benefit schemes contracted out they were required to provide members with Guaranteed Minimum Pensions (GMPs) as part of the overall occupational pension. GMPs were broadly equivalent to the SERPS foregone. These arrangements came to an end in 1997 but schemes must still keep complex records for individual scheme members, some going back as far as 1978 when GMPs were introduced. Having to maintain such records means that any simplifications we bring forward for the future simply sit on top of past complexity. Reforms in this area could lead to significant simplification.

51. Alan Pickering's report suggested that the Government could simplify administration by converting GMPs to simpler RST benefits of equivalent value. A number of other approaches have also been put forward in the past.

52. **The Government wants to find workable and affordable ways to relieve administrative burdens on schemes. In particular, we want to simplify future and past regimes. We propose to work with pensions experts on how to carry forward this simplification while maintaining appropriate protection for members. We would welcome views on the principle and on potential solutions.**

Contracting out: restrictions on how and when benefits can be taken

53. The legislation currently prevents people from taking contracted-out rights as a lump sum, except in certain limited circumstances. It also prevents contracted-out benefits being taken below a certain age in occupational defined contribution schemes and personal pension schemes.

54. These restrictions mean that many schemes treat their contracted-out and other scheme benefits differently, thereby increasing complexity and the administrative burdens on schemes. Allowing greater flexibility would make it easier for employers to offer contracted-out pension provision and give individuals more straightforward choices. These advantages need to be weighed against the principle that contracted-out rights should replace lost state scheme benefits and against the potential public expenditure implications of any reduction in the level of pension payable. On balance, however, we believe that there is a strong case for change.

55. The **lump sum restriction** means that the contracted-out rights cannot be commuted as part of the lump sum benefit, except in certain limited circumstances. We would expect many scheme members to welcome the opportunity to take these benefits as part of a lump sum at the same time as other benefits on retirement.

56. We also **propose to revise the age restrictions relating to contracted-out rights so that schemes can start to pay all elements of the pension at the same time**. This would be a substantial simplification for schemes.

57. We believe that the flexibility afforded to schemes and scheme members could be extended further. To address this **we propose to increase the size of pension funds that can be commuted into a lump sum on grounds of triviality**. At the moment where the pension would be more than £260 a year – broadly equivalent to a fund of

£5,000 – the member must take it as regular pension income rather than a lump sum. **In line with the Inland Revenue's tax simplification proposals, we are proposing to increase the limit to enable a pension fund equivalent to around £10,000, to be taken as cash at age 65.**

58. **We would welcome views on these contracting-out proposals.**

Greater flexibility for schemes

59. We have looked at both the way we legislate for pensions and what we are legislating for. **We believe that the level of prescription should be based on the degree of risk to scheme members.** We therefore propose to take a pragmatic approach to legislative change, looking at the risk in individual areas rather than opting for a rigid overall model for future legislation.

60. The Government also recognises that the sheer number of pieces of current legislation can compound confusion. While we do not underestimate the scale of the task, **we propose to consolidate pensions legislation as soon as practicable** after we have legislated on the proposals flowing from this consultation. We have already begun preliminary discussions with the Law Commission, which is responsible for consolidation Bills.

61. As well as the areas discussed above, we are looking to simplify legislation that relates directly to the administration of schemes and scheme governance rather than the value or structure of scheme benefits. **We want to give schemes greater flexibility to manage themselves in a more efficient and effective way that reflects and supports the business of the sponsoring employer.** We believe that this will both make administration easier and provide greater transparency for members. For example, we propose to:

- **simplify the arrangements under which schemes are restricted from modifying accrued rights** so that, in certain circumstances and within well-defined limits, schemes have the flexibility to make changes. Members would not suffer a reduction in their benefits – any rights foregone would have to be replaced with something of actuarially equivalent value;

- **reduce the level of prescription on selection processes for member-nominated trustees** so that legislation focuses on the outcome to be achieved – at least one-third of trustees should be member-nominated – and not, as now, on the detailed processes that schemes must follow to achieve that outcome; and

- **improve the procedures for dealing with internal disputes**, in particular giving scheme trustees more flexibility to adopt a procedure which best suits the scheme and its members and setting a shorter timescale for the process to be completed.

62. These proposals are discussed more fully in *Simplicity, security and choice: technical paper*. We are attracted to these proposals for simplification. **We would welcome views.**

4.5 Protecting employees

Summary

If they are to join schemes, prospective pension scheme members will want to have confidence that the pensions they are promised will actually be delivered. Most people receive the pension they are promised, but sadly there are exceptions. There has been a lot of concern in recent months about pension schemes that are being wound up, either through the decision of a solvent employer or as a result of the employer becoming insolvent.

We are determined to act to increase protection for scheme members. We will increase security but we will aim to ensure that in doing so we do not increase the overall burden on employers providing pensions. Employers provide schemes voluntarily, and we need to ensure that they continue to choose to do so. We want this consultation to inform our strategy so that we can provide greater protection without risking scheme existence. We recognise this is a difficult balance to achieve.

We are looking at proposals aimed at preventing problems arising in the first place while ensuring that members are properly protected when problems do arise.
We are proposing:

- a **new pensions regulator** whose objectives and resources are focused on protecting the benefits of scheme members;
- steps to give members greater confidence that, when schemes are wound up, they will **get the benefits they were promised**; and
- **ensuring that members are consulted about changes** to their pension scheme.

A new pensions regulator

63. The Government believes that regulation and regulatory bodies can only be effective – and respected – if they focus on the real risks and live up to public expectations by being seen to do so. The existing regulatory framework for private pensions does not support this approach.

64. Occupational pensions are currently regulated by the Occupational Pensions Regulatory Authority (Opra). Opra was set up in 1997 and is funded by a levy on pension schemes. It is concerned with the ongoing regulation of pension arrangements sponsored by employers. It looks at issues such as how schemes are run, how pension contributions are collected, recorded and accounted for and how monies are distributed if a scheme is wound up.

65. The report of the *Quinquennial Review of the Occupational Pensions Regulatory Authority*, published concurrently with this Green Paper, assesses Opra's performance over the five years of its existence. Opra was set up as a reactive regulator to take action in response to reports of problems with pension schemes. As a result Opra can react when problems have happened but not always anticipate problems and intervene proactively.

66. We propose that that there should be a **new pensions regulator separate from but operating alongside and complementing the Financial Services Authority (FSA).** The new regulator would be governed by objectives directly related to the protection of pension scheme members' benefits, while continuing to be funded by a levy on schemes. **It would be a proactive body whose investigative effort is focused on schemes in which there is a higher risk of fraud, bad governance or maladministration**. We propose that the new regulator would have powers enabling it to anticipate problems rather than responding to them once they have happened. We propose that it will also take a more active approach to reducing the identified risks, whether through education, guidance and support or targeted surveys and on-site investigations. The shape of the proposed new regulator is set out in the report of the *Quinquennial Review of the Occupational Pensions Regulatory Authority*.

Protection in the case of wind-up

67. We want to take action to increase members' confidence that they will receive the pension they were promised by the employer. We are looking carefully at proposals which would:

- **share out scheme assets more fairly** than is the case at present when a scheme winds up;
- introduce a **centralised 'clearing house' or some form of insurance** to increase support and protection for members whose scheme winds up following their employer's insolvency;
- **increase the compensation** payable to members in the case of fraud or dishonesty; and
- **strengthen protection** for members whose solvent employer chooses to wind up a scheme.

68. These are discussed below.

Fairer sharing of assets

Rebalancing the priorities between pensioners and non-pensioners

69. We want to ensure that when a scheme winds up, the assets are divided among scheme members as fairly as possible. That is why a statutory priority order exists. Amending the priority order might result in a fairer distribution of assets. Currently, pensioner scheme members are ranked higher than non-pensioner members in the priority order. Broadly speaking, all non-pensioners rank equally, irrespective of their age or length of time in the pension scheme. It has been suggested that there is a case for revisiting the priority order to consider whether it is as fair as it could be.

70. There are a number of possible reforms. One option would be **to increase the priority given to people who are approaching retirement age.** For example, people within ten years of a scheme's normal retirement age could be given higher priority than they have now. However, this approach could mean less protection for younger members, some of whom might have been contributing to the scheme for many years. An

alternative would be **to base the level of protection on the number of years the individual had contributed to the scheme**, irrespective of their age[2].

71. The options described above would be more generous for older workers or those who had been contributing to the pension for a long time. An alternative approach would aim to achieve **a fairer sharing of assets between those with larger and smaller pension**, probably adjusted to reflect length of time in the scheme. For example, we are aware of cases in which senior figures in companies have taken early retirement only shortly before a company becomes insolvent and its under-funded scheme is wound up. In such cases, large pension payments to these individuals can strip significant assets from the pension fund, leaving those who have not retired with little or no pension. This is unjust. We could **introduce a capping system to discourage such practices**. If there were insufficient assets to meet all liabilities, pensions of such early retirees could be fully protected up to a certain level, but amounts above this cap would be returned to the pension fund to be shared out among workers who might otherwise see their pensions much reduced.

72. Even where such early retirement is not the issue, there might be a case for re-examining the balance of protection between the better off and the less well off.

Amending the priority order of creditors

73. We might also consider **moving pension schemes up the order of priority for payment**. At present, certain sums that are due to pension schemes are included for payment with other unsecured creditors at the bottom of the list of creditors. This group lies below preferential creditors (which include unpaid wages and certain pension contributions) and secured creditors (which include banks, mortgage lenders and so on who had made secured loans). Some argue that pension scheme members should be given the same priority as preferential or secured creditors.

74. This would increase the overall level of funds available to schemes. However, it could also have significant wider economic consequences. In particular, employers with defined benefit schemes could find it harder to obtain secured loans, or see the cost of those loans increasing. So this is very unattractive.

75. One way of addressing this problem might be **to create a new category of creditor**. Pension schemes could be given a higher priority than other unsecured creditors but still have lower priority than preferential and secured creditors. This would reduce the potentially adverse economic effects. However, other unsecured creditors – for instance trade suppliers, consumers and employees – would lose out. They might consider they have at least as much right as a pension scheme to a share of the insolvent employer's assets. As a result, some – such as trade creditors – might have to downsize or go into insolvency themselves.

76. **We need to strike a careful balance between the potential impact on business and the need to provide adequate protection for members. We would welcome views on this balance.**

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2 Proposal by the Rt Hon Frank Field MP.

Insolvent employers

77. Another approach to dealing with defined benefit schemes that are under-funded when the employer becomes insolvent would be to introduce some form of **insurance or a centralised 'clearing house' arrangement**. Following a number of scheme wind-ups, the Government wants to look again at whether this might be a practical way of reinforcing the pension promise. Some form of insurance might be attractive to scheme members as it would give them greater confidence in the benefits promised.

78. There are a number of different approaches that could be taken here, for example:

- a centralised arrangement or 'clearing house' into which people whose employer became insolvent could pay the funds they receive on wind-up. The clearing house could then seek to buy on their behalf the best available annuity from an insurance company; and

- a form of insurance (possibly a Central Discontinuance Fund) that enables members to be more confident that, if their employer becomes insolvent with an under-funded pension scheme, they will receive the benefits promised.

Centralised clearing house arrangements

79. When a defined benefit scheme winds up, if working-age members wish to obtain an alternative guaranteed retirement income with the funds that they receive, they must purchase a deferred annuity. But typically, deferred annuities are expensive, especially for younger members. These costs lead to lower pensions.

80. In part, the high costs of deferred annuities reflect the fact that the provider is being asked to assume a significant amount of risk over a long period of time. But it also reflects the fact that the deferred annuity market is under-developed, and that administrative costs are high and scheme members' negotiating position weak, especially when schemes are small or they are acting individually.

81. **We are therefore interested in considering the establishment of a central fund into which members could choose to pay the funds that they receive on wind-up. The fund could then – acting as a whole – negotiate the purchase of deferred annuities with providers.** Members facing wind-up might expect to get a better deal because it would become more attractive to provide deferred annuities: administrative costs would be more widely shared and risk would be more widely pooled. In addition, members' negotiating position would be strengthened by their coming together in a single fund.

Insurance arrangements

82. **An alternative approach would be to introduce an insurance scheme**, perhaps a Central Discontinuance Fund, providing pensioners and non-pensioners with greater protection against the possible pension implications of insolvency. Different models would offer differing degrees of benefit-replacement and guarantee. The additional protection could be funded by, for example, a reduction in pension benefits or increased

contribution rates. The cost would need to be balanced against the greater overall level of security offered.

83. **We would welcome views on these options and their potential impact.**

Improved compensation arrangements

84. People need to be protected against dishonesty. The current Compensation Scheme provides compensation for losses caused by dishonesty where the employer is insolvent. It is financed by a levy paid by occupational pension schemes.

85. There are currently restrictions on the amount of compensation that can be paid in cases of dishonesty. For defined benefit schemes, it is restricted to the amount needed to bring the value of the scheme's assets up to 100 per cent of its liabilities for pensioners and members within ten years of retirement, and 90 per cent of its liabilities for other members or, if lower, the amount of the actual loss. For defined contribution schemes, compensation is limited to 90 per cent of the loss.

86. **We propose to remove these restrictions so that schemes with an insolvent employer can be compensated for the full amount lost as a result of acts of dishonesty.**

Solvent employers

87. Some solvent employers choose to wind up their pension schemes. When they do this they need to make arrangements to meet the pension promise they have made to their past and present employees. There have been instances recently in which members have lost out substantially under these circumstances. The Government believes that members need greater protection against such losses.

88. In March 2002, we increased the amount of money that solvent employers have to put into the pension fund if they choose to wind up the scheme. This means that employers are required to put enough money in to buy annuities with an insurance company for pensioners (guaranteeing their full pension) and for people who had not retired, the value of their accrued benefits, worked out on the MFR basis (which they can transfer to another pension arrangement). It does not guarantee the full pension they were expecting as the transfer value is calculated by making assumptions about the level of investment growth between the time of wind-up and when the individual retires. If investment growth is more or less than assumed then the value of the pension fund at retirement could be similarly greater or smaller. With transfer values, therefore, the risks are borne by the individual.

89. After the replacement of the MFR with scheme-specific funding requirements, it will be for schemes to determine their own transfer values on a basis that is fair to all. As the MFR has provided a minimum measure of funding, we might expect that in many cases transfer values would be higher than the minimum amount that they were under the MFR.

90. While this change provides more protection than before, some have argued that there is a case for strengthening these arrangements further. Two options that have been suggested are:

- a **'full buy-out'** where employers would be required to provide sufficient funds on wind-up to allow all scheme members to buy annuities (deferred in the case of non-pensioners) which would guarantee their full pension; or
- a **'partial buy-out'** where the amount of money in the scheme would provide full protection for pensioners and those nearing retirement. Younger workers would receive cash equivalent transfer values as now.

91. Both these options would increase the likelihood of members getting the pension they had been promised. However, at the moment there is only a small market in deferred annuities and this can work against individual choice and the market competitiveness that gives individuals good value. These options could also increase costs to employers, including those that have no intention of closing their scheme. **We can see arguments for and against increasing the amount that employers are required to put into the pension fund if they choose to wind up the scheme. The Government will be guided by the aim of not increasing the overall burden on employers providing pensions.**

92. **We would welcome views on the appropriate balance to strike here.**

Changes in employer or scheme type

Transfer of Undertakings (Protection of Employment)

93. The Transfer of Undertakings (Protection of Employment) Regulations[3] (TUPE) are designed to safeguard employees' rights when businesses transfer between employers but they exclude rights in respect of continuing active membership of an occupational pension scheme.[4] Therefore, simply as a result of transfer, an employee's future pension rights can be significantly reduced; in particular, any employer contribution can be entirely withdrawn.

94. In September 2001 in the TUPE consultation paper *Government Proposals for Reform* we sought views on the provision of explicit legal protection for employees' occupational pension rights on transfer, including within the private sector. We remain committed to the long-standing policy of protection on a 'broadly comparable' basis for public sector transfers both on initial transfer of a service to the private sector and on any subsequent transfers within the private sector.

95. In this Green Paper the Government is not proposing to set a general minimum level of employer contributions to pensions. Under TUPE, the pay of transferred employees cannot be lawfully changed by reason of a transfer. TUPE does not at present cover pensions. However, as a matter of policy the Government extends similar protection to pensions in the case of public to private transfers. Many private sector employers also provide a degree of continuity in occupational pension entitlement across a TUPE transfer.

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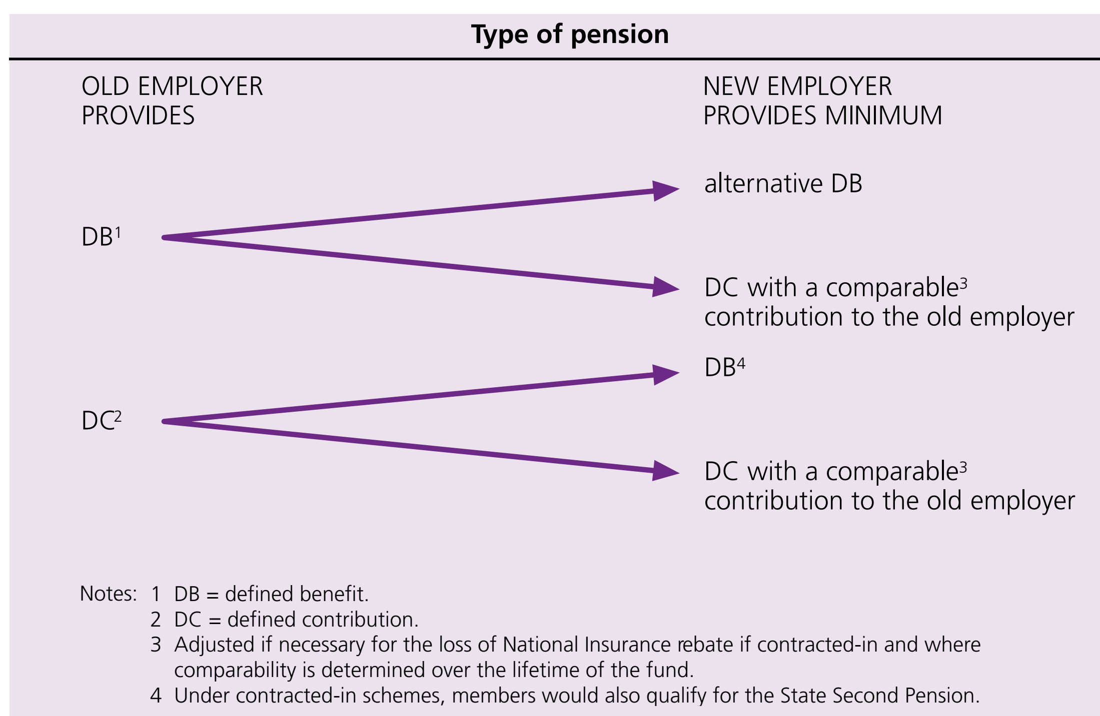
3 Transfer of Undertakings (Protection of Employment) Regulations 1981.
4 Accrued rights, on the other hand, are clearly protected under pensions legislation, and this will remain the case.

96. The Government set out a range of options on extending TUPE protection on purely private sector transfers in a public consultation document[5] published by the Department of Trade and Industry in September 2001. It is clear from the responses to this consultation that there are a wide range of views. Were the Government to extend a degree of protection for occupational pension rights to purely private sector transfers, such protection would need to be simple, flexible and worthwhile. Two possible options for extended protection that might fulfil these criteria are set out below. Both would ensure that where the previous employer made a pension contribution, so too would the new employer. It is assumed that following a transfer, the employer would be at liberty to modify the provision should this become necessary for reasons unrelated to the transfer itself.

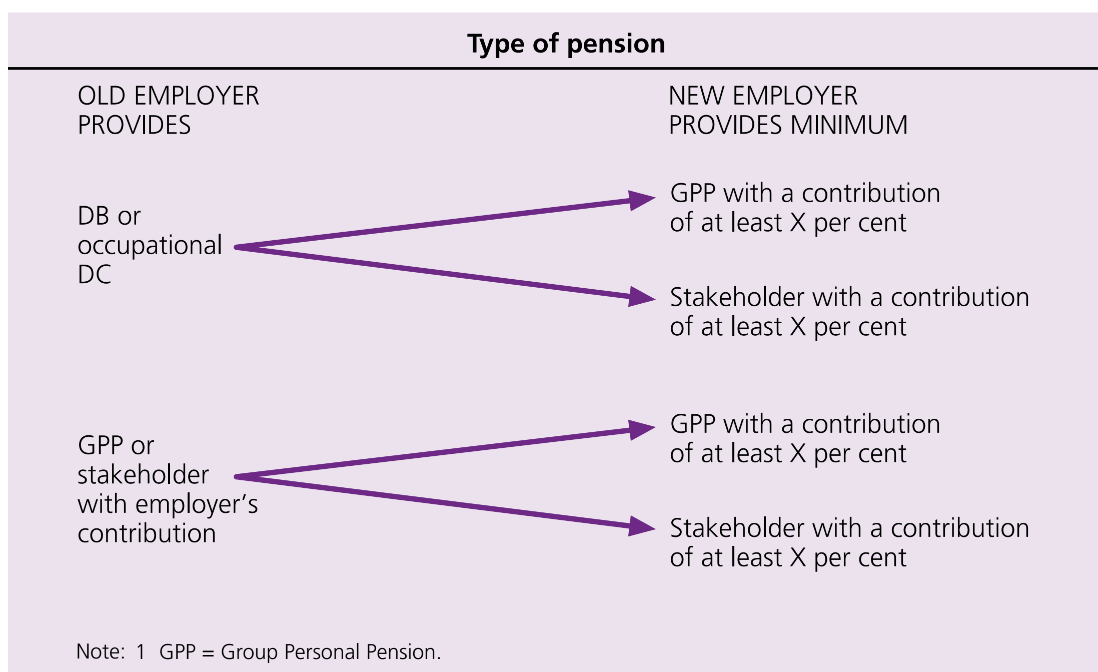
Figure 4.4: TUPE occupational pensions proposals: private-to-private business transfers



Notes: 1 DB = defined benefit.
2 DC = defined contribution.
3 Adjusted if necessary for the loss of National Insurance rebate if contracted-in and where comparability is determined over the lifetime of the fund.
4 Under contracted-in schemes, members would also qualify for the State Second Pension.

5 Transfer of Undertakings (Protection of Employment) Regulations 1981 – Government Proposals for Reform – Consultation Document (URN 01/1133).

Figure 4.5: TUPE stakeholder/GPP[1] proposals: private-to-private business transfers



Note: 1 GPP = Group Personal Pension.

97. **We would welcome comments on this general issue and on these suggested proposals. In the context of Figure 4.5 we would welcome suggestions on the employers' contribution rates (including levels and age-related contributions) when the new employer provides a stakeholder or Group Personal Pension scheme.**

98. When considering suggestions, we will also take particular account of the following:

- support for business flexibility; and
- genuine and worthwhile protection for employees against the insecurity this creates on the transfer of an undertaking.

Consulting employees about pension changes

99. It is good practice for employers to consult their employees or employee representatives, or both, before making changes to pension arrangements. It does not seem unreasonable for employees to be given the opportunity to feed in their views before employers make decisions of this importance. However, not all employers follow this good practice.

100. **We are therefore considering a requirement on employers to consult their employees or employee representatives, or both, before making changes to pension schemes.**

101. We will consider this issue alongside our consideration of how to implement the EC Information and Consultation Directive, which must be transposed into UK law by March 2005.

4.6 Better information and promotion of pensions

Summary

Chapter 3 concluded that people need better information if they are to be able to make informed choices about their retirement provision. The Government wants to encourage employers to provide good pension information to employees and to promote their pension schemes. Employers are best placed to provide information that is specific to their company, including forecasts of company provision, and evidence suggests that pensions information given in the workplace setting is more likely to be absorbed and acted on. Moreover, companies also profit when they improve their pension information, and current and potential employees can recognise the pension benefits they provide. Such employers can then reap the reward of enhanced recruitment and employee retention.

The Government has proposals in a number of areas:

- getting the active involvement of employers through an **employer task force**;
- encouraging **employers who provide pensions** to do more **to highlight their value**;
- encouraging and facilitating all **employers to provide better information**;
- helping to **extend pension provision**, including **increasing take-up** by employees; and
- encouraging employers who do not provide pensions to **provide their employees with pensions information and advice**.

Employer task force

102. There are many examples of good employer practice in pension provision and we know that many employers are keen to share and build on this experience. **We are setting up an employer task force to tap into employer experience and innovation.** This will be an employer-led body with a remit to increase and extend occupational and private pension provision, in partnership with Government and individuals. We hope that the task force will identify and promote employer-led solutions that enable and encourage employees to save more and for longer.

103. We would want the task force to develop and promote employers' role in pension provision and encourage employees to save, with particular emphasis on:

- increasing employees' access to and take-up of high-quality pension schemes;
- improving access to advice to enable employees to make informed choices;
- identifying the needs of specific sectors to consider whether targeted pensions solutions are needed; and
- acting as a catalyst in the development and promulgation of best practice.

104. **We propose that the core members of the task force will be employers, but that it will include trade union representation** to ensure that full account can be taken of the impact of any proposals on employees. The task force will also need to have ready access through an advisory group to other pensions experts.

Highlighting the value of pension provision

105. Although there is much good practice, employers often fail to make as much of what they do as they could. They should drive home to employees how valuable the pension they are providing really is. **The Government wants to encourage employers to adopt best practice in informing employees and prospective employees of the pensions offered.**

Total benefit statements

106. A number of employers have begun issuing 'total benefit statements' to their employees in recent years, bringing together in one annual statement the value of salary, pension and other pay and company benefits. Such statements are common in the US. There are numerous examples to draw upon which vary considerably in terms of presentation and contents. An example produced by the Black Mountain Group is reproduced on the next page. While details differ, their aim is common – to inform and reinforce employee understanding of the total remuneration package. **The Government believes that the issue of annual total benefit statements would help employees to recognise the commitment their employer is making by providing a pension. We will discuss with employers how best to promote their wider use.**

Pensions information in pay slips

107. Some employers show employer as well as employee pension contributions on their pay slips. This will generally be relatively straightforward as the calculation of employer contributions is, for many, an existing payroll process. The Government believes that the presentation of employer contributions in this way could do much to improve employee understanding and appreciation of the significant amounts employers regularly contribute on their behalf. **The Government believes that it would be beneficial for employers to include information about employer pension contributions on wage slips. We will discuss how to take this forward with employers.**

Pensions information in recruitment material

108. Some employers actively inform prospective employees of their pension arrangements as part of the recruitment process, but many do not. An examination of newspapers reveals that fewer than 10 per cent of employers make any explicit reference to pension provision as part of their job advertisements. **The Government believes that employers and potential employees would find it useful to have appropriate information on pension provision in recruitment adverts. It will discuss how to take this forward with employers. As a start, the Government will make changes to Jobcentre Plus systems and processes so that they inform job seekers more clearly of employer pension arrangements. We will also look to give a lead in advertising and recruiting to public sector posts.**

Example of a total benefit statement

Current Benefits for Mrs A Sample

Compensation for period January 2002 to December 2002

Base Salary:	£42,000.00
Guaranteed Bonus:	£12,600.00
Total Cash	**£54,600.00**
Benefits – Value to You	**£2,098.80**
Pensions contributions – Value to You	**£3,780.00**
Total Benefits – Value to You	**£5,878.80**
Total value of compensation	**£60,478.80**

You may be eligible for a discretionary bonus which could be up to an additional 20 per cent of base salary.

Private Medical Insurance

Provider & Registration No.:	**Monthly cost to employee:**	**Effective Date:**
BUPA – 0000000000	£10.00	01/01/2001
Annual Value to You:	**Monthly Value to You:**	**Level of Coverage:**
£1,440.00	£120.00	Single

Permanent Health Insurance

Estimated Annual Amount:	**Monthly cost to employee:**	**Effective Date:**
£31,500.00	£0.00	01/01/2001
Annual Value to You:	**Monthly Value to You:**	
£468.00	£39.00	

Basic Life Insurance

Level of Coverage:	**Monthly cost to employee:**	**Effective Date:**
£168,000.00	£0.00	01/01/2001
Annual Value to You:	**Monthly Value to You:**	
£190.80	£15.90	

Beneficiaries

Beneficiary Name:	**Address:**	**Date of Birth:**
Mrs A Sample	1 Any Street, Anytown, A1 2AA	01/02/69
Gender:	**Relationship:**	**Percentage:**
F	Wife	100%

Additional Benefits

Travel Insurance
You have immediate coverage under the business travel insurance policy if you travel on company business. For further details on this benefit please click here.

Eye Test
You are entitled to an eye exam every two years at the company's expense. For further details on this benefit click here.

GP Consultations
In certain circumstances you may visit the Medical Centre at no cost. For further details on this benefit click here.

Interest-Free Season Ticket Loan – application process
You can apply for an interest-free season ticket loan up to a maximum of £5,000. For further details please click here.

Annual Leave
You are entitled to 24 days paid leave per year. For details on how to book your leave please click here.

Pension Plan

Scheme Name:	UK Pension Fund
Scheme Section:	DC Section
Date of Birth:	22/08/1965
Base Salary:	£42,000.000
Pensionable Salary:	£42,000.00
Normal Retirement Date:	07/12/2030
Date Pensionable Service Commenced:	**01/01/2001**
Value of your Pension Plan as at 11/12/2002:	£11,200.00

Defined Contribution Plan

Vesting Date:	01/01/2003
	Value as at 17/07/2002
Your Contributions:	£3,500.00
Employer Contributions:	£6,300.00
Your AVCs:	£1,400.00
	of Pensionable Salary
Your Contributions:	5%
Employer Contributions (normal):	7%
Employer Contributions (match):	2%
Employee AVCs:	2%
Provider Link:	www.aprovider.com

Helping employers to provide information and guidance for employees

109. In order to plan for retirement, employees need to understand what income their current level of saving may provide on retirement and what their pension options are. The Government is keen to facilitate information provision by employers to their staff.

Pension information pack

110. Employers have concerns about meeting FSA and other rules when giving information on their pension schemes and pension saving more generally. To make it easier for employers to promote the benefits of their pension scheme, and meet the relevant regulatory requirements, **the Government propose to produce, in consultation with employers and others with an interest, an FSA-approved pension information pack for employers to use in communicating with their employees.** The pack has the potential to deliver better information in the workplace within the existing regulatory framework. There is, we believe, scope under current regulation for many employers to do more to deliver information in the workplace. But we will keep regulatory reform, especially for financial advice in the workplace, under review, and we are prepared to consider carefully the need for change.

111. The pack could include:

- a wake-up call – designed to alert employees to the need to think about whether state retirement provision will be enough for them;
- information on the pension options available in the workplace, including the level of employer contributions;
- information on the wider context of pensions, and how they can be turned into income for example through the purchase of an appropriate, good value annuity; and
- information on how employees might find out more and get individual help – for example, small- and medium-sized enterprises might find it useful to have easy access to FSA or Department for Work and Pensions guides.

Combined pension forecasts

112. From April 2003, defined contribution (money purchase) schemes have to provide an annual illustration of the potential amount of the pension at retirement. Although not a legal requirement, similar illustrations are standard practice for the majority of defined benefit schemes. But some employers do more in various ways to inform employees about their likely retirement position and to make clear the underlying value of the company's pension scheme contributions. The outcome is mutually advantageous – employees benefit from receiving better and more regular information and employers benefit from increased employee appreciation of the employer's pension commitment.

113. As discussed in **Chapter 3**, combined pension forecasts allow participating companies, such as Emap, to provide their employees with a state pension forecast alongside forecasts of their occupational pension. An example of a combined pension forecast is at Figure 3.4. The Government proposed combined pension forecasts in the 1998 Green Paper and

take-up by employers has continued to increase since introduction in October 2001. The Government is keen to extend the use of combined pension forecasts so that more employees can benefit. **We would welcome views on how to increase coverage of combined pension forecasts, whether on a voluntary or compulsory basis.**

Encouraging better pension provision

114. The Government is keen to encourage better pension provision by employers. Some employees, although they have access to a generous pension scheme supported by their employer, fail to take this option up. In some cases, this may be a sound decision taken in the light of full information. But more often, it may flow from a lack of knowledge and understanding or an overly short-term approach to finances.

Immediate vesting

115. Currently, employees may have to be members for up to two years for their rights to be secured in their employer's occupational pension scheme. This is called the vesting period.

116. **We propose that rights should be vested from the point at which an employee joins the scheme.** This would benefit those employees who tend to work for different employers for short spells. At present they may decide that it is not worth their while joining an employer's scheme or may be discouraged from doing so if it has a vesting period of two years.

117. Those employees who have small amounts of pension rights spread over a number of different pension arrangements will be able to consolidate their rights by transferring them to a single personal pension plan or stakeholder pension just as they can now.

118. We have included below an illustrative case study on the potential benefits of immediate vesting. However, the effect on different individuals will vary according to their sex, age, salary progression, type of pension scheme and, crucially, in the case of defined benefit schemes, the basis used to calculate the cash equivalent transfer value.

Immediate vesting

Miss Patel, aged 28, joins a company and becomes a member of the contracted-out defined benefit scheme which has a vesting period of two years. She earns £20,000 a year and contributes 5 per cent of her earnings into the scheme.

If she leaves the company after one year and 364 days, then at present she gets a cash refund of her contributions (after deduction of the employee share of the Contributions Equivalent Premium and net of tax) of £1,200. A Contributions Equivalent Premium is paid to reinstate her State Second Pension rights for the period.

However, if her rights had vested as soon as she joined the scheme, the total cash equivalent of her accrued rights after one year and 364 days would be £3,400. She is therefore better off, with over £3,000 invested towards her pension.

119. We think that immediate vesting may have benefits for employers' ability to retain staff, as employees may be more likely to stay with an employer where they have started to accrue pension rights. However, to avoid the burdens on schemes of having to administer small amounts of pension, **we propose that trustees should be able to transfer *de minimis* amounts to a stakeholder pension unless the member objects or asks for the rights to be transferred elsewhere.**

Compulsory scheme membership

120. Many employers want to do more to encourage individual saving through their pension scheme. We are keen to help them do this. **We are considering options for employers, on a voluntary basis, to be able to make membership of their occupational scheme a condition of employment for all new employees.** Allowing compulsory membership is one way of increasing the numbers of employees who are members of, and contributing to, their occupational pension scheme. This may have benefits for employers in terms of recruitment and retention of staff, as employees may be more likely to join and stay with an employer where they have started to accrue pension rights under their employer's occupational pension scheme.

121. However, in proposing changes to allow for compulsory scheme membership we want employees to be able to make informed choices about their pension provision. So they **should be able to opt out of their employer's scheme where, for example, they are already contributing to a stakeholder pension**. Other countries' methods of increasing the numbers of employees who are saving in an occupational pension scheme are outlined below.

International experience

122. Many developed countries encourage individuals to save through occupational pension schemes, but some go further by requiring employers to meet certain conditions when offering pensions to their workforce.

123. **Australia** does not have a social insurance system, but relies on means-tested state provision. Since 1992, employers have been required to contribute a set proportion (now 9 per cent) of their employees' salary to a private pension. The introduction of compulsory employer contributions has raised occupational pension scheme coverage substantially, especially among the lower paid, although this has partly been funded by lower wages, and there is some evidence that it has reduced other saving.

124. In the **US**, the approach to employer provision of pensions lies somewhere between that in Australia and the UK: employer contributions to pensions are not mandatory, but tax relief on pension contributions to employer-sponsored schemes is contingent on meeting certain conditions. In particular, 401k schemes make the receipt of tax relief conditional on the level of employer contributions, coverage of the workforce, and the fair treatment of high- and low-paid employees.

125. While such schemes have their limitations, and the US and the UK operate very different pension systems, 401k schemes have been successful in raising pension saving by the low paid, and research indicates that when lower earners participate in the plans, they tend to put new saving in their pension.

126. **The Government would welcome views on the potential application of the 401k approach to private pension provision in the UK.**

Better information from employers who do not contribute to pensions

127. All but the smallest employers are already required to provide their employees with access to a pension. Where they do not provide access to an occupational pension scheme or to a group personal pension with an employer contribution of at least 3 per cent, employers with five or more employees are required to provide access to a designated stakeholder pension.

128. The Government believes that in addition employers who do not provide a pension have a responsibility to ensure their employees have access to the information they need to make an informed choice about saving for retirement. **We have a range of options.** We might require:

- employers to provide their employees with a state pension forecast – this would include a reminder of the designated stakeholder pension to which the company provides access and the fact that the employer will make deductions to this pension direct from the wage packet on request; or
- employers to provide employees, on appointment and annually, with the information pack in the 'employer pack' described above; or
- employers to provide an annual presentation from their designated stakeholder pension provider or other authorised retailer on the benefits of saving for retirement; or
- employers to provide annual interviews for staff with the designated stakeholder provider or other authorised retailer, to discuss their pension arrangements . This option could include the Government piloting a time-limited scheme for sharing the costs with employers.

129. **We would welcome views on these options.**

Chapter 5: Financial services – building trust and improving understanding

Chapter summary

The financial services industry is a vital partner in the UK pensions system, managing the private savings of millions of people. The industry needs to build on its successes by ensuring that consumers have access to simple, well-regulated products and get the best deal possible. This chapter describes measures the Government and the Financial Services Authority (FSA) have already taken to build trust, improve understanding and make the market work better. It outlines new proposals including:

- generic **financial healthcheck products**, and **financial advice through the workplace**;
- consultation early in 2003 on **how to bring stakeholder pensions into the simple product suite** proposed by the Sandler Review. The FSA will be consulting, in parallel, on the appropriate new sales regime for Sandler products;
- options to **make the annuities market work better**, including the introduction of **value protected and limited period annuities**;
- ensuring that the **regulation of equity release and home reversion plans** protects consumers and allows the market to work effectively; and
- ensuring that **pension-fund trustees** have appropriate **investment expertise**.

5.1 Introduction

1. The financial services industry is a key player along with the Government, employers and individuals in the provision of secure incomes in retirement. The industry provides investment and administrative services to occupational pension schemes provided by employers. It also provides personal pensions to individuals.

2. The sums of capital controlled by the industry are enormous. Around £750 billion[1] is invested in occupational pension funds. Insurance companies hold around £900 billion[2]

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1 Government Actuary's Department (GAD) survey of occupational pension schemes 2000, preliminary results. Note, stock market fluctuations may have reduced this figure, which is the latest available.
2 Standard and Poors Thesys (figures relate to 2000, which are latest available).

of investors' pensions and other savings. On top of this, there is over £200 billion[3] invested in unit trusts and investment trusts. More than half of all households have liquid savings of more than £1,500[4] and, even among low- and middle-income groups, 90 per cent of people will have saved at some time[5]. So for most people, the workings of the financial services industry is of real, direct, personal interest.

3. The Government's aim is to ensure that both these markets – for the provision of pension services to occupational pension schemes and of personal pensions to individuals – work efficiently and effectively for all. Properly functioning markets will allow fund managers to earn an adequate return on investment. They will invest the sums tied up in pensions in the businesses best able to make use of them, thereby promoting economic growth. And, most importantly, they will deliver the maximum possible benefit to the end-users: pensioners and those saving for a pension.

4. The Government recognises the concerns individuals have about the risks involved in investing in a private pension. Pension funds typically invest about three-quarters of their funds in equities. Market volatility over the last two years – reflecting difficulties in the global economic environment – has raised concerns about whether this level of investment in equities entails an acceptable degree of risk.

5. Recent falls in the stock market should be viewed in the context of the historically higher return on equities over the longer term compared to other mainstream investments such as bonds and property. Over time, stock market performance is likely to reflect the underlying performance of the economy. The fundamental drivers of a successful economy – high employment, low inflation and low interest rates – are in place, and are delivering a secure environment conducive to investment and long-term planning.

6. However, when making pension investments both individuals and pension funds should weigh the risks of different types of investment and ensure that they have an appropriately balanced portfolio. The financial services industry is increasingly offering pension products that manage risk over the lifetime of the individual. Many stakeholder pensions, for instance, offer a default investment option that shifts the balance of an individual's investment as they approach retirement into less volatile asset classes such as bonds and cash. This will lock in gains made by investing in riskier assets like equities in early years.

7. Another concern expressed in some quarters is that the value of people's pension funds in the private sector will fall dramatically as a larger number of pensioners seek to sell their assets at the same time. The potential risk is that, as people sell the assets (such as equities and bonds) that make up their pension funds, the price of those assets will fall due to over-supply and therefore the value of the funds will also fall. However, most commentators[6] believe the impact of demographic change on asset prices to be small relative to the historic volatility affecting asset prices, as retirees are expected to liquidate assets gradually and over a long period of time. And again, such effects should be mitigated by the open nature of the UK economy and capital markets.

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3 Investment Management Association and Association of Investment Trust Companies.
4 *Family Resources Survey,* 2001/02.
5 Whyley and Kempson, 2000, *Understanding Small Savers II*.
6 For example, Porteba, 2000, *Demographic Structure and Asset returns*, MIT mimeo; and Bank of England, 2002, *The implications of an ageing population for the UK economy*, Working Paper No. 159.

8. **Chapter 3** discussed some of the reasons why individuals do not save enough for retirement. The pension choices people face are complicated. Many people lack either the financial expertise, or the necessary information, to make these choices. The Government is working with the industry to empower consumers to make the right savings choices, and simpler products are key to this strategy. Our guiding principles are building trust, improving understanding and increasing market efficiency.

9. This chapter discusses the role of the financial services industry in:

- helping people to save for their retirement;
- helping them find the most efficient way of turning their savings into retirement income; and
- improving the investment decisions of occupational pension funds.

5.2 Helping people to save for their retirement

10. The personal investment market has enabled millions of people to save for rainy days, for retirement, and for the other opportunities and problems life may throw at them. But it has not always produced the best outcomes for consumers.

11. It is a highly complex market, inherently difficult to understand for consumers and made more difficult by the use of technical terms impenetrable to the layperson. Over the years, charging structures have disadvantaged those who cannot, for whatever reason, continue to save as they originally planned. Competition among providers has focused as much on winning access to customers as delivering good-quality investment services to consumers at the best price. This misdirected competition has driven further product proliferation and complexity, making choices even more difficult for the consumer.

12. The Government's vision is of a simpler, more transparent market in which trusted and trustworthy providers sell simple, good-value products to informed consumers. The Government has been working towards this over the last five years, with measures to give savers confidence in the products they are offered, to make it easier for people to save and to improve the working of the market.

Building trust in the market

Pensions mis-selling

13. The Government inherited a legacy of problems in 1997 that needed to be put right. Ensuring justice for the victims of personal pensions mis-selling was the biggest immediate problem to be tackled, as the essential pre-condition for the establishment of trust and confidence in financial services. When the Government came to power, less than 2 per cent of pension mis-selling cases had been satisfactorily resolved. The Government immediately sought to accelerate the process by 'naming and shaming' the worst performers. By the end of this year over 99 per cent of consumers with mis-selling claims will have been compensated. Total compensation will have reached £11 billion.[7]

7 All figures on personal pension mis-selling are provided by the FSA.

14. The Government's aim throughout has been to ensure that the victims of mis-selling received redress as rapidly as possible. Individual firms responsible for mis-selling were required to review their sales of personal pensions. If a pension was mis-sold, and a loss incurred as a result, the firm must offer redress to restore their customers' financial position.

15. The FSA will continue to work hard to ensure that the relatively small number of outstanding cases are dealt with effectively. It has taken tough disciplinary action against firms that do not stick to their timetables. So far, 349 firms have been disciplined – fines for failure to comply properly with the review have reached £11 million.

A new regime for financial regulation

16. Having tackled these immediate problems, the Government moved on to put the regulation of the market on a firm footing for the future. A properly regulated market is essential if trust is to be rebuilt after the problems of the past. The Government has created a radically new regulatory regime with the introduction of the FSA.

The Financial Services Authority

The Financial Services and Markets Act 2001 replaced ten different regulators with a single regulator, the FSA, covering the whole financial services market. It also introduced a single financial services ombudsman scheme to resolve consumers' complaints, a single compensation scheme and a single tribunal.

The FSA has clear statutory objectives. This is an innovation: no previous financial services regulator had its objectives debated by Parliament and set out in statute. The statutory objectives are that the FSA should seek to:

- raise market confidence;
- raise consumer awareness;
- protect consumers; and
- prevent financial crime.

This new regime is a model for the best standards of regulation in the world. The UK is the first major nation to adopt the 'one regulator, one body of law' approach. This radically new regime provides:

- **clarity** – authorisation, regulation and (when necessary) discipline by one body on a consistent basis, rather than by a multitude of different regulators;
- **fair competition** – a level playing field for banks, securities firms and insurance companies operating in the same market;
- **protection for consumers** – a single financial services ombudsman to resolve consumers' complaints, and a single financial services compensation scheme; and

The new regime is **fair to firms and consumers alike**. The FSA will balance appropriate consumer protection with proportionate regulation.

17. The FSA is already improving the regulatory environment. It has recently published a report on the future regulation of insurance[8], focusing on securing a fair deal for customers and strengthening the management of firms. It is also currently reviewing the regulation of unit trusts and open-ended investment companies – the main other way in which individuals save for the long term.

18. The Government continues to take action. It has published a consultation document on the proposed implementation of the Insurers' Reorganisation and Winding-up Directive, which will give policyholders a better chance of getting more of the money they are owed if an insurance company becomes insolvent.

Action taken by the Financial Services Authority

19. The industry has also acted. The Raising Standards initiative developed by the Association of British Insurers (ABI) has significantly improved the clarity and consistency of information provided by life-insurance companies to their customers. As increasing numbers of companies achieve accreditation, the stamp of approval awarded by the Pension Protection and Investment Accreditation Board should reassure customers about the level of service they will receive.

20. These safeguards are clearly essential to prevent problems and deal with them when they happen. But, for the vast majority of people, investment does not cause problems. To put the numbers into perspective, last year, 5,881 people sought the help of the financial services ombudsman[9] about their personal pensions. But this represents only 0.15 per cent of the 4 million[10] people who save through a personal or stakeholder pension.

Making the market easier to understand

ISAs and CAT standards

21. The Government has made it simpler and easier for people to save. For example, the simplicity and transparency of Individual Savings Accounts (ISAs) have translated into significant amounts of saving. ISAs are more flexible than their predecessors – Tax Exempt Special Savings Accounts (TESSAs) and Personal Equity Plans (PEPs) – and this advantage has meant that ISAs have attracted more significant funds. And saving in ISAs is widely spread across the population: since their launch in 1999, more than 14 million investors – 30 per cent of adults – have contributed nearly £100 billion to ISAs.

22. Despite the recent problems of the equity market, ISA sales have held up well, with subscriptions falling only 4 per cent in the last year[10]. Some investors, who put a higher priority on being able to access their investment before retirement, may already be using ISAs to save for retirement, perhaps transferring some of their savings into a pension as they approach retirement. The increased flexibilities offered by the changes to the tax regime for pensions will make this kind of saving easier.

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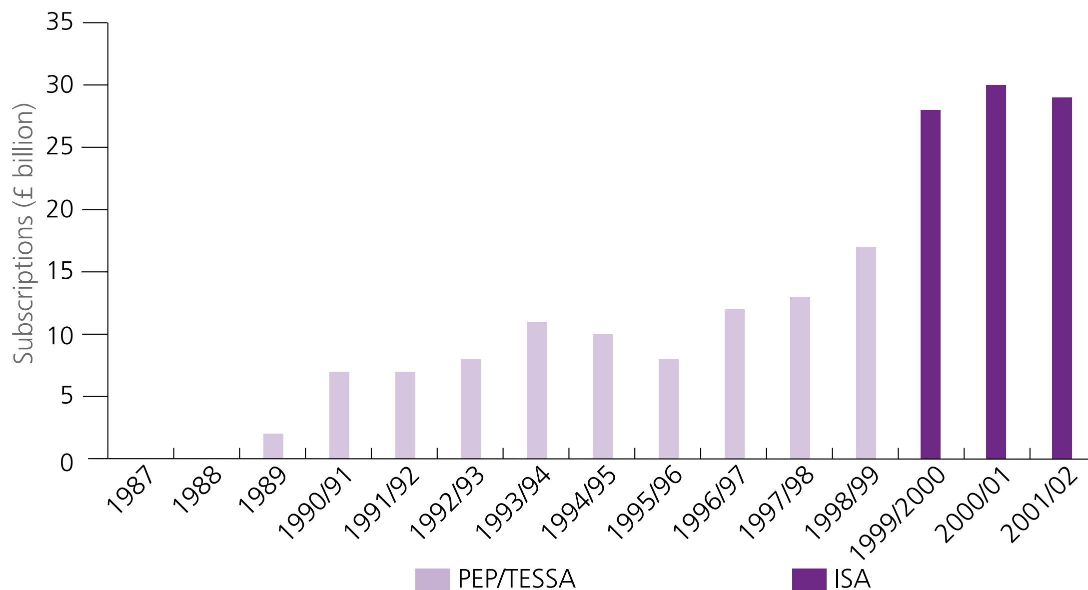
8 *The Future Regulation of Insurance: a Progress Report*, FSA, October 2002.
9 Financial Ombudsman Service: Annual Review and Report and Financial Statements.
10 Inland Revenue.

Figure 5.1: Subscriptions to PEPs, TESSAs & ISAs



Source: Inland Revenue.

23. CAT standards – covering **charges, access and terms** – introduced the idea of a good-value benchmark product, with a simple and easy-to-understand charging structure. Around half the ISA market is for CAT-standard products.

Stakeholder pensions

24. Stakeholder pensions developed the idea of simple, easy-to-understand products by legislating to produce a pension product free from many of the features that had traditionally disadvantaged many savers. These features included high charges, particularly during the early years of investment.

25. Launched in April 2001, stakeholder pensions have extended the opportunity for pension saving to previously excluded groups. They provide a portable, flexible and low-charge way for moderate and higher earners to save for retirement. And although concerns have been raised about the economics of the 1 per cent cap, it is clear that charge caps have put pressure on providers' profit margins leading them to focus more tightly on driving cost improvements in their businesses. Over one million stakeholder pension policies had been sold by the end of September 2002[11].

26. Employers with five or more employees are obliged to provide access for employees to a stakeholder pension scheme unless they already provide an occupational pension or a group personal pension arrangement with a contribution of at least 3 per cent of employees' salary. One of the indirect benefits of the stakeholder pension is that it has encouraged some employers to widen access to their company pension schemes to the whole workforce.

11 ABI figures.

27. Many existing schemes exceed the minimum requirements set by the Government and low stakeholder charges have helped to exert downward pressure on pension charges generally. Research for the Sandler review compared cumulative reductions in yield, which measure the cost of investing through particular investment products. The period around the introduction of stakeholder pensions saw significant falls in reduction in yield. For a 15-year single premium insurance product, the cumulative reduction in yield fell from 17 per cent in 1996 to 14.3 per cent in 2001. For a 10-year product, it fell from 13.8 per cent to 10.3 per cent. This highlights the success of stakeholder pensions in driving down changes.

Stakeholder pensions: ABI analysis

An ABI report – produced in November 2002 – provides detailed analysis of the stakeholder pensions market. The analysis is based on information received from 38 out of the 49 stakeholder pension providers registered with the Occupational Pensions Regulatory Authority (Opra). It reports on a subset of approximately 390,000 of the stakeholder pension contracts, most of which were sold in the period 1 January 2002 to 30 June 2002. There are several key findings from the report.

- Limited information is available on earnings, and it may not be fully representative. However, where earnings of purchasers are known (for about 67,000 cases, 18 per cent of the sample), the majority earned less than £30,000 a year and just under 40 per cent earned between £10,000 and £20,000.
- The vast majority of stakeholder pensions (97 per cent) have been bought by, or for, people of working age. Only 2 per cent were bought for children, and 1 per cent by those aged 65 or older.
- 56 per cent of stakeholder pensions have been bought by men, 44 per cent by women.
- Around 50 per cent of stakeholder pensions have been bought through the workplace.
- 90 per cent of employer-designated schemes with members have employer contributions.
- 74 per cent of policies have been bought with the intention of making contributions at regular intervals. The average monthly contribution to such policies was £130 in the third quarter of 2002.

Reforming the regulation of advice and sales

28. The FSA has conducted a major consultation on reforming the regulation of advice on, and sales of, investments. Current regulations allow two mutually exclusive approaches. Tied advisers can only advise on, and sell, a single firm's products. Independent Financial Advisers have to be able to advise on, and sell, any firm's products. Both tend to be paid through sales commissions. This structure is known as 'polarisation'.

29. Polarisation has been widely criticised. Independent advice has tended to be the preserve of the better-off. Commission-driven selling has focused competition on distribution rather than the savers ultimately buying the product. There is also some evidence of bias towards the sale of high commission products[12].

30. The FSA announced the outcome of this work on reforming polarisation on 21 November 2002. It has proposed allowing a new intermediary model. It will be possible to advise on a limited range of products, without having to advise on every firm's products. This proposal builds on limited changes made in 2001 for stakeholder pensions. It is argued that this new approach could increase practical choice for the majority of consumers who currently use tied agents. The FSA will consult early in 2003 on draft rules giving effect to its detailed proposals.

31. As announced in October 2002, the FSA also plans to reform the way commissions are disclosed, to make it clearer how much consumers are paying for the services of an adviser. Independent Financial Advisers will have to offer customers the option of paying an up-front cash fee, or of having the advisers take their remuneration as a sales commission from the provider.

32. The FSA has also developed tools to help those who do not have access to advice to make informed choices. Decision trees for stakeholder pensions help consumers to decide if a stakeholder is right for them. Comparative tables allow consumers to compare products easily.

Generic financial advice

33. Financial advice will continue to play an important role in the retail financial services market. The perception of advice as available free of charge in the commercial sector (when it is actually paid for through commissions) has inhibited the development of a market for advice as a stand-alone service. There is still a gap in the market for those on moderate incomes who would like help in assessing their financial needs.

34. Product specific advice – leading to a sale and therefore commission – is highly regulated and relatively costly to provide. However, generic advice – for example a financial 'healthcheck' that helps you make sense of your financial situation and the types of products that might help you – would not be regulated as product sales are and, with the use of software, could potentially be made available cheaply. The FSA is exploring how a new interactive financial planning tool might be used as a stand-alone service by community or voluntary organisations to help consumers assess their financial position.

35. The Government believes that the FSA's planned reform of polarisation and the recommendations of the Sandler review create an opportunity for producers and distributors to **develop a market for generic financial advice to help those on moderate incomes to identify their financial priorities and to save where it seems sensible for them to do so.** 'Healthcheck' products on these lines are already being offered by some providers, both in the high street and online. However advice or

12 Charles Rivers Associates, *Polarisation: research into the effect of commission based remuneration,* FSA, January 2002.

information is packaged and delivered – whether through technological solutions or new styles of advisers working face-to-face in the high street, in the workplace or in consumers' homes – the Government believes these changes will usher in new opportunities for firms. **We would welcome views on how best to facilitate the development of a market for generic financial advice.**

The role of employers and the workplace

36. The workplace could also play a bigger part in the provision of information and advice on, and the sale of, financial products such as pensions. There are economies of scale for the distributor, and the number of employers who enter into arrangements with distributors is growing, although at the moment this is more common in firms with higher-paid employees. The creation of the Sandler suite of products, with a new sales process, should make workplaces more attractive places for provider firms as a channel for distributing their products. The role of employers and the workplace in the distribution of financial information and advice is discussed more fully in **Chapter 4**.

Making the market work better: the Sandler review

37. The Government has recently sponsored a major review of the working of the market for medium- and long-term retail savings by Ron Sandler[13], former Chief Executive of the Lloyds Insurance Market. The review found compelling evidence that there is still insufficient effective competition in the retail savings market. It identified two core problems in the UK savings market: competitive forces in the industry do not work effectively to deliver cost efficiency or value-for-money investment practices; and savings levels are insufficient, particularly among the less well-off, in part because of the high cost of serving this market segment.

38. The review made a number of recommendations to the FSA and the Government to tackle these problems. Of particular relevance for individuals' pensions saving is the review's proposal for the introduction of a suite of simple regulated products, which the review called 'stakeholder products'. These products would have capped charges, restrictions on investment profile and people would be free to exit on reasonable terms. The products would be sold without the need for regulated advice; the regulation of the products themselves would be the main source of consumer protection.

39. The Sandler review's proposal for stakeholder products builds on the ideas behind the stakeholder pension. CAT standards, and to an even greater degree stakeholder pensions, have driven improvements in quality and price for investors. However, the Sandler review argued persuasively that the current system of advice and sales regulation for financial products has, with its attendant costs, discouraged selling to savers of modest means. Advised sales of CAT standard ISAs and stakeholder pensions are effectively subject to two sets of regulation: both product and sales regulation. The industry's incentives to sell such products in the current regulatory environment can therefore be blunted.

13 *Medium and Long-Term Retail Savings in the UK: a Review*, HM Treasury, July 2002.

40. Any advised sales of financial services are bound to involve an element of fixed cost for the provider that will vary little with the size of investment being made. That is not a problem created by the current system of sales regulation: it is inherent in the nature of advice. But, the current regime has set a floor for reductions in this fixed cost by setting high minimum quality standards for the advice process.

41. This has meant that it is difficult for lower- and middle-income consumers to access advice. With smaller amounts to invest, these customers are less attractive – even unviable – for the industry to sell to.

42. The Sandler review proposed tackling this problem by creating a suite of regulated products that could be sold outside the current regime for advised sales. This will allow providers to strip out some of the fixed costs of distributing investment products, extending the market to which firms can profitably sell investments. And, as with any change in the regulatory regime, it has the possibility to empower the industry to create new distribution models – perhaps through high street bank branches, or workplace-based sales – that widen the market for distribution.

43. As well as changes to the regulatory regime, on which the FSA will be consulting, the tax changes proposed by the Inland Revenue will also have benefits for the market for private pensions. These changes are discussed more fully in **Chapter 3**. Simpler tax rules will reduce providers' administrative costs, further widening the profitable customer base and reducing barriers to entry.

44. The Treasury announced when the review was published that it would be taking forward **the Sandler proposal for a suite of regulated products**. It has been working with a group of industry and consumer representatives to create the product specifications for the suite of stakeholder products.

45. The existence of the stakeholder pension raises issues for the design of the Sandler suite of products. The proposed pension product is clearly of particular importance, and one of the biggest issues for Government will be the relationship of the pension product proposed by Sandler with the existing stakeholder pension. Although there are many similarities between the Sandler review's proposals and the existing stakeholder pension, there is one significant difference. Stakeholder pensions do not currently have a prescribed investment strategy.

46. The Government will consider how significant this difference is. If change is needed, one possibility would be to **build on the current requirement for stakeholder pensions to have a default investment option. Investment controls of the kind envisaged by Sandler could be placed on this default investment option. It may still be possible to offer a wider range of investment options to investors who want them. This approach has the potential to combine the advantages of the Sandler suggestions with the existing strengths of stakeholder pensions. We will pursue this idea and others as part of the consultations the Treasury is undertaking.**

47. The Government will issue a consultation paper on the Sandler stakeholder products idea early in 2003. This will include the options for bringing stakeholder pensions into the Sandler product suite.

48. **In parallel, the FSA will be consulting on the appropriate new sales regime for these products. It will publish a discussion paper shortly on options for the possible new sales regime for Sandler stakeholder products.**

49. The Sandler review concluded, based on a rigorous analysis of the way competition works in the market, that a price cap would be an essential component of the design of stakeholder products. The review further recommended that, given the existence of CAT-standard ISAs and the existing stakeholder pension, a 1 per cent ceiling would be a suitable starting point.

50. The Government agrees that there have been clear advantages to a price cap in a market that had hitherto experienced only limited price pressure. Experience shows that it has delivered good value to consumers and driven efficiency improvements. There are also strong inherent attractions in a simple 1 per cent annual management charge. It is easy to understand and simple to convey to consumers – essential ingredients of any stakeholder product. There would therefore be a high threshold for persuasion for any change to the current arrangements.

51. The industry and others have raised concerns about the economics of a flat 1 per cent charge on funds under management. Providers have argued that it makes business plans more sensitive to assumptions about volume and persistency. They have also suggested that it would mean longer pay-back periods than the industry has historically been used to, and a greater requirement for capital in the early years of a policy.

52. The Government needs to be sure that stakeholder products can be a success. It will therefore encourage further views from industry and consumer representatives on the costs and benefits of the proposed 1 per cent flat annual management charge, in the consultation document to be issued on stakeholder products early in the new year.

5.3 Turning savings into retirement income

53. As the population ages, people's requirements of the financial services industry will change. Turning savings into retirement income will become relatively more important as the demographic changes outlined in **Chapter 2** come about.

54. For a growing number of people, annuities are an important way of turning pension savings into pension income. In 2001, 258,000 annuities were sold, amounting to £6.2 billion in new premiums. £6 billion was paid out to pensioners under pension annuity contracts. The average fund used to purchase an annuity was £25,000[14]. But this figure masks a large number of smaller funds. Almost two-thirds of annuities purchased were for less than £20,000 and nearly half – 43 per cent – for less than £10,000[15].

55. Annuities are a financially efficient and secure means of turning pension capital saved through defined contribution arrangements, such as a personal or stakeholder pension, into income that lasts throughout retirement. The Government has three reasons for its strong ongoing support for annuities:

14 ABI, *Annual Insurance Statistics.*
15 ABI Report, *Reforming Annuities: Big Bang or Softly Softly?*

- annuities pool people's risk, ensuring that they are the most financially efficient way of turning capital into an income stream;
- annuities make sure that people continue to receive an income from their savings no matter how long they live; and
- tax relief on pension contributions is provided so people can save for an income in retirement, not for other purposes.

56. Using a pension to save for retirement is a two-stage process. While people are working they pay into the pension, and accumulate savings to fund their retirement. Once they retire, they need to turn these savings into an income stream that will continue for the rest of their life. In a defined benefit pension scheme, members pay in contributions in return for a pension promise that is related to the number of years over which they contributed. In a defined contribution pension scheme, the saver buys an annuity at retirement which guarantees an income for life. This means that they are buying two products – a pension and an annuity – and need to make two choices.

57. Many people think that when they buy a pension they are tied into a product that provides retirement income, as well as saving. They assume that the annuity they are offered on retirement is part of the deal. Recent research by the ABI[16] shows that only around half of annuitants actually shop around for their annuity, and about a third of all annuitants ultimately purchase their annuity from a different firm to the one they saved with.

58. We need to be clear that people have two choices. The first is to save for a pension. The second is how to use those savings to generate an income. The Government is itself seeking to ensure that it makes clear this distinction in the information it offers. **The Government is interested in the role the industry can play, through initiatives like the industry's 'Raising Standards' proposals, in making providers' messages as clear as possible.**

The right annuity at the right rate

59. The FSA has already taken action to encourage people to shop around for the best annuity rate. From 1 September 2002, it has required firms to tell policyholders about the benefits of the 'open market option' – jargon for shopping around – to find the best rate for the annuity that is most suitable to them. These new FSA rules apply to personal and stakeholder pensions.

60. The Government will bring forward **legislation to make the same arrangements apply to defined contribution occupational schemes to ensure that shopping around becomes easier for all those who need to buy an annuity**.

16 *Annuities – The Consumer Experience*, ABI, 2002.

Choosing the right annuity

The right annuity for you depends on your personal circumstances.

- Do you have a spouse, or other dependants, that you have to provide for?
- What is your general state of health? Could you buy an annuity that pays significantly higher income to those in ill-health?
- Is your annuity going to provide most of your retirement income or just a part of it? (It might be appropriate to take more investment risk if it is only a small part of your overall income.)
- Do you want your income to be inflation proof?

Answering these kinds of very simple questions can result in a considerably improved choice of product and a potentially higher income in retirement.

61. The FSA has produced a fact sheet on people's options. Firms can use this to explain choices to their customers. It contains a decision tree to help a consumer to decide on the type of annuity that would suit him or her (or decide whether to seek independent financial advice if their circumstances are more complex or difficult). From early next year, FSA comparative tables will be available on annuities. The tables will enable consumers to compare annuity rates by provider for the most popular types of annuity product, to help them get the most from shopping around.

62. Some have argued that the nature of annuity purchase as a once and for all decision means that independent financial advice should be compulsory for all consumers. Making advice compulsory would be a way to ensure that consumers get the best deal for them. The Government believes this would not be appropriate at this stage. We believe that reforms to the market for financial advice and sales look likely to increase both consumer choice and the availability of low-cost financial advice.

Modernising annuities

63. The Government published *Modernising Annuities* earlier in 2002. The Government wants to promote innovation in the annuities market – both in the type of products offered and in the way the market operates. Further proposals relating to the tax rules governing annuities and the types of annuities which may be used to provide income in retirement are discussed in the consultation paper *Simplifying the taxation of pensions* published alongside this document and discussed in **Chapter 3**.

64. **The Government wants to deliver increased product choice and flexibility for consumers in the annuities market. The Government proposes that more kinds of annuities should be allowed.**

65. **Limited period annuities would allow someone to use part of their personal pension fund to buy an annuity for a short period** – perhaps three or five years. The length of time would be decided at the time of purchase. At the end of this period the pensioner could use the remainder of the fund (together with any capital growth) to buy another limited period annuity or to buy a lifetime annuity. Limited period annuities would be an alternative to income drawdown which some people may find attractive.

66. **Value protected annuities would allow for a proportion of the original fund remaining on the death of the pensioner to be paid to the pensioner's estate**, if the pensioner dies before age 75. The amount of the payment would be calculated by using the difference between the amount paid for the annuity and the value of payments made before death. Of course, the benefits from this type of annuity would be paid for during the pensioner's life in the form of a lower income stream.

67. The Government recognises that for those with small aggregate funds it can often be uneconomic to have to convert their funds into income. Therefore, the Government is proposing to introduce a valuable concession to **allow small funds to be paid as a lump sum rather than as an income stream** – a process known as commutation. People over 65 whose total matured pension funds from all sources amount to no more than £10,000 would be able to take them, if they wished, as a lump sum.

68. A similar facility will be available **for people with severely reduced life expectancy who will, with appropriate medical evidence, be able to withdraw all the value of their pension fund as a lump sum**. This serious ill-health commutation is available currently in some types of scheme but will, in future, be available in all types of scheme.

69. During the consultation on *Modernising Annuities*, the issue of the complexity involved in buying an annuity was raised by many people. This complexity discourages consumers from shopping around and discourages new providers from entering the market. The Government recognises the difficulties this complexity can cause and accepts that some of the complexity stems from its own requirements. **The Government is looking at ways to make buying an annuity both simpler and easier to understand.**

Unisex annuities

70. Some have argued that providers should be compelled to offer unisex annuity rates, as women's longer life expectancy results in them receiving lower annuity rates than men. The Government is not attracted to this proposal, as the evidence is that it would result in lower aggregate retirement incomes for the population as a whole, and only marginal – if any – benefits for women. It would increase the risk that provider firms would be taking on (because they would have to make assumptions about the proportion of men and women buying their policies) and this risk would have to be priced in.

Property and equity release

71. As property ownership increases, equity in housing is likely to play a growing role in providing income for pensioners, particularly where they have made insufficient pension savings before retirement. 'Trading down' is well established, though not everyone would

want to give up the family home or to go through the stress involved in house buying, selling and moving. Products such as equity release exist to allow people to gain access to the equity in their home without moving.

72. The Government needs to ensure that the market for equity release is effectively regulated and that individuals fully understand the implications and risks of the deal. One issue of potential concern is that while equity release mortgages will be regulated by the FSA from 2004, home reversion plans are outside the scope of regulation. **The Government will be looking at options to create a level playing field for the regulation of equity release and home reversion plans to protect consumers and make the market work better.**

5.4 Better investment by occupational pension schemes

73. Paul Myners' review of institutional investment[17] set an agenda for reform of the institutional investment market. The review concluded that there are a number of areas where change would result in improved investment decision-making by occupational pension schemes.

74. Improving the quality of funds' investment decisions is important to the economy at large. Pension funds' holdings of around £750 billion include around 20 per cent of the equity of UK companies. Better investment means better allocation of capital feeding through to increased productivity in the UK economy. Better investment also benefits current and future pensioners and employers offering pensions. Higher investment returns reduce the costs of funding. They make defined benefit pensions cheaper for employers and increase the final pensions of members of defined contribution schemes.

75. However, the review found that pension fund trustees often lack the resources and expertise required to make informed judgements about investment matters. As a result, trustees rely heavily on investment consultants for decisions on asset allocation. Yet these consultants may not have specialist skills and rarely have their performance assessed or measured. Asset allocation – the selection of the markets a fund will invest in – is under-resourced. The lack of attention to these decisions will reduce investment performance.

76. The Government has been working to take forward the Myners review recommendations. With industry support, the Government introduced a voluntary set of investment principles for pension funds. We intend to review the extent to which change has occurred as part of our evaluation of these principles beginning in March 2003.

77. Discussion with the industry has led to the Institutional Shareholders Committee producing a tough voluntary code to encourage shareholder activism by all institutional investors. The Government has previously consulted on possible legislation to underpin institutions' obligations to promote their beneficiaries' interests through shareholder activism. However, the Government welcomes the Committee's proposal to drive through an approach based

17 *Institutional Investment in the UK: a Review*, HM Treasury, March 2001.

on best practice, and to review the impact of the principles after two years. The Government will at that point review whether a non-legislative approach has been successful in delivering behavioural change. The Government also welcomes the industry's proposal that the new principles should be included in industry fund management contracts.

78. The Government is also taking forward two outstanding issues from the Myners' review. It will be legislating to ensure that trustees have the expertise they need to take investment decisions. It will be replacing the Minimum Funding Requirement (MFR) to remove excessive short-term funding volatility for sponsoring employers and allowing pension funds to invest to meet their long-term liabilities better. Replacement of the MFR is discussed in **Chapter 4** and the accompanying technical paper.

Trustee expertise

79. The Government consulted earlier this year on a proposal to legislate to require trustees to be 'familiar with the issues' when they are taking investment decisions. The Government is committed to legislating. The role of trustee is of the highest importance: trustees need to have appropriate expertise to look after the investment of other people's pensions.

80. However, the consultation process delivered some important messages about the approach the Government had proposed to take to legislation. Respondents felt that it would be necessary to define further what was meant by 'familiar with the issues'. They thought that leaving this to the courts to decide would be cumbersome and expensive for schemes and their trustees.

81. The Government agrees that it would be helpful to give schemes as much certainty as possible, by better defining what expertise would be required. A strong element of practitioner input will be necessary to arrive at this definition, and decide how it would be given legal force. It will also be important for legislation to maintain flexibility to meet changing circumstances. The Government will also want to take account of the two-year review of the Myners' principles, and any possible changes to wider pensions legislation, before finalising legislative proposals.

82. **Before finalising legislation, the Government wants to work with practitioners – in the light of the two-year review – to define what expertise trustees need to carry out their investment duties.**

Chapter 6: Extending opportunities for older workers

Chapter summary

Increasing employment among older workers is essential if we are to address the pensions challenge. Working longer can dramatically reduce the rate at which people need to save for their retirement. The Government inherited relatively high inactivity rates among those aged 50 and over in 1997 – something we have already done much to tackle. But many people willing to, and capable of, work still do not have the opportunities they need. We cannot allow this waste of older workers' experience and talents to continue. Using these talents is vital both to the economy and to the quality of life of older people. We must remove the cliff-edge between work and retirement.

The Government is determined to do more to promote employment among those aged 50 and over and to tackle age discrimination. In this chapter we seek views on the following issues and proposals:

- providing **extra back-to-work help for those aged 50 and over** and **piloting measures to help recipients of incapacity benefits return to work**;
- treating **men and women between 60 and women's State Pension age as active labour market participants** when women's State Pension age rises from 2010;
- bringing forward **more generous increases for deferring state pensions** and **maintaining State Pension age at 65**;
- **implementing by December 2006 age legislation covering employment and vocational training**, in which compulsory retirement ages are likely to be unlawful unless employers can show that they are objectively justified;
- **allowing people to continue working for the sponsoring employer while drawing their occupational pension, raising the earliest age from which a pension may be taken from age 50 to age 55 by 2010**, and consulting on best practice to **ensure that occupational pension rules do not discourage flexible retirement**; and
- changing **public service pension scheme rules, for all new members initially, to make an unreduced pension payable from 65 rather than 60**.

6.1 Introduction

1. Older people possess a wealth of talent and experience. We need to make better use of this. The Government has already taken steps to help older people remain in work if they choose to. These measures have started to produce results, but we need to go much further.

2. In the late 1970s and early 1980s, the employment rate of older male workers declined sharply. Although the rates have improved slightly in recent years, they are still far below the employment rates seen in the 1960s. Given that life expectancy is increasing, this trend is incompatible with decent living standards in retirement for the average pensioner.

3. Economic growth and the commercial success of businesses depend on all groups playing a full part in the world of work. In 20 to 30 years' time, we expect there to be fewer 20–50-year-olds in relative terms than there are now. In this context we need more of our older people to remain in work.

4. Many older people retire early even though they find work rewarding. Given greater flexibility, they would prefer to stay in work. Longer working can dramatically reduce the amount of saving needed for retirement – it gives people more time to save and means that their savings do not have to last as long. People could therefore save less as a proportion of their annual earnings each year to generate the same income in retirement.

Figure 6.1: The impact of delaying retirement: the amount people need to save each week for different target incomes (net)

Target weekly income	Retirement age		
	55	65	70
£50	£45	£15	£10
£100	£85	£30	£15
£200	£175	£60	£35
£300	£260	£90	£50

Source: Department for Work and Pensions' calculations.

Notes: Full modelling assumptions are set out in **Annex 5**. All figures rounded to nearest £5.

5. Figure 6.1 shows how the level of savings needed for a given target income depends on the age at which a person retires. It is based on a man who starts saving at age 30. The figures are net of tax at the basic rate. For example, to achieve a target private income of £100 a week in retirement, he needs to save £30 a week if he plans to retire at 65. The same man would need to save £85 a week – nearly three times as much – if he wants to retire at 55. So, effective policies to extend working lives can have a big impact on the savings individuals need to fund the retirement that they want.

6. This chapter sets out progress since 1997, explores the issues facing older workers and the key role of employers, and runs through the further steps that the Government believes need to be taken.

6.2 Progress since 1997

7. The Government has promoted employment by providing a stable macroeconomic environment. It has also introduced a number of specific measures to help older people remain in or return to work.

New Deal 50 plus

8. New Deal 50 plus has helped many jobless people aged 50 and over return to work. It offers personal guidance and help in searching for jobs, a weekly cash Employment Credit on taking up work, and an in-work training grant.

9. In the period between its national launch, in April 2000, and October 2002, over 86,000 people aged 50 and over returned to work and claimed the New Deal 50 plus Employment Credit. Of these, a third were people with disabilities, and almost a third were women. Evaluation shows that the cash payment to the individual has been successful as a back-to-work incentive. Even though the Employment Credit payments last for only 12 months, the majority of participants were still in work a further year on. The programme has also benefited employers, as it has helped to expand the stock of people with valuable skills and experience in a tightening labour market.

New Deal 50 plus in action

55-year-old Stanley Willis from Bury had been on Incapacity Benefit for seven years, followed by two months on Jobseeker's Allowance (JSA), before volunteering for New Deal 50 plus. His personal adviser helped him to find a job as a mobile security supervisor. He was given food vouchers and support to buy clothes to help him during the period from his last benefit payment to the time he received his first wages. He was delighted and said that he was "staggered" as he was "not expecting any help to be available".

10. From July 2002, the in-work training grant was doubled to £1,500 and made available for two years rather than the original one year. This will help to increase further the skills and future employment prospects of those New Deal 50 plus clients who have gone back into work.

Jobcentre Plus

Jobcentre Plus is a new business, designed to help meet the Government's aim of promoting work as the best form of welfare, while providing appropriate help and support for those without jobs. It is part of the Department for Work and Pensions and brings together the former Employment Service and Benefits Agency. The organisation runs all of the country's Jobcentres and social security offices.

Jobcentre Plus has been created to provide a better and more personal customer service to those without work, with a new emphasis on those not currently searching for work – a group that includes many older people.

Regional and Area Initiatives

11. People in different areas and regions of the country are also being helped back into work through special measures that reflect their local labour markets. In 63 areas of Britain, Action Teams for Jobs are helping people back into work, with people aged 50 and over being one of the priority groups. And in Employment Zones contractors have the flexibility to provide innovative solutions to help people move from claiming JSA into work. About 31 per cent of Employment Zone participants who are aged 50 and over move into work and, of these, 80 per cent move into sustained employment.

The Working Tax Credit

12. As part of the next steps in tax and benefit reform, from April 2003 the Government will introduce the Working Tax Credit. This will extend general in-work financial support – like that already offered to parents through the Working Families' Tax Credit – to adults without children. One of the main groups of beneficiaries is likely to be adults aged 50 and over who are on low pay. The Working Tax Credit will make work more worthwhile for them.

13. The Working Tax Credit will replace the New Deal 50 plus Employment Credit. It will include a return-to-work element for people aged 50 and over who have been receiving certain out-of-work benefits for at least six months. This is designed to provide further help to those people aged 50 and over who have been away from the labour market and may therefore face greater barriers to returning to work.

Tackling age discrimination

14. In 1999 the Government produced the *Code of Practice on Age Diversity in Employment* after consulting employer and employee representative groups. These included the Employers Forum on Age, the Recruitment and Employment Confederation, the Trades Union Congress, the Confederation of British Industry, Age Concern, the Chartered Management Institute and the Chartered Institute of Personnel and Development.

15. The Code of Practice sets the standard for non-ageist approaches to recruitment, training and development, promotion, redundancy and retirement. Evaluation of the Code[1] shows that considerable progress has been made. Since it was published in 1999, the proportion of employers using age in recruitment has halved from 27 per cent to 13 per cent. Two-thirds of employers now include age in their equal opportunities policies and the proportion of employers with a policy against employing older people has halved from 14 per cent to 7 per cent. However, evaluation also showed that nine out of ten people believe employers do discriminate against older people, and that small- and medium-sized employers were less aware of the Code of Practice and of the benefits that age positive employment practices can bring. An updated Code of Practice, taking into account lessons from the evaluation, was launched as part of Age Positive week on 3 December 2002. But more remains to be done.

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1 *Evaluation of the Code of Practice on Age Diversity in Employment* – independent research commissioned by the former Department for Education and Employment, published by the Department for Work and Pensions, December 2001.

16. The Government's Age Positive campaign uses a range of publicity tools, including national awards, to promote the business benefits of age-diverse employment practices to employers. Evidence[2] shows that employers with an age-diverse workforce enjoy lower staff-turnover rates, lower absenteeism and have workers with higher levels of motivation and efficiency.

17. The Age Positive initiative has highlighted many examples of good practice. For instance, B&Q have no fixed retirement age; nearly one in six of Tesco's workforce is aged 50 and over; and Domestic and General estimate that their policies of employing and keeping older workers have reduced their recruitment costs by 50 per cent. These policies are driven by business need.

The views of employers and employees on Age Positive

"A large proportion of our workforce falls into the 'older worker' category, so our business is heavily reliant on them. Our continuing profitability and success is a testament to the commitment, loyalty and productivity of our older workers."
Kappa Packaging, South Wales site with 83 workers

"We have a high retention rate amongst our older workers. They add balance to a team, bring excellent life skills, and also reduce our recruitment costs with a resultant direct effect on our bottom line."
Domestic and General Insurance plc, Nottingham Centre with 600 employees

"I'd been turned away by one supermarket who said their upper age limit on drivers was 70. I responded to a Domino's flyer advertising for delivery drivers. It said age didn't matter, so I contacted them. I'm grateful that Domino's was willing to give me a chance."
Eric Avis-Dakin, aged 72, Domino's Delivery Driver of the Year

6.3 The remaining challenges

18. Since 1997, the employment rate for those aged between 50 and State Pension age has increased from over 64 per cent to over 68 per cent, with nearly 900,000 more people aged 50 and over in work, as shown in Figure 6.2 overleaf. This is a large increase – larger than that experienced by the labour force as a whole. The employment gap between those aged 50 and over and the rest has therefore narrowed since 1997, reversing the previous trend among men. For men and women aged 55 to 64, the employment rate is over 52 per cent,[3] making the UK one of only four Member States already to meet the Stockholm employment target for workers aged 55 to 64.

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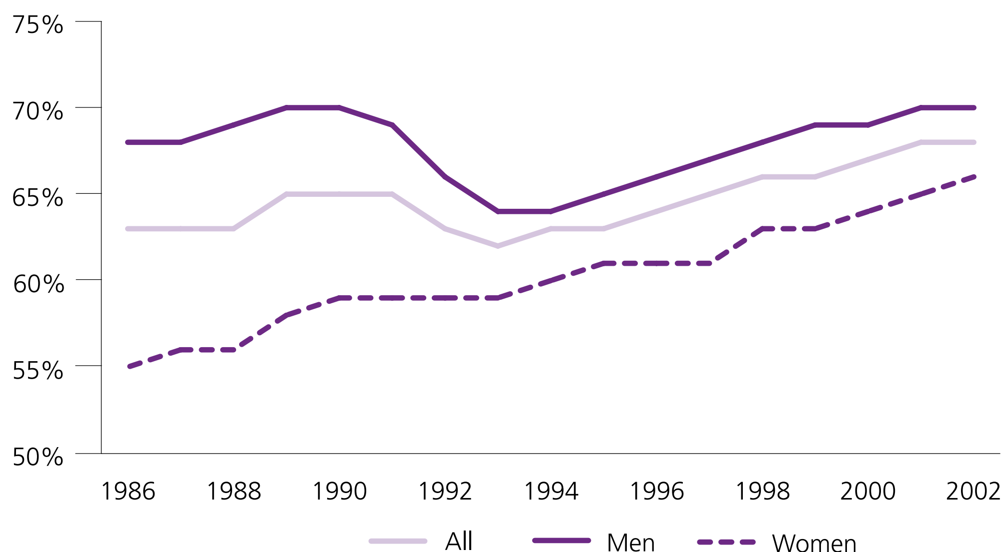
2 *Good Practice in the Recruitment and Retention of Older Workers*, Department for Work and Pensions, published December 2001, and *Flexible Retirement: A Snapshot of Large Employers' Initiatives*, Department for Work and Pensions working with Employers Forum on Age, published June 2002.

3 Figure for 2001, from *Employment in Europe 2002*, European Commission.

19. However, there is more to do. Employment rates for this age group remain some way below the overall UK average of 75 per cent. Accordingly, the Government has set a Public Service Agreement target to increase the employment rate of people aged from 50 to State Pension age, and by 2006 to reduce further the gap which currently exists between the over-50 and overall employment rates.

Figure 6.2: Employment rates for those aged between 50 and State Pension age



Source: *Labour Force Survey*, 2002.

20. We need to ensure that all employers leave behind outdated attitudes and practices. In addition, we need to tackle barriers to flexible retirement to allow people the opportunity to move gradually from full-time work to retirement – too many people feel they have no choice but to retire, because they cannot reduce their hours or level of responsibility.

21. The Government's strategy must also help people to work beyond State Pension age if they want to. People should not stop work simply because they reach 60 or 65. Far from it – at this point in their lives most people could still have many productive years ahead of them. This is the point at which people **can** start to draw their State Pension, not the point at which they necessarily should.

22. Currently, 8 per cent of men and 9 per cent of women choose to continue to work after State Pension age. This has clear financial benefits.

Figure 6.3: Total weekly income among working and non-working pensioners

	Average income (£ per week)
All over State Pension age	£154
Working men	£402
Working women	£212
Non-working men	£191
Non-working women	£114

Source: *Working after State Pension Age*, Quantitative analysis by Deborah Smeaton and Stephen McKay. Forthcoming Department for Work and Pensions' research. Data taken from *Family Resources Survey 1997/98–1999/2000.*

Note: Figures rounded to nearest £1.

23. Figure 6.3 shows the differences in income between those over State Pension age who are working and not working – labour market participants have twice the income. There are also higher rates of saving amongst those who are working, suggesting they are making provision for the period when paid work ends.

6.4 Helping older people to remain in or return to work

24. This section sets out the Government's proposals for tackling the remaining challenges, in partnership with employers and individuals.

Extra back-to-work help for those aged 50 and over

25. **From 2003 we will progressively introduce a new package of more intensive back-to-work help for people aged 50 and over**, and guidance to employers on the benefits of recruiting and training older workers.

26. We will **extend the support available through New Deal 50 plus** so that individually tailored help for each customer can be drawn from a range of possible options. These options will include personal advice, training, work trials, volunteering opportunities and an in-work training grant. This will be available to all people aged 50 and over who have been on specified benefits for six months or more, and their dependent partners aged 50 and over.

27. For people aged 50 to 59 who have been claiming JSA for 18 months, we propose running a pilot study to trial mandating their participation in the New Deal 25 plus Intensive Activity Period from 2004. Long-term unemployed jobseekers aged 25 to 49 are already required to participate in this programme because it offers extensive help back into work. At present, jobseekers aged 50 and over who have claimed JSA for 18 months can volunteer to take up this extra help. However, they often fail to do so because many have grown demoralised about the chance of returning to work.

28. We will pilot work with voluntary sector organisations to **extend information about back-to-work help** and local job and volunteering opportunities to help improve the employment prospects of jobless people aged 50 and over.

29. We will **pilot the use of local agents based in the business community** to raise employer awareness of the business benefits of recruiting and training older workers. These agents will focus on those sectors experiencing skills and labour shortages in their area.

Reforming Incapacity Benefit

30. The majority of inactive people aged between 50 and State Pension age receive an incapacity benefit because of a health problem or disability. We know that most new Incapacity Benefit claimants aged 50 and over expect to return to the labour market in due course but that significant proportions fail to make the transition back and effectively start early retirement. We also know that, for many people on these benefits, poor skills, poor confidence and employer discrimination are just as important obstacles to work as health difficulties. That is why on 18 November 2002 the Government published *Pathways to work – helping people into employment*, a Green Paper on measures to help recipients of incapacity benefits to return to work.

31. **That Green Paper proposes piloting, from around October 2003:**

- **early active support** – ongoing skilled personal adviser support through a regime of repeat work-focused interviews, combined with action planning to encourage a strong focus on returning to work;

- **access to a wider range of specialist employment programmes** – introduction of better referral arrangements to existing provision such as the New Deal for Disabled People and the New Deal 50 plus and new work-focused rehabilitation support. This will be offered jointly by Jobcentre Plus and the NHS to help clients manage conditions such as back pain and depression more effectively, with the aim of an eventual move into employment;

- **a larger financial incentive to return to work** – introduction of a 52 week return-to-work payment of £40 a week to all those moving back from Incapacity Benefit to work of more than 16 hours a week, to encourage people to make the transition back to work; and

- **more support for those having to come off Incapacity Benefit and onto JSA** – mandatory early access to the relevant New Deal to allow this group to get personal support from the outset of their claim to JSA.

32. The Government welcomes views on these measures as part of the consultation on the Incapacity Benefit reform Green Paper, *Pathways to work – helping people into employment*.

The benefit position of 60–64-year-olds in the longer term

33. People with low incomes are entitled to higher rates of support, through the Minimum Income Guarantee (MIG), once they or their partners reach the age of 60. This reflects the fact that women aged 60 have reached State Pension age. Men aged 60 and over are treated in the same way to avoid unfairness.

34. The level of MIG is significantly higher than working-age Income Support and JSA. Consequently, those in receipt of the MIG have less incentive to move into work. Currently those aged 60 to 64 who are out of work and on benefits are not obliged to undertake any form of labour market activity. The Government acknowledges the need to do more to signal the importance and the benefits of work for this group.

35. State Pension age is being equalised at 65 for men and women between 2010 and 2020. The Pension Credit, which replaces the MIG from October 2003, has a minimum qualifying age linked to women's State Pension age. The entry point for the Pension Credit will therefore rise in line with women's State Pension age between 2010 and 2020. This means that, from 2020, age 65 will be the minimum qualifying age for the Pension Credit.

36. **During the transition and subsequently, both men and women aged between 60 and women's State Pension age will be entitled to the full range of job-search support and benefits** available to others of working-age, through Jobcentre Plus.

37. Those affected by the changes will need to be made aware of the extra labour market help available to them between 2010 and 2020.

38. The Government will also consider the age eligibility for other age-related benefits such as the higher rate of Income Support and income-based JSA for people with partners aged 60 and over.

More generous increases for deferring state pensions

39. The Government also recognises the role of the State Pension in encouraging flexible retirement. If people wish to delay taking their State Pension, they should be paid an increased amount to take account of the fact that they will be receiving it for fewer years. The Government intends to ensure that people who choose to work beyond State Pension age and defer taking their pension are properly rewarded by the State system.

40. Currently, a person who does not draw their pension at State Pension age has their pension increased by around 7.5 percentage points for each year it is deferred, up to a maximum of five years. Under existing legislation this will increase to around 10.4 percentage points for each year in 2010. **The Government proposes to bring forward the date of the increase so that people can benefit from it as soon as possible. We will involve the Government Actuary's Department in discussions to ensure that the rate is fair. We will also remove the existing five-year limit on increases.** The change will apply to new cases. We expect to be able to make the change by 2006.

41. As well as improving arrangements for deferral, the Government proposes to **offer a choice of either an increased regular State Pension or a taxable lump-sum payment, to compensate people adequately for deferring their pension**. Some people may find the prospect of a lump sum more attractive than a comparable regular pension increase.

Effect of increasing the reward for deferring the State Pension and offering a lump-sum alternative

Single person
A person who has built up a State Pension (basic State Pension, State Earnings-Related Pension Scheme [SERPS] and the State Second Pension) of £100 a week can currently increase their pension by 7.5 percentage points for each year deferred. If they defer drawing their pension for five years, the maximum period currently allowed, their pension would increase to over £137 a week.

With the higher deferral rate of 10.4 percentage points, after five years of deferral their pension will be worth over £152 a week – £15 a week more.

If a lump sum were to be taken instead, they would receive a one-off payment of around £20,000 (assuming income tax is applied at the standard rate) as well as their pension of £100 a week.

Couples
A couple with a combined State Pension of £150 a week who both deferred for five years would receive £206 a week under the current rules.

With the increased deferral rate their pension would increase to £228 a week – £22 a week more. If they choose to take a lump sum instead they would receive a one-off payment of just over £30,000 (assuming income tax is applied at the standard rate) as well as their pension of £150 a week.[4]

42. These proposals would help to give people a choice over when they take their State Pension. The changes would encourage people to work beyond State Pension age and ensure that they are rewarded properly for having done so.

43. **The Government would welcome views.**

State Pension age

44. A number of commentators have recommended that the Government should raise the age at which people can start to draw their State Pension (the State Pension age).

45. State Pension age for women is already set to increase from 60 to 65 between 2010 and 2020 to match State Pension age for men. It has been suggested – for example by the

4 Figures shown are in real terms. Actual cash amounts paid after deferral would be higher due to the uprating of pension rates during the deferral period.

National Association of Pension Funds and the Institute for Public Policy Research – that the Government should go further, increasing State Pension age for men and women to perhaps 67 or 70.

46. It is argued that an increase could change attitudes and encourage more people to work into later life. But the connection between the State Pension age and when most people actually stop working is not straightforward. For example, two-thirds of men have stopped working by the time of their sixty-fifth birthday. So, the proposal does not deal with the core problem of working lives ending too soon. The primary challenge is to ensure that people can keep working until 65.

47. Of course, many people will want to continue working beyond this age, something the Government welcomes, and is making easier by other measures in this Green Paper. But raising the State Pension age is not necessary to ensure that these ambitions are fulfilled. Indeed, given our proposal for a better deal for those who defer taking their pension beyond State Pension age, the idea of a single fixed State Pension age might start to seem anachronistic – we would expect people will start drawing their State Pension at a range of ages starting at 65.

48. It is important that people have the choice to work beyond age 65, whereas raising the State Pension age would leave many of those on low incomes with no option but to continue working.

49. An increase in State Pension age would also reduce long-term public expenditure. However, it would disproportionately affect lower-income people who rely more on state benefits in retirement. The same people tend also to have lower life expectancies, and so, with fewer years in retirement, they would see a disproportionate reduction in their income. The effect might be particularly severe on those who have done manual work for long periods in heavy industries, in which there is a record of low life expectancy.

50. Although we are not attracted to plans to increase the State Pension age overall, it could be recast so that the point at which people could start to draw their State Pension was worked out on an individual basis – depending on how many years have been worked, rather than simply on age. This could allow those who had been working since school-leaving age to claim their State Pension earlier than those who had stayed in education far longer. But such a change would require very careful consideration. For example, the system of credits and Home Responsibilities Protection would need to be reviewed to ensure that women in particular were not unfairly disadvantaged.

51. Many other countries have equalised male and female State Pension ages as we are doing in the UK. For example, Italy and Germany have increased the State Pension age of women to match that of men. However, few countries have increased State Pension age for both sexes. A notable exception is the US where State Pension age will increase to 67 for both men and women between 2003 and 2022.

International comparisons

All countries in the Organisation for Economic Cooperation and Development (OECD) face similar demographic challenges and a similar trend towards earlier retirement. Some have responded to the challenge by increasing their State Pension age and often mitigating the effects of the change with flexible retirement options. The US, Sweden and Italy provide examples of different approaches to these challenges.

Increased State Pension age
In the US the age of entitlement to full benefits is to rise to 67 by 2022. The State Pension age is currently 65, but significant numbers of people start leaving work at 60. Later retirement will be rewarded by an increase of 8 per cent in pension income for each extra year worked.

Flexible retirement with increased entitlement for late retirees
In Sweden's reformed pension system, the State Pension age has been increased to 65. Early retirement is still possible through an actuarially neutral reduction in pension income of 6 per cent a year. At the same time, later retirement is encouraged through a generous increase for each extra year worked.

Flexible retirement with actuarially adjusted pensions up to a ceiling
In Italy, seniority pensions allow retirement with full pension at age 60. Many people have been stopping work in their 50s. To address this, a new system will be phased in up to 2036. Under the new system, there is a flexible retirement age from 57 to 65 with actuarial adjustment on benefits, but no enhanced rate for those who retire above 65.

52. **Overall, while recognising the arguments in favour of an increase in State Pension age, the Government believes that the arguments against are more compelling, principally because our approach is based on choice. The Government would therefore welcome views on our plans to:**

- **help people work up to age 65;**
- **help people work beyond age 65 where they want to; and**
- **keep the State Pension age at 65.**

6.5 Building on best practice among employers

53. Employers have a key role to play in promoting work for older people. They need to ensure that their attitudes and practices concerning recruitment and retention do not discriminate against older workers. This is not altruism. Companies are increasingly realising that employing older workers makes good business sense.

Age discrimination

54. The Government is developing **proposals to outlaw age discrimination in employment and vocational training by December 2006**. This accords with the EU Employment Directive on equal treatment. It will bring a sharper focus on changing culture and attitudes regarding older workers, and offers us a significant opportunity to address wasteful discrimination that is damaging to the well-being of so many people in their fifties and sixties.

55. Under the Directive, compulsory retirement ages are likely to be unlawful unless employers can show that they are objectively justified.

56. The Department of Trade and Industry (DTI) will continue its consultations on the proposals for the legislation into 2003. In the future, it is clear that employers will need to adopt more flexible approaches to retirement.

57. **The Government will welcome views on its proposals here as part of the DTI consultation, and a separate consultation in Northern Ireland, in 2003.**

58. In advance of legislation, we will seek to work with national and local partners to provide employers with the further advice and support they need to benefit from non-ageist employment practices now, and also to help prepare them for the legislation ahead.

Flexible retirement – occupational pension rules

Tax changes to encourage flexible retirement

59. 'Flexible retirement' is the term often used to describe a move from full-time to part-time work, or to less responsible positions, towards the end of a person's career. It is an alternative to the cliff-edge that many people face when moving from full-time, demanding work to complete retirement. The Government believes that more people would like to make use of such flexibility. However, in the past the tax treatment of pensions has dissuaded some people from doing this.

60. Currently, tax rules allow people to work and draw an occupational pension, but only where they no longer work for the company that is paying the pension. Often people who would like to carry on working do not want, or are unable, to change employers at this stage in their career. So they end up retiring when they would have preferred instead to stay in work in a reduced capacity, supported by a combination of earnings and pension. The Government proposes to remove this constraint. As part of the Government's consultation on the simplification of the pensions tax regimes, **we are proposing to allow schemes to offer people the opportunity to continue working for the sponsoring employer while drawing their occupational pension**. In the future the concept of normal retirement age will no longer feature in the tax rules, although some pension schemes may choose to continue with it if they find it makes sense to do so.

61. **In addition, we propose that the earliest age from which a pension may be taken should increase from age 50 to age 55 by 2010.** This would offer an effective signal that work up to age 55 at the very earliest is the norm.

62. **The Government welcomes views on these proposals, as part of the consultation on the Inland Revenue document, *Simplifying the taxation of pensions*.**

Occupational pension rules

63. Employers should help wherever possible. In particular, they should ensure that occupational pension rules do not discourage flexible retirement. Employers should:

- ensure that people are offered a fair return for deferring their pension while they work beyond normal retirement age. That is, people should see an increase in the annual amount of pension they receive to make up for the fact that it will be paid for fewer years;
- allow people who are working past normal retirement age to continue to build up their pension entitlement. The separate Inland Revenue consultation includes a proposal to allow people to work longer while supplementing their salary with occupational pension income; and
- ensure that final salary schemes treat fairly those who go part-time or step down in responsibility near the end of their careers. For part-time workers this means basing the pension on the full-time equivalent salary, and adjusting the accrual rate to take account of the part-time hours. For those who choose to step down in responsibility, one approach is to take the best year's salary out of one of the last few years of employment.

64. **The Government would like all employers to follow best practice in occupational pension rules. We will be consulting with leading employer, employee and pensions representative organisations on how to promote best practice.**

Public service pension schemes

65. The Government has already begun to address the social and economic consequences of demographic change in its role as employer. One of the recommendations of *Winning the Generation Game*[5] was that public-sector employers should review their retirement ages and examine the case for allowing those who want to work on to age 65 to do so. Already 75 per cent of civil servants now have the option to retire at age 65 and the numbers able to serve beyond age 60 are expected to increase. But most public-service pension schemes still allow a normal pension to be taken at age 60 or under, or allow an earlier pension for those with longer service.

66. We would welcome views on the proposal that **the rules of public-service pension schemes should be changed and applied to all new members during the next few years to make an unreduced pension payable from age 65 rather than 60**. Such a change would reflect improved longevity, modern working patterns and the practice in the majority of private sector pension schemes. This age would apply regardless of an employee's length of service. There will continue to be some occupations such as the

5 *Winning the Generation Game – Improving Opportunities for People Aged 50–65 in Work and Community Activity*, Cabinet Office Performance and Innovation Unit report, April 2000.

armed forces, fire service and police where the need for a recognised physical capacity justifies the award of normal pension at a lower age, but for individuals who leave before they reach such an age their pension would also be deferred to age 65.

67. The Government envisages that the higher pension age might be introduced in most schemes as part of a package of changes to pension arrangements, including some features which proposals elsewhere in this Green Paper will make possible for the first time. A change of pension age would help to offset the cost of increased longevity. The reviews of the public-service schemes will be the subject of consultation and are likely to take a few years to complete, but once introduced the higher pension ages would apply to all new entrants.

68. These reviews would aim to identify scope for redirecting resources to finance greater flexibility – particularly in the transition from work to retirement – and to offer improvements to benefits which employers and staff value and will have positive impact on staff recruitment and retention. Diverse and flexible employment practices will have a key part to play. An increase in the age from which pensions are payable will also help the financial sustainability of public service pension schemes. Early retirement options would continue to be available but as a departure from a normal pension age of 65 rather than 60.

69. For existing members, accrued pension rights from service before the change would be fully protected enabling them to receive a pension from the age they currently expect. However, while it is envisaged that the new arrangements would be introduced for all new employees, the Government will also consult on how and to what timescale the higher pension age and any associated enhancement to benefits could be extended to existing employees, while protecting rights already accrued. In many areas there is a demand from employees to work for longer and it is appropriate to encourage and reward that accordingly.

Chapter 7: Women, work and pensions

Chapter summary

The state and private pension systems have together delivered impressive improvements in the living standards of successive cohorts of pensioners. But although the average pensioner has done well in recent decades, inequality in pensioners' incomes has increased dramatically. The current generation of female pensioners are over-represented in those groups of pensioners with low incomes.

This reflects the historical gender gap in employment rates and pay that women faced over their working lives, which was partly driven by the different family roles of women and men. Men of all ages and family circumstances tend to be in full-time work. Many women, on the other hand, move from full-time work to part-time work or out of the labour market as they acquire caring responsibilities. These trends adversely affect occupational pension coverage, which is much higher among full-time than part-time employees. They also feed through from lower pay into lower pensions.

All of these factors together mean that it is harder for women to build up adequate state and private pensions than it is for men. The pension they do accrue then has to last longer in retirement due to the greater life expectancy of women.

The Government has already taken action to help women accrue state pensions despite the various labour market disadvantages they face. It is also supporting women's labour market position. This includes additional investment in childcare, the introduction of the National Minimum Wage, and extra support for families from April 2003 with the introduction of the new tax credits and changes to maternity and paternity provision. Measures suggested in this Green Paper on promoting labour market participation of older workers will help more women work later in life, often when childcare responsibilities have ended.

The Government has also introduced stakeholder pensions which are designed to suit female employment patterns. But awareness of pensions issues remains low among women. Proposals in this Green Paper will greatly improve the information women receive on pensions issues and will help them to get the best value out of their savings for retirement.

7.1 The position of current female pensioners

1. The partnership between the State, employers and individuals has been very successful. It has delivered real growth in pensioners' incomes over the past 20 years that has far outstripped the growth in average earnings. Pensioners' incomes grew by 64 per cent in real terms between 1979 and 1996/97 compared to real average earnings growth of only around 36 per cent. However, inequality also increased dramatically over this period. A major part of this inequality is the relatively poor position of women in the pensioner income distribution.

2. Because of their longer life expectancy and (currently) lower State Pension age, women make up the majority (64 per cent) of the pensioner population. However, the average female pensioner has far less income than the average male pensioner – £153 a week for a single woman in 2000/01 compared to £194 for a single man.

Figure 7.1: Average gross individual income by gender and family type 2000/01

Family type	Men	Women
Single pensioner	£194	£153
Pensioner couple	£248	£96

Source: Individual Income 1996/97–2000/01.

Notes: Figures in £ a week.
The income of a woman in a pensioner couple is the income that she has accrued in her own name. No assumption about the degree of access she has to her partner's income has been made.

3. Women's pension incomes are lower than those of men for several reasons. In the past, women tended to build up less state income in their own right than men because the state system did not recognise caring responsibilities. This changed in 1978 when the Government introduced Home Responsibilities Protection (HRP) which reduces the number of qualifying years needed for the basic State Pension. It is awarded to people looking after children and can help to reduce the number of qualifying years required for the basic State Pension (normally 39 years) to just 20 years.

4. Prior to 1978, women were able to pay a reduced rate of National Insurance. This meant that they would not build up their own basic State Pension entitlements but rely on a State Pension calculated on their husband's contributions. The effects of the pre-1978 system are still feeding through in to pensioners' incomes now and will continue to do so for some time.

5. As well as having less in the way of state entitlement, around 70 per cent of today's female pensioner population have no private pension in their own right. Women end up with far less private pension income than men because women have historically had much lower levels of participation in the labour market and, on average, lower rates of pay. Women have tended either to withdraw from paid employment altogether, or work part-time, in order to care for children, whereas men's labour market participation does not change as they become parents. Among certain groups of women this is less likely

than it has been in the past so future pension provision is improving for many women. However, in general it is still the case that women with dependent children have lower employment rates than men. These trends are described more fully below.

6. In summary, over their lifetime, most women work fewer hours for lower pay and for fewer years than most men. So they acquire less National Insurance entitlement to a State Pension, and fewer occupational pension rights. But that reduced pension income, given women's earlier retirement and greater longevity, has to last them for longer. Reducing the greater risk of poverty for women in old age requires action in each area.

7.2 The labour market patterns of women compared to men

7. Britain now has one of the highest female employment rates in Europe. Almost 70 per cent of women of working age are in employment. The largest increase in employment has occurred among women in their late 20s and early 30s, the age when their employment is most likely to be affected by childcare responsibilities.

8. Between 1979 and 2002, the employment rates for women aged 25 to 34 rose from around 52 per cent to over 70 per cent[1]. Childbirth and childcare now have a far lower impact on women's employment rates than they did in the 1960s and 1970s. This should have a positive impact on the pension position of future female pensioners.

9. Another key characteristic of the labour market is the high rate of female part-time work. Around 44 per cent of women in employment currently work part time[1]. While the availability of part-time employment opportunities has been key to boosting female employment rates, it could also have adverse implications for future pension provision.

10. As Figure 7.2 shows, the level of part-time work varies with age and, for women, appears to reflect the impact of caring responsibilities. Men tend to be in full-time employment at all ages, with this rate only declining as they approach retirement. For women, on the other hand, the full-time employment rate peaks in their mid-20s. Many women then choose to leave the labour market altogether or switch to part-time working for a period after having a child.

11. Even taking full-time and part-time employment together, and despite the progress that has been made, the total employment rate for women overall is nearly 10 percentage points lower than that for men. Employment rates are lowest for lone mothers, particularly those with young children.

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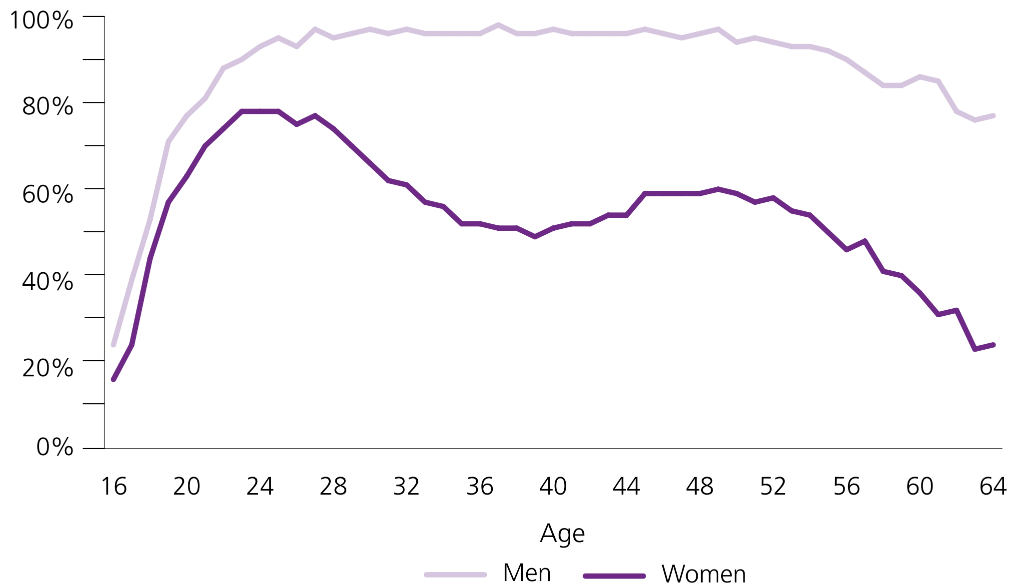
1 *Labour Force Survey*, 2002.

Figure 7.2: Proportion of men and women in employment in full-time work

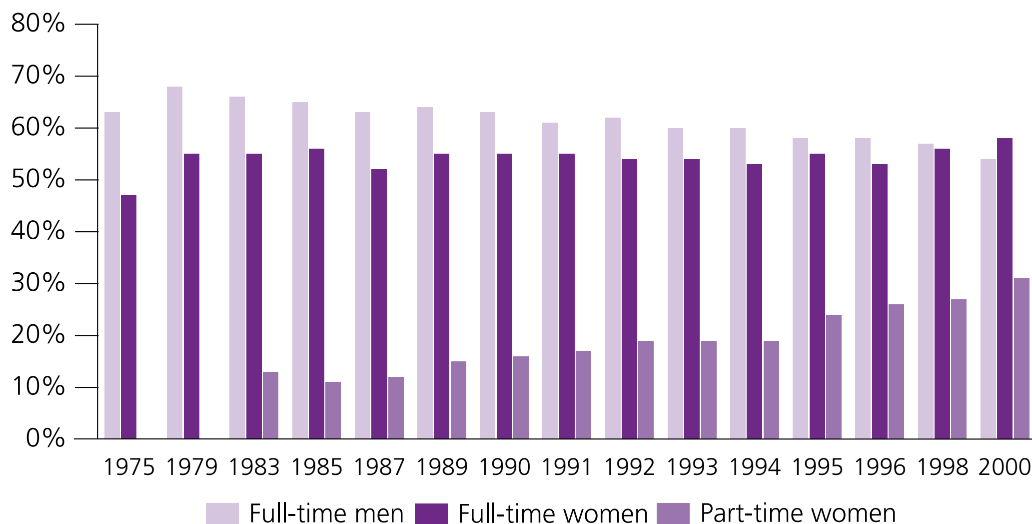


Source: *Labour Force Survey*, 2002.

7.3 The effect of differential employment patterns on occupational pension coverage

12. Historically, women's shorter average working week has had a direct effect on their occupational pension coverage. And in the past, many part-time workers have been excluded from occupational pension provision. Figure 7.3 shows the coverage of occupational pensions amongst women (compared to men) in full- and part-time work. Part-time men are omitted because they are a very small group but their occupational pension coverage is relatively low, too. The gap in coverage between women and men working full time has now closed, so that a greater percentage of women, compared to men, in work, have an occupational pension. Coverage among part-time workers is still low, but has improved over time.

Figure 7.3: Percentage of employees who are a member of their current employer's pension scheme



Source: *General Household Survey.*

Note: Data for part-time women not available for 1975 and 1979.

13. On 1 July 2000, the Government introduced new rights for part-time workers. The regulations ensure that Britain's 6 million part-time workers, 79 per cent of whom are women, are not treated less favourably than comparable full-time workers in their contractual terms and conditions, unless objectively justifiable. This includes, for example, an entitlement, in principle, to the same hourly rate of pay and same access to company pension rights.

7.4 The effect of differential employment patterns on earnings

14. The fact that women's work histories are interrupted by caring responsibilities also has a knock-on effect on pay. Interruptions to labour market participation are one factor in the gender pay gap, along with lower average levels of qualifications, occupational segregation and discrimination. On average, women experience a drop in pay of around 16 per cent after a year out of the labour market, a wage penalty that is more than double that faced by men[2].

15. Combining lower average hourly pay with shorter working hours means that even where women work full time, male average weekly earnings are over £100 higher than female earnings. When women working part time are included, the average weekly wage of all women is £200 a week lower than that of men. This is shown in Figure 7.4.

2 Gregg, P, 1998, *The Impact of Unemployment and Job Loss on Future Earnings*, in HM Treasury (1998) *Persistent Poverty and Lifetime Inequality: The Evidence*, Occasional Paper, No. 10.

Figure 7.4: Average gross weekly earnings by gender and whether full- or part-time

	Full-time	Part-time	All
Men	£514	£165	£484
Women	£383	£144	£284
All	£465	£148	£387

Source: New Earnings Survey, Great Britain.
Note: Figures relate to April 2002, rounded to nearest £1.

16. However, progress has been made on closing the gender pay gap over time. Equal pay legislation came into force over a quarter of a century ago and since then, women's hourly full-time pay has increased from around two-thirds that of men to over four-fifths.

17. Relative full-time hourly pay has improved most over time for younger cohorts of women. Analysis from the New Earnings Survey, published in a Cabinet Office report on women's income in 2000[3], showed that for women aged between 25 and 29, relative hourly full-time pay increased by around 10 percentage points to reach 95 per cent of the male equivalent by 1999. This increase will generate higher entitlements in the future within both state and private pensions.

18. The position of women aged over 40 did not, however, improve over the period. It is not clear whether younger women today, whose hourly full-time pay is almost equal to that of men now, will maintain their relative position as they get older.

7.5 The greater life expectancy of women in retirement

19. Women can expect to accrue fewer pension rights than men over time. This problem is compounded in retirement by the fact that women's savings have to last them longer. At present, women can expect to live almost three years longer than men at age 65 (19 years compared to 16 years). This difference is expected to continue into the future.

20. In the case of women with personal pensions, longer life expectancy also translates into lower annuity rates. It has also meant that women are more likely to survive their partners. For those women relying on their husbands' pension in retirement, widowhood will lead to a drop in income although most private pension provision offers half of the pension income to a surviving spouse.

3 *Women's Incomes over the Lifetime*, a report to the Women's Unit, Cabinet Office, 2000.

7.6 Government measures to help women who have already retired

21. For those pensioners who have already retired, the Government acted quickly to increase the incomes of the poorest who had been left out of private pension provision. This is why one of the first priorities of the Government was to introduce and substantially increase the Minimum Income Guarantee (MIG) for the poorest pensioners. Around 2 million pensioners benefit from the MIG, half of whom are single women.

22. In October 2003, the MIG will be replaced by the Pension Credit. Many female pensioners have small amounts of private income or have inherited private pension provision upon the death of a spouse but do not have enough income to bring them over the level of the MIG. Since the Pension Credit rewards people in this position, it is particularly good for female pensioners.

23. The Pension Credit will potentially benefit around half of all pensioners. Just over half of those entitled to the Pension Credit are single women. Two-thirds of those entitled to the Pension Credit will be women, and half of these women will be aged 75 and over.

7.7 Government measures to help working-age women build up better pensions

24. For future pensioners, the Government has recognised that many women balance family and labour market roles, which creates a major disadvantage in accruing pension provision. It has intervened at every stage to improve their relative position. The steps taken so far are outlined on the following pages.

Increasing state entitlements

25. As explained above, because of interruptions in their working life, women have accrued less in the way of basic State Pension and the State Earnings-Related Pension Scheme (SERPS) than men. HRP now helps women to accrue a full basic State Pension.

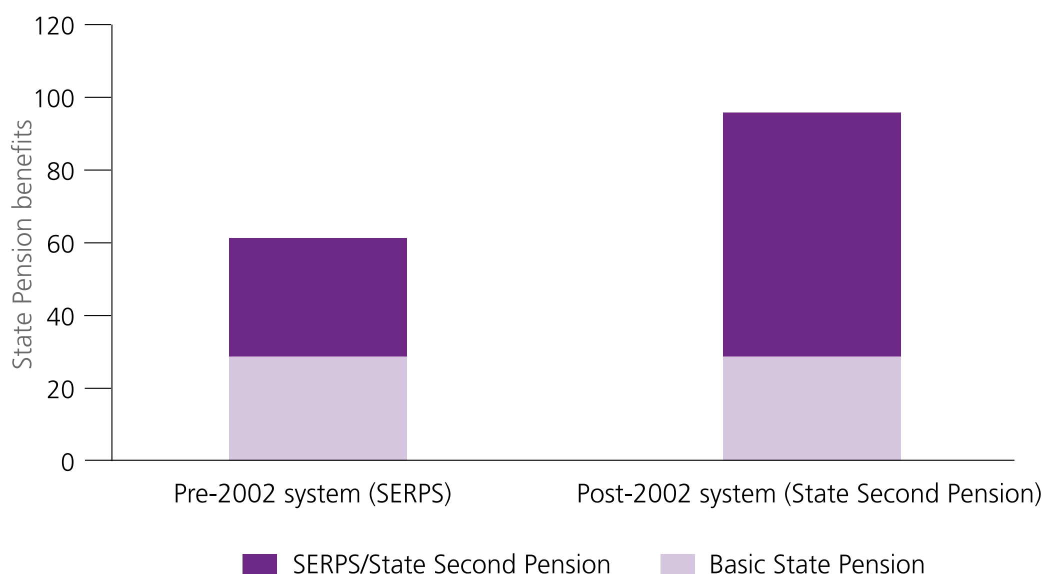
26. The Government has further rewarded years of caring. The State Second Pension extends second-tier pension rights for the first time to people without earnings who are caring for young children or a disabled adult. Almost all of the 2 million carers who will benefit from the State Second Pension are women.

27. Figure 7.5 illustrates the effect the State Second Pension would have compared to SERPS on the pension income accrued during a 'typical' working life of a woman. It is assumed she works for around 30 years, slightly less than half of which is made up of part-time work. Most of the rest of the time before State Pension age is spent caring full time.

28. Assuming that the appropriate average female wage is earned while in work, the effect on her final pension income under SERPS and the State Second Pension is compared in

Figure 7.5. In this example, the State Second Pension provides extra pension income worth more than £30 a week in today's earnings terms, an increase in total pension income of around 50 per cent.

Figure 7.5: Pension income under SERPS and the State Second Pension for a woman retiring in 2050



Source: Department for Work and Pensions calculations using Lifepen.
Note: All figures in 2002/03 earnings terms.

29. Many of the Government's employment policies have also sought to help women who have been some years out of the labour market. In the past, two groups of women in particular were ignored and missed out on the help they needed to find a job – the partners of benefit claimants, and lone parents. 83 per cent of the partners of people getting Jobseeker's Allowance, Income Support or disability benefits, are women, as are 90 per cent of lone parents. Often they lack the confidence and skills to return to work.

30. Our New Deal for Partners and New Deal for Lone Parents are accordingly built around personal advisers who can help with childcare options, in-work benefit calculations, job search, bridging finance, and access to training. By June 2002, 372,000 lone parents had joined the New Deal of whom nearly half (over 163,000) had been helped into work.

Helping parents balance work and family life

31. The Government is committed to helping parents balance their work and family lives. From April 2003, a series of reforms, including the introduction of the new Child Tax Credit and Working Tax Credit, will help to deliver a step change in choice and support for parents. Details of the Government's strategy, including next steps, will be set out in the forthcoming publication, *Balancing work and family life: enhancing choice and support for parents*.

32. From April 2003, the Government will increase the level of maternity pay from £75 a week to £100 a week and increase the duration of maternity pay from 18 to 26 weeks. Also, the introduction of two weeks Statutory Paternity Pay and the extension of Income Support during paternity leave for low-paid fathers will help men share parenting responsibilities more easily and this, in turn, may help women retain their jobs.

33. From April 2003, employers will have a legal duty to consider applications for flexible working from employees who are parents of young or disabled children.

34. The part-time workers regulations introduced by the Government (in 2000 and 2002) will ensure that 6 million part-time workers, the majority of whom are women, are not treated less favourably than comparable full-timers in their terms and conditions.

35. In March 2002, the Prime Minister launched the Work-Life Balance campaign. It aims to convince employers of the economic benefits of work-life balance, and the need for change by presenting real-life case studies. The campaign supports employers through the Challenge Fund, which helps them assess the business benefits of flexible working arrangements, the needs of employees, and then find solutions. How parents balance – and share – their work and childcare responsibilities is for them to determine, and may well change over time. But men as well as women stand to gain from a healthier work-life balance of their choice.

36. Women tell us that a key obstacle to their re-entering the labour market is accessing affordable and good-quality childcare. Lower- and middle-income working parents can receive help – up to 70 per cent of eligible costs, subject to cost limits of £135 a week for one child or £200 a week for two or more children – through the tax credit system. From April 2003, childcare support will continue in an improved, more flexible form within the Working Tax Credit. This will be extended to cover approved childcare in the home, which will in particular help parents working outside conventional hours, or those with disabled children.

37. Following the 2002 Spending Review, the Government has committed to more than doubling resources for childcare, resulting in an extra 250,000 childcare places by 2006. This will be achieved through targeted assistance to childcare providers, especially those in disadvantaged areas. The extra funding will also support the creation and operation of Children's Centres, bringing together childcare, early years education, family support and health services.

Improving pay

38. As explained above, relative low pay is particularly a problem for older women and women working part time. The Government introduced the National Minimum Wage in April 1999 which now stands at £4.20 an hour for workers aged 22 and over. This benefits over one million people, around 70 per cent of whom are women. The Low Pay Commission estimates that it has had the greatest effect on women's pay since the 1970 Equal Pay Act.

39. In addition, the Working Families' Tax Credit (WFTC) has been designed to make work pay for people working more than 16 hours on low and moderate earnings. By May this year, over 1.3 million families received WFTC, in 60 per cent of which a woman is the main or sole earner.

40. Building on the success of the Working Families' Tax Credit, from April 2003 the Working Tax Credit will deliver new, more generous, in-work support, extended for the first time to those aged 25 or over without children. In addition, the Child Tax Credit will support working and non-working families with children. From April 2003, as a result of the new tax credits and Child Benefit, a lone parent with two children on the minimum wage will be guaranteed a weekly income of £217 if she works 16 hours a week, and £270 if she works 30 hours.

41. Families will also find it easier to share work in a way that suits them best, with couples with children now able to claim the 30-hour element of the Working Tax Credit if they jointly work 30 hours or more.

Occupational pension coverage

42. As explained above, women have shorter working lives than men and work for about half of the time part-time. It is now illegal to exclude part-time workers from occupational pension provision if it is offered. The Government proposes to encourage, rather than compel, employers to provide pensions for their staff.

43. The Government will continue to encourage individual saving. In the past, for many women personal pensions were not suitable. This is largely because personal pensions typically have relatively large charges up-front, penalising those people who can only make small contributions and those who are unable to sustain their contributions over a long period of time. In fact, traditional defined benefit occupational pension schemes have also in relative terms disadvantaged some women. This is because such schemes are mostly based on final salary and therefore favour employees with strong salary progression late in their career. Well-funded defined contribution schemes are more flexible and suit the career patterns of many women.

44. Stakeholder pensions are flexible defined contribution vehicles and were designed with the employment patterns of women in mind. Stakeholder pensions have restricted charges that are capped at 1 per cent of the fund and there are no penalties for breaks in contributions and for switching providers. This means that funds will be bigger – a direct benefit to women in particular.

45. For those households who can afford to, it is possible for a woman to contribute to stakeholder pensions and receive tax relief at the basic rate even if she is not currently working. This helps women to maintain their own individual pension rights over time as breaks in contributions can have a serious impact on final pension income. According to Association of British Insurers (ABI) research[4], over 40 per cent of the stakeholder pensions sold so far have been bought by women. By contrast, only 30 per cent of all personal pension products are held by women.

46. However, even though better products are now available, a major remaining problem preventing saving among women is low financial awareness. Women have particularly low levels of knowledge about pensions – either of what the State offers or of what options

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4 ABI research produced in November 2002, based on a sample of sales between January and June 2002 – more details in **Chapter 5**.

are available to them privately. Department for Work and Pensions research[5] found that one in five women say they know little or nothing about pensions compared to one in ten men. Around a third of women had given little or no thought to their income in retirement compared to a quarter of men.

47. The proposals in this Green Paper will radically improve the information available to people on both their state rights and employer provision. For the first time, employers not providing pensions will have to take action to inform employees of their pension position. This will particularly help women working part time who are mostly not members of occupational pension schemes.

Women working below the lower earnings limit

48. The Government has also brought more people into the National Insurance system without requiring low earners to pay contributions. From April 2001, the start-point of National Insurance contributions was separated from the lower earnings limit (LEL) for employees and aligned with the personal allowance for income tax. From April 2002/03, National Insurance contributions only become payable on earnings from £89 a week whereas entitlement to National Insurance benefits start accruing at £75 a week. This has benefited around 500,000 women. However, the Government recognises that some low-paid and part-time working women may face difficulties in accruing sufficient individual rights for the State Pension. We will continue to look at the effect of this on overall entitlement to contributory and other benefits in retirement and at ways of ensuring that everyone can understand how they can earn entitlement to contributory benefits.

The role of partners

49. Many women working part-time are relying wholly or partly on the retirement pension saving of partners in retirement. It is up to individuals how they wish to arrange to save for retirement. However, there are risks in women relying solely on a partner's pension. Approximately one in two marriages end in divorce or separation. It is important that those who find themselves in this situation receive a fair proportion of the partnership's assets, including pension rights.

50. The Government has already legislated to permit the sharing of the value of pension rights on divorce. A court can order that a percentage of the value of one spouse's pension is to be used to give the other spouse their own pension. This is explained more fully below.

51. However, a woman in a cohabiting relationship has no such entitlement. Nearly 60 per cent of the population continue to believe that that there is a legal concept of a 'common law wife', with appropriate legal rights. There is not. A cohabiting woman, with or without children, currently has no rights to her partner's private pension or State Pension if she stays with him or if she leaves him. If she has not built up her own independent National Insurance record, she may face old age heavily reliant on state support. It is important for everyone to understand the need to build a pension. It is vital for women, as they are, after all, the majority of pensioners.

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5 *Pensions 2000: Public Attitudes to Pensions and Planning for Retirement*, Research Report no. 130, 2001.

Pensions sharing on divorce

In December 2000, the Government brought in legislation that enabled couples to share the value of their pensions on divorce or annulment of their marriage. Before the introduction of pension sharing the options available to the courts for dealing with the value of pensions were more limited. The court could either offset the pension value against the value of other assets or 'earmark' the pension, ordering the spouse with the pension to pay either a lump sum or periodical payments from a pension when it becomes payable.

The pension sharing arrangements introduced by the Government allow the former spouse to acquire a pension in their own right, and provide security of income throughout retirement, and a clean break. They also enable more couples to reach a fairer settlement in cases where the pension to be shared is a significant asset in the marriage. The legislation ensures that the courts take full account of the value of pensions in all cases in reaching a financial settlement, and the standardised valuation and streamlined information processes ensure that the treatment of pension in divorce cases is consistent throughout the UK.

Although pension sharing applies equally to both men and women, because of the current distribution of pension rights, beneficiaries of a pension derived from a pension share are much more likely to be women.

Earlier retirement

52. A relatively low proportion of women work later in life. As with men, the employment rate of women declines steadily with age after 50. The full-time employment rate declines even faster. These trends, coupled with the fact that women have a lower State Pension age, means that many women miss out on earnings later in life and the opportunity to boost their pension rights.

53. Over time, the State Pension age of women and men will be equalised at age 65. The equalisation will happen gradually between 2010 and 2020. Along with the measures described in **Chapter 6** to help older workers back into employment, such as anti-age discrimination legislation and back-to work policies for those aged 50 and over, the Government hopes that women will be able to extend their working lives over time, allowing women more time to fund adequate retirement incomes in their own right.

Lower annuity rates

54. Although it is true that women's life expectancy at age 65 is around three years longer than that of men, there are even more significant differences between different groups of people of the same gender. For example, the difference in male life expectancy at age 65 is over four years between professional men (who can expect to live to around 82) and unskilled manual men (who can only expect to live to just under 78). However, as discussed in **Chapter 5**, it is difficult to impose a single annuity rate for men and women on a disaggregated market of private providers.

55. However, this Green Paper has proposed new measures to make sure people get the very best value from their savings and find the best value annuity on offer, given their circumstances. The Financial Services Authority is already encouraging people to shop around for the best annuity rate and this will be extended to money purchase occupational pensions, as well as personal pensions.

7.8 Conclusion

56. The Government has significantly improved the position of the poorest pensioners, many of whom are women. In addition, steps have been taken to help women build up better National Insurance rights despite breaks from the labour market and lower earnings. Some progress has also been made in facilitating private pension provision for women, in particular, the introduction of stakeholder pensions.

57. But much of the improvement in the pension position of future female pensioners will come from labour market improvements – higher employment rates and better pay. The Government's new employment measures help build on the favourable trends.

58. However, the pension position of women will still lag behind that of men for some years to come and there is significant variation in the position of different groups of women. Women in full-time work are seeing improvements in their relative pay and occupational pension provision but almost half of women in work are part-time and many are low paid. Occupational pension coverage remains low amongst part-time women and some low-paid women do not qualify for National Insurance benefits because their earnings are below the lower earnings limit. Many of these problems flow in part from a lack of awareness and understanding of the pensions system.

59. The Government is committed to improving pensions information for everyone, but this is particularly important for women. Proposals in this Green Paper to promote informed choice, such as individualised pension forecasting, will help women. **We propose to look at how best to ensure that women are aware of their pension position and the choices they face. We would welcome views.**

Annex 1: Issues for consultation and the consultation arrangements

1. The Government would welcome views on the issues and proposals set out in this Green Paper.

Chapter 3: Informed choice for individuals

The Government proposes to:

- **simplify the taxation of pension schemes** radically so that all pension schemes are covered by a single set of simple rules (paragraphs 23 to 29);
- **improve financial education and awareness** by, in particular, continuing its **publicity campaign** and sending **targeted information** to people at key points in their lives (paragraphs 31 to 33);
- **rebrand tax relief on individuals' contributions to personal and stakeholder pensions** to demonstrate the generous incentives that their reliefs provide (paragraphs 34 to 38);
- **extend information tailored to individual circumstances**, notably **combined pension forecasts** from employers and pension providers, and **automatically issue state pension forecasts** to self-employed people, and people who are not members of private pension schemes (paragraphs 48 to 49); and
- **simplify savings products**, and asks for views on offering the **self-employed** the right to opt in to the **State Second Pension** (paragraphs 50 to 52).

Chapter 4: Pensions and the workplace

Simplification

In addition to the **simplification of tax rules**, the Government proposes to:

- introduce **more flexible rules for scheme funding** to reduce the short-term burdens on schemes (paragraphs 31 to 35);
- undertake a **major simplification and restructuring of the contracting-out regulations** (paragraphs 38 to 58); and
- give schemes **much greater flexibility** in how they comply with the regulations (paragraphs 59 to 62).

Protecting employees

The Government proposes to:

- develop a **new pensions regulator** whose objectives and resources are focused on protecting the benefits of scheme members (paragraphs 63 to 66);
- take steps to give members greater confidence that, when schemes are wound up, they will **get the benefits they were promised** (paragraphs 67 to 92); and
- **ensure that members are consulted about changes** to their pension scheme (paragraphs 99 to 101).

Better information and promotion of pensions

The Government proposes to:

- get the active involvement of employers through an **employer task force** (paragraphs 102 to 104);
- encourage **employers who provide pensions** to do more **to highlight their value** (paragraphs 105 to 108);
- encourage and facilitate all **employers to provide better information** (paragraphs 109 to 113);
- help to **extend pension provision**, including **increasing take-up** by employees (paragraphs 114 to 126); and
- encourage employers who do not provide pensions to **provide their employees with pensions information and advice** (paragraphs 127 to 129).

Chapter 5: Informed choice in pensions – building trust and understanding in financial services

The Government proposes to:

- develop generic **financial healthcheck products**, and **financial advice through the workplace** (paragraphs 33 to 36);
- consult early in 2003 on **how to bring stakeholder pensions into the simple product suite** proposed by the Sandler review. The Financial Services Authority (FSA) will be consulting in parallel on the appropriate sales regime for Sandler products (paragraphs 37 to 52);
- **make the annuities market work better**, including the introduction of **value protected and limited period annuities** (paragraphs 63 to 69);
- ensure that the **regulation of equity release and home reversion plans** protects consumers and allows the market to work effectively (paragraphs 71 to 72); and
- ensure that **pension fund trustees have appropriate investment expertise** (paragraphs 78 to 82).

Chapter 6: Extending opportunities for older workers

The Government proposes to:

- provide **extra back-to-work help for those aged 50** and over (paragraphs 25 to 29) and pilot **measures to help recipients of incapacity benefits return to work** (paragraphs 30 to 32);
- **treat men and women between 60 and women's State Pension age as active labour market participants**, when women's State Pension age rises from 2010 (paragraphs 33 to 38);
- bring forward **more generous increases for deferring state pensions** (paragraphs 39 to 42) and **maintain State Pension age at 65** (paragraphs 44 to 52);
- **implement age legislation covering employment and vocational training by December 2006**, in which compulsory retirement ages are likely to be unlawful unless employers can show that they are objectively justified (paragraphs 54 to 58);
- allow people to **continue working for the sponsoring employer whilst drawing their occupational pension, raising the earliest age from which a pension may be taken from age 50 to age 55 by 2010, and consulting on best practice to ensure that occupational pension rules do not discourage flexible retirement** (paragraphs 59 to 64); and
- to **change public service pension schemes**, for all new members initially, to make an unreduced pension payable from age 65 rather than age 60 (paragraphs 65 to 69).

Chapter 7: Women, work and pensions

The Government proposes to look at how best to ensure that **women are aware of their pension position and the choices they face** (paragraphs 56 to 59).

The consultation arrangements

2. The Government is committed to a wide-ranging consultation process. We are designing a programme of events that will enable us to hear the views of all groups with an interest. These events will be banded under three broad themes:
   - the future of work;
   - savings and taxation; and
   - the new regulatory approach.
3. The consultation, which will run from 18 December 2002 until 28 March 2003, will aim to take views from academics, the financial services industry, consumer (working age and pensioner) representative organisations, employers' and employees' representative organisations and pensions practitioners.

4. The Government would welcome comments and views from individuals and organisations. If you are responding on behalf of a representative group or organisation, it would be helpful if you could make this clear.

5. Please address any **comments on this Green Paper by 28 March 2003** to:

   Working and Saving for Retirement Consultation
   Department for Work and Pensions
   Pensions Strategy Team
   3rd Floor
   Adelphi
   1–11 John Adam Street
   London
   WC2N 6HT

   Comments can also be sent by email to: pensionsresponse@dwp.gsi.gov.uk

6. Please address any **comments arising from the Inland Revenue's consultation document, *Simplifying the taxation of pensions*** to:

   Maggie Anderson
   Pensions Simplification Project
   Room 132a
   New Wing
   Somerset House
   The Strand
   London
   WC2R 1LB
   Tel: 020 7438 8374
   Fax: 020 7438 6527

   Comments can also be sent by email to: pensionsconsult@ir.gsi.gov.uk

   If you are sending comments by email, please include 'Response Pensions' in the subject header.

7. The information you send to us may need to be shared within the Department for Work and Pensions and the Inland Revenue and/or published in a summary of responses received as part of this consultation. We will assume that you are content for us to do this, and that if you are replying by email, your consent overrides any confidentiality disclaimer that is generated by your organisation's IT system, unless you specifically include a request to the contrary in the main text of your response to us.

Annex 2: Partial Regulatory Impact Assessment

Background

1. This partial Regulatory Impact Assessment (RIA) is designed to help inform the consultation on proposals in the Green Paper. The Inland Revenue is publishing *Simplifying the taxation of pensions* alongside this Green Paper. The Inland Revenue publication includes a separate, partial RIA covering the tax proposals, so they are only covered in summary here.

2. In producing this RIA, we have consulted with the Small Business Service in the Cabinet Office. Most of the measures relate to private pensions. A more detailed RIA for the changes to private pension legislation outlined in **Chapter 4** can be found attached as an annex to the technical paper[1] which accompanies this Green Paper.

3. We are proposing a **simplifying and deregulatory package** to give greater flexibility for schemes while maintaining protection for scheme members and pensioners. This addresses employer concerns about funding pressures and the administrative effort required to comply with private pension legislation. The package of measures is also intended to promote information for individuals to help them make **informed choices**.

4. In some areas we are consulting on increasing the level of **protection for scheme members**. Any increase in employer costs in these areas should be viewed within the context of the package as a whole. While there will inevitably be some transition costs, we believe that longer-term benefits will mean an overall gain both to businesses and individuals. Our aim is to ensure that we do not increase the overall burden on employers providing pensions. We will want to work closely with all interested parties to ensure we understand the costs of these options.

5. The effects on businesses[2] will vary depending, among other things, on the nature of the scheme provided (for instance, whether it is defined benefit or defined contribution) and the size of the firm or organisation making the provision. Further, several of the proposals discussed within this RIA would be **voluntary**. Businesses would therefore be **free to choose whether or not to implement them**. The table below sets out estimates of the number of open and closed private sector schemes of different types and sizes[3].

1 *Simplicity, security and choice: technical paper*.
2 The impact upon charities and the voluntary sector is minimal.
3 This does not represent a one-for-one mapping of schemes to firms. One firm may run several schemes. One scheme can cover several firms. However, the estimates of the size and nature of scheme can be taken as a reasonable proxy for the sorts of employers who may be affected.

Figure A2.1: Estimated number of private pension schemes by type and size, 2000

Number of scheme members	Defined benefit	Defined contribution	Hybrid	**Total**
10,000+	200	*	*	**200**
5,000–10,000	100	*	*	**200**
1,000–5,000	800	200	100	**1,000**
100–1,000	3,700	1,000	300	**5,000**
12–100	4,500	4,400	*	**9,000**
1–12	19,800	55,700	*	**75,500**
Total	**29,100**	**61,400**	**500**	**91,000**

Source: Government Actuary's Department *Survey of Occupational Pension Schemes 2000*, preliminary results.
Notes: This table includes all open and closed schemes. Some of the policy options in this publication will also affect schemes that are frozen or winding up. All figures rounded to nearest 100. * implies low sample size.

6. This is a consultation document. We welcome your views on the costs and benefits (both initial and ongoing costs) that the measures outlined in this RIA would have for businesses and individuals. Calculating costs and benefits for many of the options is extremely difficult, and the figures described within this RIA should be taken as indicative. If a measure is taken forward, a more detailed calculation of figures will be undertaken in a final RIA.

7. Given the range and diversity of businesses, we welcome first hand views from different types of business on the effect proposals will have on them. In particular, we are keen to identify if any of these measures will have a disproportionate impact on small- and medium-sized businesses, and whether we have accurately identified potential costs and benefits.

Summary of findings – savings

8. The proposals which would be likely to have the biggest effect in terms of providing ongoing **administrative savings** for those running pension schemes are:

- tax simplification;
- replacement of the Minimum Funding Requirement (MFR);
- simplification of contracting out;
- removal of prescription on the selection of member-nominated trustees (MNTs);
- move from a two-stage to a one-stage internal disputes resolution system;
- less prescription on communication with scheme members;
- easier transfers of small amounts of pension; and

- changes to restrictions on powers to alter schemes.

9. The proposals which, if implemented, could have the biggest effect in terms of producing ongoing **funding savings** for employers are:
   - a lighter contracting-out test;
   - abolition of compulsory indexation of pensions;
   - abolition of compulsory survivors' benefits for contracted-out schemes; and
   - savings resulting from the effect of MFR replacement on schemes' investment strategies.

Administrative savings

10. Informal soundings with pensions experts suggest that for the largest schemes (those with over 40,000 members), the average administrative cost is around £28 per member a year. For smaller schemes (those with fewer than 500 members), the cost is around £80 per member a year.

11. We have been able to estimate the administrative savings of some of the individual proposals, but not all. Those we have been able to estimate are **replacement of the MFR** (ongoing savings of £10 million a year across all pension schemes), **removal of prescription on the selection of MNTs** (ongoing savings of £20 million a year across all pension schemes) and **tax simplification** (ongoing savings of at least £80 million a year).

12. We have not been able to estimate the savings of the other individual proposals, but a very rough estimate of the net effect of them is that they could **save in the region of £40–£80 million** a year.

13. So, if all the measures were to be implemented, we would expect the **total administrative savings to be of the order of £150–£200 million a year**[4].

Funding savings

14. The options that could affect funding are **voluntary** measures for businesses. All the measures would allow employers to choose whether or not they wish to make changes to their pension schemes[5].

15. The options to **lighten the contracting-out test**, both by switching from pensions based on final salary to career average earnings and by reducing the accrual rate from 1/80th a year to 1/100th a year, could save some companies with defined benefit schemes up to

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4 £10 million for MFR, £20 million for MNTs, at least £80 million from tax changes and £40–£80 million of savings from all the other changes.

5 It should be noted that one of the options, discussed later, is to require employers to consult with employees or their representatives before making changes to their pension scheme.

30 per cent of their contributions. Some schemes that decide not to provide **indexation** of pensions (which is not restricted to contracted-out schemes) would save roughly 20 per cent of their contributions. Some schemes choosing not to provide **survivors' benefits** would save 20 per cent. All these estimates should be taken as a broad order of magnitude only, and the savings each firm might make would depend on the composition of the staff and whether or not they choose to reduce the level of benefits they offer. The removal of compulsory provision of indexed benefits for pensions of up to £30,000 a year could save some firms a small proportion of the cost of contributions, while ensuring the value of smaller pensions are preserved through retirement. We would welcome the views of business on this last option.

16. We estimate that the effect on investment strategies of the **MFR replacement** might be in the region of £70 million a year across all pension schemes.

17. There are number of important points to note.

- The majority of contracted-out schemes provide pensions in excess of the requirement of the contracting out test. And the limited evidence we have suggests that the majority of schemes would continue to provide indexation (which is not limited to contracted-out schemes) and survivors' benefits, so it may be that only fairly small funding savings would actually result across the whole pensions industry.
- We do not know what the behavioural effect would be in terms of how firms would react. For example, we do not know how many businesses would keep their defined benefit schemes open who might otherwise have closed them down. **We welcome any evidence about the likely behavioural response of employers.**
- In terms of funding, we recognise that any savings to firms represent lost benefits for members. However, we also want to evaluate the evidence as to whether these reforms might encourage firms to maintain schemes which they might otherwise close. **Only if we believe that these options will lead to more pension provision overall than would otherwise be the case would we consider implementing them.**

Summary of findings – costs

18. The proposals which would be likely to have the biggest effect in terms of ongoing **administrative costs** for those running pension schemes are:

- a statutory requirement to consult with scheme members or their representatives before making changes to the pension scheme;
- a new pensions regulator (leading to an increase in the levy which funds the regulator);
- provision of combined pension forecasts;
- provision of pension information on total benefit statements, pay slips and job advertisements;

- extension of requirements in relation to trusteeship (implementation of the Myners' proposals); and
- possibly, immediate vesting, although the allied proposals of easier transfers of *de minimis* amounts of pension might more than offset any extra costs.

19. The options which, if implemented, could have the biggest effect in terms of ongoing **funding costs** for employers are:
    - increased compensation for scheme members in cases of loss through fraud or theft;
    - immediate vesting; and
    - strengthening the debt on the employer in the case of a scheme winding up.
20. We also consider the option of some form of insurance or central clearing house arrangement. A central clearing house would involve minimal administrative costs. An insurance arrangement could be funded by, for example, a reduction in pension benefits or increased contribution rates.

Administrative costs

21. The ongoing additional cost of the **new pensions regulator** is likely to be in the region of £3.5 million a year, funded through an increase in the levy on occupational pension schemes. The start-up cost is likely to be about £2.5 million.
22. Implementation of the **Myners proposals** to require trustee training could cost in the region of £6 million a year for each of the next three years, with a small ongoing cost thereafter.
23. So, we estimate that the **total administrative costs of this package of proposals could be around £8.5 million in the first year[6], £9.5 million for years two and three[7] and finally an ongoing cost of £3.5 million a year[8]**.
24. **We welcome views on these estimates.** In particular, whether you agree that the new pensions regulator and Myners' proposals aside, the options would have minimal ongoing administrative costs (although some could involve start-up costs). These are discussed later in this RIA.

Funding costs

25. We estimate the cost of **higher compensation in the case of fraud or theft** as negligible. It is difficult to estimate the costs of **immediate vesting** as this will depend on a number of factors, including current scheme rules in relation to vesting and waiting periods, and the extent of any increase in membership by new employees.

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6 £2.5 million for the new pensions regulator start-up and £6 million for Myners' proposals.
7 £3.5 million for the new pensions regulator and £6 million for Myners' proposals.
8 The new pensions regulator only.

Analysis of individual proposals

26. This section looks only at the costs and benefits to businesses. Detailed information for each proposal can be found within the technical paper and the tax simplification paper.

Tax simplification

27. The proposals will remove almost all the existing compliance burdens on pension scheme administrators. Most notably, data requirements will be dramatically reduced, calculating benefits and payments will be far simpler, and complying with tax limits will, in almost all cases, comprise a one-off valuation. Overall, we estimate that the annual savings in administrative costs will be at least £80 million a year.

A new framework for scheme funding

28. There are around 40,000 defined benefit schemes that are subject to the MFR (this includes schemes that are open, closed, frozen and winding up). The objective of replacing the MFR with a new, scheme-specific funding standard is to provide greater flexibility for schemes and to increase transparency so that members are clearer about the funding position of their schemes. The proposals will lead to one-off administrative costs in respect of schemes currently subject to the MFR of around £70 million[9] in total. Ongoing administrative savings will be around £10 million a year.

29. In addition to this, ongoing savings of around £70 million a year might be generated from the impact of the removal of the MFR on schemes' investment strategies. There will also be short-run benefits to under-funded schemes resulting from the increase in the period of time during which funding deficits are reduced.[10]

30. The proposals for replacing the MFR apply regardless of the size of the sponsoring employer and should not have a disproportionate impact on small- and medium-sized businesses. **We would welcome the views of individual businesses on the impact they believe this measure will have on them.**

Contracting out

Contracting out: survivors' benefits and indexation

For defined benefit schemes:

31. Removal of indexation (which is not limited to contracted-out schemes) and survivors' benefits requirements should reduce the financial pressures on defined benefit schemes that choose to take these options. However, the evidence we have suggests that many

9 There is limited information on which to base reliable estimates of the costs and benefits, and estimates must therefore be regarded with caution. Estimates will also be affected by future changes in economic conditions (such as stock market fluctuations), and changes in the number and membership of defined benefit schemes.

10 Other things being equal, this represents neither a real cost nor a saving in the long term. It arises from the estimated overall impact of the replacement of the MFR on the periods over which schemes' under-funding is corrected, but the actual cost of providing the pension benefits is not altered. Estimates indicate that, overall, sponsoring employers would pay around £800 million a year less than currently to correct under-funding (equal to £600 million net of Corporation Tax) over the first ten years, but any short-term cash flow saving is offset by higher aggregate payments over the long term (schemes which put more money in now will have to put less in later, and vice versa). This issue is covered in more detail in the RIA that accompanies the technical paper.

employers would still wish to provide such benefits. **We would welcome the views of businesses on this.**

32. Subject to responses to issues raised in **Chapter 4**, if employers were to consider adopting these measures, then under other proposals in **Chapter 4** they might be required to consult with employees or their representatives first. For those firms offering defined benefit schemes that took advantage of the flexibility provided by the removal of the obligations, savings would be generated through a reduction in the rate of their contributions to the pension scheme.

33. **It is estimated that the removal of compulsory indexation could save some firms making defined benefit provision roughly 20 per cent on their contributions to pension schemes, and that the removal of compulsory survivors' benefits could reduce funding costs for some firms by roughly 20 per cent.** Future funding savings to employers if they were to cease providing indexation **and** survivors' benefits would be somewhat **less than 40 per cent**. These figures should be taken as a broad order of magnitude only, and the savings each firm might make would depend on the composition of the staff.

34. However, savings for employers would result in **losses to individuals**. A recipient of a non-indexed pension will, over time, see his or her pension lose its purchasing power. **For an average man, this could result in the final pension in payment being around 30 per cent less than it otherwise would have been; for an average woman, the equivalent figure is around 40 per cent.** With regard to the proposal to remove survivors' benefits, it is not possible to make such a comparison as we are considering the removal of a whole benefit, not a loss in value. **However, the shortfall in pension income over a whole, combined retirement for an average couple would be around 20 per cent.** Most of the individual losers would be women, as they form, and are expected to continue to form, the majority of surviving beneficiaries.

35. One way of reducing the potential impact of this measure on individuals would be to introduce an **indexation threshold**, say, £30,000 a year. Such a threshold would mean that the requirement to provide indexation would not apply to pensions above the threshold. Those with smaller pensions would continue to receive indexation. However, there would be correspondingly smaller savings for businesses and this would add complexity to the administration of schemes.

36. The range of costs to individuals and savings to businesses would depend upon the level at which the indexation threshold was set. However, both in relation to the removal of mandatory indexation or the introduction of an indexation threshold, it would be for each employer to decide if they wish to provide indexation.

37. We believe there is a strong likelihood that many employers would continue to provide index-linked pensions, even if the mandatory requirement to provide indexation is removed. This is an enabling option (schemes could continue to provide indexation for all members if they wanted) so there are no additional administrative burdens being placed on schemes. **We would welcome the views of businesses on the likely effects on them.**

38. In terms of funding costs, we do not expect that proposals regarding indexation and survivors' benefits would have a significant or disproportionate impact on small- and medium-sized businesses.

For defined contribution schemes:

39. In contracted-out defined contribution arrangements, annuities purchased with that part of the pension fund derived from protected rights must include indexation (this also applies to non-contracted-out defined contribution schemes) and survivors' benefits. Removing these requirements would provide greater choice for the individual scheme member and increase the headline pension payable.

Contracting out: the Reference Scheme Test

40. Pension schemes that want to contract out of the state scheme can only do so if they provide benefits that meet a test called the Reference Scheme Test (RST). Key proposed changes are outlined in Figure A2.2.

Figure A2.2: Proposed changes to the Reference Scheme Test

	Current test	New test
Pension age	65	Scheme rules (but no later than 65)
Pension accrual rate	1/80th	1/100th (1 per cent)
Pensionable salary	Average qualifying earnings in the last three tax years.	Career average earnings, cumulatively revalued by prices up to 5 per cent a year (or, allow schemes the option of revalued career average or final salary, as in the current test).
Qualifying earnings	90 per cent of earnings between the lower earnings limit (LEL) and the upper earnings limit (UEL).	All earnings (though some restrictions may be required).
Pensionable service	The maximum number of years service should not result in an annual pension of greater than half the earnings on which it is calculated.	No change.
Spouse's pension	50 per cent of the member's pension under the RST.	This aspect of the test is discussed in the section on survivors' benefits.

41. The lighter RST would allow employers with defined benefit schemes to reduce their contributions if they decided to provide only the level of benefits required by the RST requirement and no more.

42. These measures are likely to involve initial administrative costs, but longer-term administrative savings. For example, the main cost of the reform of the RST for businesses is likely to be short-term administrative costs as they make the transition from the current arrangements to the reformed RST basis. However, this cost should be more than offset by reduced contributions if employers choose to fund the scheme to the level set out by the reformed RST.

43. Excluding the savings available from cessation of survivors' benefits, we estimate that employers could save up to around 30 per cent of their contributions. However, these savings would be at the expense of individual scheme members. **We would welcome the views of all businesses on the administrative costs and savings, which would result from these measures. We would also welcome views on the contribution reductions which could result, including whether schemes would actually make these reductions.**

Contracting out: simplification of Guaranteed Minimum Pensions

44. Guaranteed Minimum Pensions (GMPs) were introduced in 1978 to ensure people who contracted out of the State Earnings-Related Pension Scheme (SERPS) received a pension at least broadly equivalent to the SERPS they had foregone. This arrangement lasted until 1997, but for pension accrued between 1978 and 1997, it is still in force. The existence of GMPs is a contributory factor in the complex nature of occupational pensions, both for the individual to understand and for those running pension schemes to administer. The proposal is to discuss with the pensions industry how to achieve a workable and affordable solution to the problems GMPs cause.

45. We have not been able to estimate the administrative savings which might accrue from these changes to contracting out on their own. However, we estimate that if combined with a move to a one-stage internal disputes resolution, easier transfers, and less prescription in relation to disclosure of information, the overall administrative savings could be of the order of £40–£80 million a year. **The Government wants to find workable and affordable ways to relieve administrative burdens on schemes; in particular, to simplify future and past regimes. However, we also need to ensure that the new pensions framework provides scheme members with appropriate protection. We propose to work with pensions experts to achieve these aims.**

46. **We would welcome views on the potential impact of simplification in this area.**

Changes to restrictions on powers to alter schemes

47. At present, Section 67 of the Pensions Act 1995 prevents changes being made to the rules of a scheme that would reduce a member's accrued pension rights without the member's consent. It preserves not just the value of the member's rights, but the rights themselves.

48. This proposal will allow schemes to make limited modifications to members' accrued pension rights, without consent, and so provide them with some scope to rationalise their arrangements and therefore reduce administrative costs. **Its use will be voluntary.** We do not believe this proposal will have a disproportionate impact on small- and medium-sized businesses. This is because these measures are likely to be used more by larger self-administered schemes – who could use this measure to reduce their administrative costs over time. There may be minimal additional costs for the regulator. **We would welcome the views of businesses on the administrative savings that this measure could generate.**

Member-nominated trustees

49. The Government is in favour of boards of pension trustees containing a third member-nomintated trustees (MNTs). The proposal is to remove the existing arrangement whereby schemes can opt out of having a third MNTs but also to remove the current prescription that sets out in detail how the selection system must operate.

50. The benefits of this proposal are to provide greater member involvement in more schemes, which will help to raise standards of governance and increase member confidence, and to provide more flexibility for schemes to adopt arrangements to suit their circumstances.

51. We envisage there should be financial savings for many employers and schemes. There are likely to be one-off start-up administrative costs for some schemes, but the exact amount for each scheme will depend on a number of factors including the size, and whether it already has member trustees.

52. Overall the one-off administrative costs could be in the region of £35 million across all schemes. We would of course welcome the views of businesses on these estimates. However, we envisage there will be significant ongoing savings, as schemes will not have to undertake a statutory consultation procedure, and will have more flexibility to adopt arrangements that suit their own circumstances.

53. The overall estimated savings could be in the region of £20 million a year across all schemes. **We would welcome the views of businesses on the costs of implementing the proposals and also on the overall estimated level of savings that we believe could be generated from this measure.**

Internal disputes resolution

54. At present, there is a complex and prolonged system for resolving disputes. The proposal, which would be a voluntary change, would allow trustees to choose to make the statutory internal dispute resolution procedures simpler by removing the requirement for a two-stage process. This will make the system more flexible.

55. If trustees choose to go down this route there may be one-off administrative costs if systems need to be changed. However, we believe that the simplified arrangements should reduce costs in the long term as an internal review will no longer be required and this will reduce administrative costs.

56. **The exact savings to businesses of implementing this measure will depend upon the level of demand for their dispute resolution procedures and the proportion of disputes that cannot be resolved at the initial stage.** We have not been able to estimate the administrative savings which might accrue from this proposal on its own. However, we estimate that if combined with a move to simplified contracting-out rules, easier transfers, and less prescription in relation to disclosure of information, the overall administrative savings could be £40–£80 million a year. **We would welcome views on the impact of these proposals.**

A new pensions regulator

57. The new pensions regulator is a key element in our aim to provide a more flexible approach to pensions legislation, which will be of benefit to everyone in the long run. Businesses will gain through the development of a more proactive, high profile, risk-focused regulatory regime. This should result in a reduction of unnecessary bureaucracy and better targeting of resources, for example towards quickly identifying serious problems of fraud, maladministration and bad governance, which will benefit all parties including scheme members and individuals. This new pensions regulator will also provide support to the pensions industry – including advice and guidance.

58. Opra have estimated the initial administrative costs of introducing a new pensions regulator to be in the region of £7 million. Of this £7 million, £4.5 million would be related to IT replacements that would occur in the normal course of events even if a new pensions regulator was not introduced. Assuming that the new pensions regulator is operational from 2005/06, the annual budget, which will cover running costs for the new regulator, will increase by around £3.5 million a year.

59. The 2002/03 budget for Opra is £16.9 million, so this represents an increase of around 20 per cent.[11] This would be funded through a levy on occupational and personal pensions. This proposal should not have a disproportionate impact on small- and medium-sized businesses.

Protection in the case of wind-up

60. We want to consider options that would increase members' confidence that they will receive the pension they were promised by the employer. Therefore, we are looking carefully at proposals which would:

- **share out scheme assets more fairly** than is the case at present when a scheme winds up;
- introduce a **centralised clearing house arrangement or some form of insurance** to increase support and protection for members whose scheme winds up following their employer's insolvency;
- increase the **compensation** payable in the case of fraud or dishonesty; and

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11 Excluding the OPAS (the Pensions Advisory Service) grant of £1.794 million which is included in the Opra budget each year.

- **strengthen protection** for members whose solvent employer chooses to wind up a scheme.

61. These are discussed below.

Fairer sharing of assets: rebalancing the priorities between pensioners and non-pensioners

62. Changes to the priority order would benefit one group of scheme members at the expense of other members, who would move lower down the priority order. The first option discussed in the Green Paper is to increase the priority given to people approaching retirement age or to those who had been contributing to the scheme for the longest. However, such changes to the priority order would not produce a net cost or saving, since they are about sharing out a finite amount of assets.

63. The Green Paper also discusses the option of a cap on pensions in the case of wind-up so that pensions up to a set figure remain fully protected, but the excess is put back into the fund to be shared out among non-pensioners. Again, this is about sharing out finite assets in a different way, so we envisage there are no net costs or savings.

Fairer sharing of assets: amending the priority order of creditors

64. It would be possible to give pension schemes a higher priority in the list of creditors on insolvency than at present. Pension scheme members would be the beneficiaries at the expense of business creditors. This could result in costs to business, and some creditors, previously ahead of pensions, could find themselves having to downsize or go into insolvency themselves. In addition, employers who provide defined benefit schemes could potentially face significantly increased costs if banks or firms that they trade with increase the cost of providing credit, to reflect the reduced likelihood of their being compensated should the firm become insolvent.

65. **We would welcome views on the likely costs to business of these proposals.**

Insolvent employers

66. We propose to give renewed consideration to a form of insurance or a centralised clearing house arrangement which would provide better protection for scheme members if a scheme was wound up under-funded as a consequence of employer insolvency:

- a form of centralised clearing house into which scheme members whose employer became insolvent and whose scheme is winding up could choose to pay the funds that they receive on wind-up. The clearing house might be able to negotiate better annuity rates than individual members could negotiate for themselves; and

- an insurance arrangement, such as a Central Discontinuance Fund (CDF), which would protect scheme members whose employer became insolvent. This would provide scheme members with a guarantee of a certain level of benefits. Different models would offer differing degrees of benefit replacement and guarantee. The

additional protection could be funded by, for example, a reduction in pension benefits or increased contribution rates. The cost would need to be balanced against the greater overall level of security offered.

67. **We would welcome views on these options and their potential impact.**

Improved compensation arrangements

68. A compensation scheme was established by the 1995 Pensions Act to compensate schemes where the employer is insolvent for loss caused by dishonesty. It is financed by a levy paid by occupational pension schemes. There are currently restrictions on the amount of compensation which can be paid in cases of dishonesty.

69. For defined benefit schemes, legislation restricts what can be paid to the amount needed to bring the value of the scheme's assets up to 100 per cent of its liabilities for pensioners and members within ten years of retirement, and 90 per cent of its liabilities for other members (calculated using the valuation methodology for the MFR) or, if lower, the amount of the actual loss. For defined contribution schemes, compensation is limited to 90 per cent of the loss.

70. It is proposed to enhance the current arrangements to remove these restrictions, and provide that schemes with an insolvent employer can be compensated for the full amount lost as a result of acts of dishonesty. Compensation is financed by a levy paid by occupational pension schemes.[12]

71. Broad estimates indicate that the increase in the total amount which would have to be raised by the levy might be of the order of around £10,000 a year across all pension schemes.[13] We do not consider that this measure will have a disproportionate impact on small- and medium-sized businesses. **We would welcome your views on the costs of these proposals.**

Solvent employers

72. Employers that voluntarily wind up under-funded defined benefit pension schemes would bear the costs of changes to the employer debt provisions. The costs of the illustrative options described in the technical paper could be between £200 million and £1.25 billion a year, depending on the extent to which the debt provision may be strengthened. However, costs would only actually arise if an employer chose to wind up an under-funded scheme. The illustrative options are described in the technical paper, including the detailed RIA. Because of the potential magnitude of the costs, these options would need to be considered very carefully. We will aim to ensure that we do not increase the overall burden on employers providing pensions. **We would welcome views on the impact of these proposals.**

12 Schemes pay a flat-rate levy per member.

13 However, the estimate must be regarded with caution, since it is based on the small number of cases which have come to light in the short time the existing compensation scheme has been in operation. (Compensation has been paid in only three cases.) There is no other available information on which to base an estimate, but the figure would clearly be substantially increased in the event of a large fraud.

Transfer of Undertakings (Protection of Employment) (TUPE)

73. Were the Government to extend a degree of TUPE protection for occupational pension rights to purely private-sector transfers, companies would be required to provide some degree of comparability with previous arrangements. The options under discussion would not necessarily imply business costs for actuarial certification but there could be some (modest) immediate and ongoing administration costs. These would vary on a case by case basis. **We would welcome views from all businesses (particularly small- and medium-sized ones) on the administrative costs they feel they would incur under the proposed options.**

Consulting employees about pension changes

74. The benefits of employers consulting the workforce or their representatives ahead of pension changes include encouraging individuals to take an active interest in their pension schemes. The proposal is to make such consultation a statutory requirement. This proposal, which we will consider alongside our consideration of how to implement the EC Information and Consultation Directive, could strengthen the broader partnership between employers and employees and ensure that employers are open about all changes they make to schemes, including ones that employees may perceive as detrimental.

75. The proposal would bring administrative costs across the private, voluntary and public sectors. The Government is open to innovative ideas that achieve the desired benefits without imposing unnecessary regulatory burdens. **We would welcome views on ways in which this requirement might be implemented with the minimum of administrative costs, in particular for small- and medium-sized businesses.**

Information to employees

76. This includes: providing total benefit statements for all employees showing in one annual statement the value of salary, pension and other pay and company benefits; providing information on employers contributions on employee wage slips; and including key details of an employer's pension provision in job adverts. **All of these measures are voluntary** and it will be for individual businesses to decide if they wish to implement them.

77. The common objective of all of these measures is to build on existing employer best practice to provide employees with a better understanding and appreciation of employer pensions contributions, encouraging them to value the pension package relative to other employer benefits and providing greater transparency of employer contributions. There will be some costs associated with implementing these measures, but it should be borne in mind that some employers are already implementing the above, as part of good practice.

- **Total benefit statements:** Some employers provide this information already. The set up and running costs for small and medium employers could be around £4 to £8 per annum per employee.[14] For larger employers an automated solution is likely to be preferred and we understand that typical set up costs could be in the range £25k to £60k. Running costs should however reduce to around £1 to £2 per employee.

14 Based on the assumption it takes around 15–30 minutes to clerically produce a statement.

- **Pensions information in pay slips:** Some employers provide this information already. For some employers the set up and running costs should not be significant, as the information will already be gathered as part of their payroll process. For any employers wishing to purchase a new, compliant payroll package, a typical package is £250 serving up to 100 employees.

- **Pensions information in recruitment material:** Some employers already provide this information. There are no set up or running costs.

78. We believe these measures should impact equally across the whole industry.[15] We would welcome the views of small- and medium-sized businesses on the impact of these measures on them. **We would welcome the views of all businesses on the costs that these measures may generate.**

Combined pension forecasts

79. Combined pension forecasts will help people to make informed choices about their pension provision. Feedback from a pilot scheme indicated that 98 per cent of those who received a combined pension forecast found it useful and that 31 per cent sought information about increasing their pension provision. One private pension scheme reported an increase of almost 3 per cent in the value of pension contributions after the forecasts had been issued, while another reported that 8 per cent of those who received a forecast either joined or increased their contributions to the company pension scheme.

80. Private pension providers and employers would incur costs, although many employers (particularly small companies) use a third party to administer their pension scheme. The main recurring costs will be on handling enquiries arising from the issue of forecasts. However, this is not likely to be significant for private pension providers as it is part of their core business. There are also likely to be some start-up costs for all schemes in issuing consent letters and amending or purchasing software to allow state pensions data to be handled and inserted into annual statements.

81. Estimated one-off costs for a typical pension provider requiring some IT changes could be from £10,000 to £50,000. If all schemes with more than 12 members were to make these changes, the one-off administrative cost could be around £160 million or more, but ongoing costs would be minimal. We believe these measures should impact equally across the whole industry. **We would welcome the views of businesses on these costs. We would welcome in particular the views of small- and medium-sized businesses on whether this proposal would have a disproportionate impact on them.**

Encouraging better pensions

Immediate vesting and transfer to stakeholder products

82. The proposal is to introduce immediate vesting. This will mean that as soon as someone joins a pension scheme, they start accruing pension rights which remain in place even if they leave the scheme within two years. (Currently, in many cases people who leave within two years get a refund of their own contributions but have no private pension for that period.)

15 This assumes a two-year lead-in time to allow for IT development in 'off the shelf' developments.

83. In addition, to avoid trustees having to look after small amounts of accrued pension, the proposal is to allow them to transfer *de minimis* amounts to a stakeholder pension unless the member objects or asks for rights to be transferred elsewhere. These proposals will improve the pension rights of workers who change jobs frequently.

84. Immediate vesting would increase costs if take-up of membership of pension schemes by people in short-term employment were to be high. It is difficult to estimate the effect of any potential increase in funding costs that this measure might result in. This will depend on a number of factors including current scheme rules in relation to vesting and waiting periods, and the extent of any increase in membership by new employees. There may also be increased administrative costs. Average administrative costs of maintaining rights in a pension scheme are estimated to be about £30 a year. Trustees would therefore have the option of arranging for transfers of small amounts of pension rights out of the scheme to a stakeholder scheme on the members' behalf, unless they object.

85. Where trustees decide to arrange for transfers, this is likely to involve one-off start-up costs to make changes to their systems, as well as ongoing costs associated with making these transfers. The net effect in terms of overall costs or savings for businesses is likely to vary from case to case. **We would welcome the views of businesses of all sizes on whether they feel the adoption of immediate vesting and easier transfers would result in a net saving or cost for them. In particular we would welcome information about the number/proportion of employees who leave a business's scheme each year without having their rights vested or who may currently be deterred from joining because of a two year vesting rule. We would also welcome information on the current cost of calculating a transfer value and arranging a transfer, and the extent to which those costs are charged to individuals.**

86. The effect of this measure on different individuals will vary according to their sex, age, salary progression, type of pension scheme and, crucially, the basis used to calculate the cash equivalent transfer value. We have included below an illustrative case study.

Miss Patel, aged 28, joins a company and becomes a member of the contracted-out defined benefit scheme, which has a vesting period of two years. She earns £20,000 a year, and contributes 5 per cent of her earnings into the scheme.

If she leaves the company after one year and 364 days, then at present she gets a cash refund of her contributions (after deduction of the employee share of the Contributions Equivalent Premium and net of tax) of £1,200. A Contributions Equivalent Premium is paid to reinstate her State Second Pension rights for the period.

However, if her rights had vested as soon as she joined the scheme, the total cash equivalent of her accrued rights after one year and 364 days would be £3,400. She is therefore better off, with over £3,000 invested towards her pension.

Allowing compulsory membership

87. The proposal is to allow companies to make membership of their pension scheme a condition of employment for new employees. This would be voluntary for employers. A survey carried out by the National Association of Pension Funds (NAPF) in August 2002[16] shows that 61 per cent of those surveyed answered definitely or probably yes, when asked if they would make scheme membership compulsory if given the right. Where an employer decided to make membership a normal condition of employment, it would boost pension saving for future employees.

88. Where there is no opt-out for employees, there may be administrative savings through no longer having to separate the workforce into members and non-members. However, we think there is a strong case for allowing employees to opt out where they are making alternative provision.

89. Further, each additional member is likely to add to the total pension scheme administration costs. The cost of establishing a scheme record for a new member could be in the range of £25–£100 so overall we think it is unlikely that administrative savings would result from this proposal. Also, there may be one-off additional administrative costs from allowing those with personal pension provision to opt out.

90. The net effect of the above will depend on the characteristics of the firm. The advantage of the option would be greater pension coverage among the workforce – at any one time, it is estimated that around 25 per cent of all employees with access to a pension provided by their employer do not take it up. **We would welcome estimates from business of the costs, and savings, that might arise as a consequence of this proposal.**

Employers who do not offer a pension

91. The Green Paper asks for views on a range of options that would give additional responsibilities to employers who do not run pension schemes, requiring:

- employers to provide these employees with a state pension forecast via a compulsory annual statement of entitlement, which should also include a reminder of the designated stakeholder pension which the company provides access to (this is linked to the proposals on forecasting – see above);
- employers to provide these employees on appointment and annually with the information in the 'employer pack' discussed above;
- employers to provide an annual presentation from their designated stakeholder provider or other authorised retailer on the benefits of saving for retirement; and
- employers to provide annual interviews for staff with the designated stakeholder provider or other authorised retailer to discuss their pension arrangements.

16 These are the results of a telephone survey carried out by NAPF. The intention was not to provide a comprehensive picture of the industry, but to provide a snapshot from the point of view of the scheme providers. One hundred NAPF members were interviewed; they include pension managers, administrators or other people responsible for some aspect of the scheme.

92. In terms of cost, the most expensive of these options would be the annual interviews with staff about their pension arrangements. These could be made available by financial services industry intermediaries free of any direct charge to the employer and employee, where the normal industry mechanisms for funding advice and sales administration operate, for example, where commissions are paid by the providers of the products sold to the intermediary concerned.

93. Recent proposals in the Sandler report would simplify the sales process for regulated products (like stakeholder pensions), thereby reducing the cost of the sales process. However, at present the cost of a one-hour interview might be around £100–£150 per person. **We would welcome views on the potential cost of these proposals.**

Myners' recommendation to ensure trustee familiarity with relevant issues when making investment decisions

94. In his report on institutional investment, Paul Myners recommended that steps should be taken to ensure that trustees were more familiar with the issues surrounding investment decisions and, accordingly, were able to ask the right questions of their advisers. We will seek views from pensions practitioners on the level of expertise required.

95. An increased emphasis on training would have administrative implications for pension schemes, and possibly employers. The level of cost will not only vary with the size of the pension scheme, but will also differ depending on the level of expertise that trustees currently possess.

96. Based on assumptions set out below, we estimate that this proposal could result in a cost per scheme of £250 and a total cost of £17 million over a three-year period across all schemes. This is based on the following assumptions:

- an investment management trainer costs £2,500 per day;
- that there would be an average of 20 people on each course;
- that each trustee would require two days of training; and
- that only one trustee is trained per scheme.

97. However the proposal would be expected to improve investment performance. It is difficult to estimate the extent of these improvements, but if performance increased by 0.05 per cent, costs would be reduced by £350 million for employers[17]. **We would welcome your views on both the costs and the impact of this proposal for small- and medium-sized businesses.**

17 Assuming this leads to an improvement in investment performance of 5 basis points (0.05 per cent) on the £683 billion under control of the pension trustees.

Myners' recommendation that there should be an activist duty on those responsible for the investment of pension scheme assets

98. This measure will be taken forward by the investment industry through a **voluntary** statement of principles. There could be unquantifiable benefits for schemes and their beneficiaries in the longer term through better returns. However, there are also likely to be some additional administrative costs.

Competition assessment

101. We have assessed the impact of all the proposals in this Green Paper and judge that as a package, they will not have a significant impact upon competition. One of the main objectives of this Green Paper is to simplify the regulatory framework around private pensions. **We would appreciate comments on whether there may be any unintended effects upon competition within the financial services industry from any proposals highlighted within this RIA.**

Annex 3: Public pension spending, the long-term sustainability of public finances and the challenges to economic growth

Public pension spending and the long-term sustainability of public finances

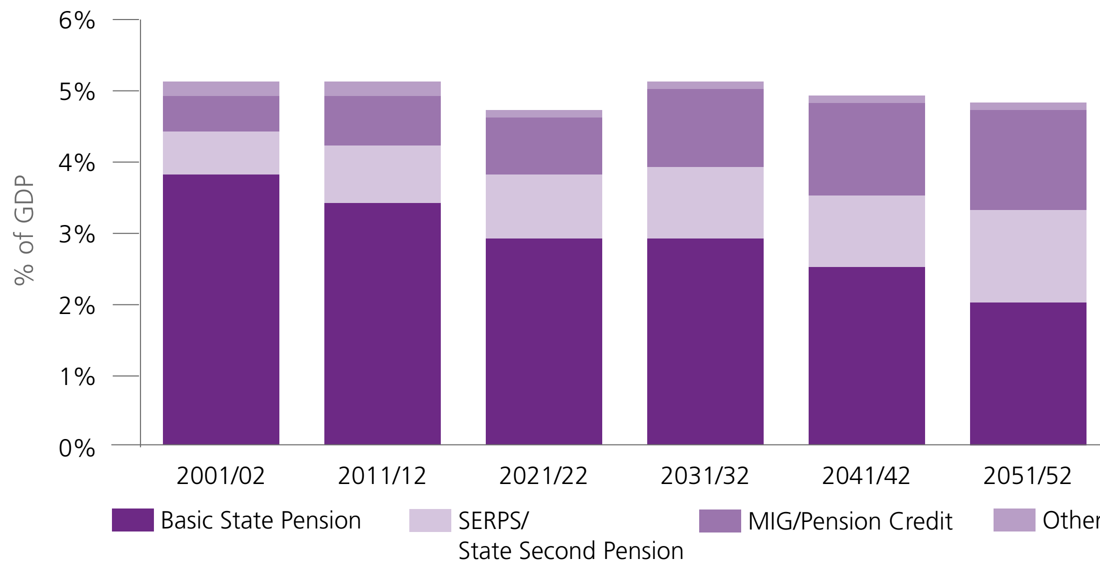
1. The Government believes that sustainable public finances are a prerequisite to achieving stable long-term economic growth.

2. In November 2002, the Government presented the *Long-Term Public Finance Report*[1], which provides a comprehensive analysis of long-term economic and demographic developments, and their likely impact on the public finances. The report shows that the public finances are sustainable in the long term.

3. Figure A3.1 shows projected total spending on public pensions, and a breakdown of the total, at ten-year intervals, up to 2051/52. The projections are based on current policies and on specific assumptions listed below. The latter have been updated slightly compared to those underlying the projections in the 2002 Pre-Budget Report. Total public pension spending is projected to remain relatively stable over the next five decades, fluctuating around 5 per cent of Gross Domestic Product (GDP).

1 *Long-Term Public Finance Report: an analysis of fiscal sustainability*, HM Treasury, November 2002.

Figure A3.1: A detailed breakdown of pension spending



Sources: HM Treasury, Department for Work and Pensions.

4. Aggregate spending on the basic State Pension, as a proportion of GDP, is projected to fall gradually over time, except for the period between 2021 and 2031 when the 'baby-boom' generation reaches retirement age. This gradual decline reflects the assumption that over the long term, the basic State Pension is indexed to prices. However, this decline is more or less offset by higher spending on the Minimum Income Guarantee (MIG) and the Pension Credit, and State Earnings-Related Pension Scheme (SERPS) and the State Second Pension. Other pension spending, which comprises Winter Fuel Payments and TV licences for people aged 75 and over, is projected to decline as a share of GDP over the coming decades.

5. As with any long-term projection, these results should be interpreted with care. There are large uncertainties surrounding the assumptions used, and when projecting over such a long period relatively small changes in assumptions can significantly affect spending profiles.

6. The key assumptions used in these projections are set out below.

- **Demography** – changes in the size of the pensioner population have been modelled using demographic projections provided by the Government Actuary's Department (GAD). Specifically, the interim 2001-based projection has been used. This was a revision of the 2000-based projection, and is informed by 2001 Census data.

- **State Pension age** – from 2010 to 2020 the State Pension age for women will rise from 60 to 65. In each year shown, spending on the basic State Pension, SERPS and the State Second Pension is only made to those above State Pension age. From 2020, the Pension Credit is assumed payable to those above the age of 65. Up to 2020, the guarantee credit is assumed payable from the State Pension age for women.

- **Inflation** – prices are assumed to increase at a rate of 2.5 per cent a year in all years beyond 2007/08. Up to 2007/08, the assumptions for inflation are consistent with those used in November 2002 Pre-Budget Report (Cm 5664, Table B3).

- **Basic State Pension** – the basic State Pension is assumed to rise by the greater of 2.5 per cent or prices each year in the medium term, that is up to 2007/08, and by 2.5 per cent each year thereafter.

- **The State Second Pension** – the State Second Pension is assumed to retain its current structure.

- **The Pension Credit** – in all years from 2003, the guarantee credit (formerly the Minimum Income Guarantee) is uprated in line with average earnings and the savings credit threshold is uprated in line with prices. On average, income brought to account in the Pension Credit is assumed to rise in line with average earnings. In all years for which data is shown, except 2001/02, caseload take-up of MIG and the Pension Credit is assumed at 80 per cent. Projected spending on the Pension Credit would be about 0.3 per cent of GDP higher by 2050 under an assumption of 100 per cent take-up.

- **Other pension spending** – Winter Fuel Payments are assumed to remain at their current level of £200. The TV licence fee is assumed to increase in line with prices.

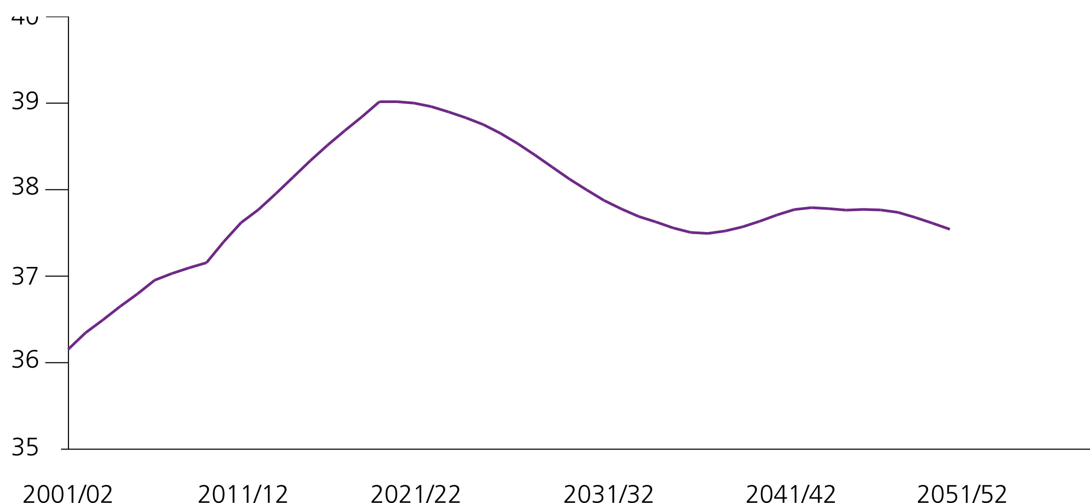
- **Growth of GDP** – real GDP growth is driven by changes in employment and productivity. For the projections it is assumed that the overall employment rate remains unchanged from 2007/08 onwards. This implies that changes in employment are entirely due to changes in the size of the working-age population. These are derived using GAD's 2001-based projections. Productivity is assumed to grow at 2 per cent a year from 2007/08 onwards. Average real earnings are assumed to grow in line with productivity. Up to 2007/08, the assumptions for GDP growth are consistent with those in the 2002 Pre-Budget Report. The impact of demographic trends on long-term economic growth is discussed in greater detail below.

7. The Government will continue to evaluate all future pension policy proposals in the light of their implications for fiscal sustainability.

The challenges to economic growth

8. Regardless of the form of pension system, all developed countries face the long-term challenges to economic growth arising from the demographic and employment trends outlined in **Chapter 2**. This is because an economy's output is determined by the number of workers and their productivity. Figure A3.2 shows the projected evolution of the UK population of working age over the next five decades.

Figure A3.2: Projected working-age population (UK)



Source: Government Actuary's Department 2001-based interim principal projections.

9. Everything else being equal, the projected increase in the working-age population up to 2020 will help to increase the rate of growth of GDP in these years. The projected decline between 2020 and 2035 will act as a drag on economic growth. After 2035, the specific impact of projected changes in the working-age population on GDP growth are likely to be small. The projected average growth rates for the coming decades are summarised in Figure A3.3.

Figure A3.3: Projected real GDP growth and its components

Year	2011–2020	2021–2030	2031–2040	2041–2050
Productivity	2.00%	2.00%	2.00%	2.00%
Employment	0.25%	–0.25%	0.00%	0.00%
Real GDP	2.25%	1.75%	2.00%	2.00%

Source: *Long-Term Public Finance Report: an analysis of fiscal sustainability,* HM Treasury, November 2002.

10. In the UK and elsewhere, measures of the dependency ratio are very sensitive to underlying assumptions on life expectancy, fertility rates and net migration. It has been thought that increased net migration could help to mitigate the rise in the old-age dependency ratio, as long as the migrant population is mainly of working age. Such factors may well be helpful to an economy with an ageing population, but the scale of expected net migration, at least in the UK, is unlikely to be sufficiently large to significantly reduce the dependency ratio.

Annex 4: Retirement saving behaviour

1. This annex outlines the analysis carried out to estimate the extent to which working-age people may be under-saving for retirement. The extent of individual and aggregate under-saving will depend on the amount of income people want for retirement. The Government does not believe it should seek to prescribe the levels of future pensioners' incomes – this is a matter for individual choice. However, we can use broad-brush assumptions, including a range of possible outcomes that individuals might want to achieve, to make an indicative assessment.

How much retirement income do people want?

2. It is reasonable to assume that in planning for their retirement, most people will compare their projected living standard in retirement to that enjoyed during their working life. Therefore, one measure of whether or not an individual is making sufficient retirement provision is the ratio of pension income to final earnings (the 'earnings replacement rate'[1] that a given level of pension income will provide).

Estimates of replacement rates

3. To assess the replacement rate that current pensioners have, on average, we have compared the average incomes of recently retired couples and single people with those approaching retirement[2]. This is a proxy measure because we do not have data on earnings of current pensioners over their lifetimes. Using this measure, the estimated gross replacement rate of both single pensioners and couples is approximately 63 per cent.

4. The difference between net and gross replacement rates reflects tax and National Insurance contributions. Net replacement rates exceed gross replacement rates because pensioners are no longer liable to pay National Insurance contributions after the State Pension age, even if they remain in employment. Pensioners also benefit from higher personal tax allowances and may have moved down to a lower marginal tax rate when they retire. For someone on final earnings of £20,000, a two-thirds gross replacement rate would be equivalent to a net replacement rate of nearly 80 per cent, while a 50 per cent gross replacement rate would be equivalent to a 62 per cent net replacement rate.

5. For the purposes of this analysis, we have used gross replacement rates to calculate the likely replacement rates of current pensioners and to estimate the possible degree of under-saving by future pensioners.

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1 Throughout the analysis in this annex, calculations of replacement rates are based on gross pension income as a proportion of gross final earnings. Entitlement to income-related benefits, including the Pension Credit, is included on both sides of the ratio.

2 The pre-retirement group consists of people up to five years either side of State Pension age, who are still working. The post-retirement group are people who are up to five years either side of State Pension age who consider themselves to be retired. The sample was drawn from the *Family Resources Survey,* 1999/00.

6. Given that there is no 'right' replacement rate, we have considered two benchmarks in our analysis of under-saving – two-thirds of final gross earnings (similar to the replacement rates of current pensioners) and half of final gross earnings.

7. Individuals' preferences will vary. Benchmark replacement rates of half and two-thirds provide us with a range that seems likely to reflect the majority of individual desired outcomes.

How much are people actually saving?

8. The amount that people save tends to vary over their lifetime. Typically, those who are young and many of those who are retired will borrow or run down savings, while people are likely to save most in their 40s and 50s when their earning potential is highest and they may not have to support their children. Also, individuals' saving patterns will be influenced by movements in and out of the labour market. These factors highlight the need to look at individuals' pattern of saving over several years, rather than taking a snapshot at one point. Unfortunately, we lack detailed longitudinal data which would enable us to map the pattern of retirement savings.

9. Any attempts to measure the levels of saving for retirement also require us to decide whether to measure retirement provision of individuals or households. Both methods provide useful insights into savings behaviour, but when looking at individuals it is important to note, for example, that where an individual is not seen to be saving in a pension, he or she may have a partner who has a pension and they may be planning to pool their resources in retirement.

10. To get as accurate a picture as possible of under-saving we have matched data from the *Family Resources Survey* (FRS), 2000/01, which has information at a point in time, and the *British Household Panel Survey* (BHPS), which has information on a sample of individuals over nine years (1992–2000 inclusive). The BHPS has also been used to assess the extent of other assets, including housing wealth.

11. The FRS provides good cross-sectional data on income. The FRS collects data from a sample of about 24,000 households in Great Britain each year. Its primary function is to collect information on the resources of households, that is, income received from all sources including wages and salaries, state benefits and tax credits, private (occupational and personal) pension schemes and investments.

12. The FRS shows how many people at different income levels are saving in a pension and whether this is an occupational or personal pension. However, it does not provide data on: total contributions to a pension; the size of accrued pension rights; and the number of years people have been saving. It provides some data on financial assets but does not cover the value of housing wealth or debt.

13. From the FRS, we have estimated the pension coverage of **employees and the self-employed** by annual earnings in that year. The summary results are presented in Figure A4.1.

Figure A4.1: Private pension provision by earnings

	Annual earnings			
	Under £10,000	£10,000 to £22,000	Over £22,000	All
Number in each earning band (millions)	7.8	10.7	6.8	25.3
No private pension	5.6	4.4	1.1	11.1
Occupational pension	1.5	4.8	4.5	10.8
Personal pension	0.7	1.5	1.2	3.4

Source: *Family Resources Survey*, 2000/01.

Notes: Figures relate to all employed and self-employed people of working age.
Numbers rounded to nearest 100,000.

The main characteristics of non-pension savers

14. Figure A4.1 shows the estimated number of people building up private pension rights at a given point in time.

15. As shown above, almost half of those without a private pension are low earners. If they were persistent low earners, the State would provide them with relatively high replacement rates in retirement.

16. According to the FRS, other important characteristics of employees and the self-employed who are not saving in a pension are that:

- they are split evenly between men and women. However, two-thirds of the low earners without private pensions are women;
- a third are working part time. Many people in part-time work are not members of occupational pensions and/or cannot afford to save privately; and
- around a third of all non-pension savers are young (aged under 30) and therefore are likely to save later in life.

Savings behaviour over time

17. Those without private provision in a given year may, of course, save in the future or have saved in the past. Over time, people move in and out of private pension saving and between different types of pension products.

18. The Institute for Fiscal Studies (IFS)[3] has analysed individuals in employment in the 2000 wave of the BHPS, and has compared the characteristics over the period 1992–2000 of those who did, and those who did not have a private pension in 2000. This sample is quite different to the FRS because it is restricted to those individuals who stayed in the survey for the full nine years.

3 *Retirement, Pensions and the Adequacy of Saving: A Guide to the Debate*, IFS Briefing Note No. 29, October 2002.

19. The key findings are as follows.

- Many moderate earners not saving in 2000 have saved in earlier years: 56 per cent of moderate earners who did not save in 2000 had saved at some point in the period 1992–1999 and they had saved for an average of four years.
- Under-saving may therefore be more closely related to lack of persistence in saving rather than a reluctance to save at all. Those middle-earners who had pensions in 2000 had saved for an average of 6 of the 9 years.
- Those not saving in pensions often had interrupted work records: 48 per cent of middle-earners without a pension in 2000 had experienced a period of unemployment during 1992–1999. This is twice the average of those with a pension in 2000. People with interrupted work records were more likely to have faced lower earnings and been unable to afford to save.
- 49 per cent of low earners and 32 per cent of moderate earners not paying into a pension in 2000 had a partner who was. These couples may be planning to pool their resources in retirement.
- People under 35 were less likely to be saving in a pension: Among moderate earners, 30 per cent of 25–34-year-olds did not have a pension in 2000, whereas among 35–49-year-olds, the figure was only 18 per cent.
- Many non-savers are women (70 per cent). Of non-savers with low earnings, 91 per cent are women.

Saving in other assets in 2000

Financial wealth

20. The IFS has also carried out analysis of the BHPS to help understand the distribution of non-pension assets[4]. Its analysis shows that the distribution of financial wealth aside from pensions is very unequal. Figure A4.2 shows that a quarter of the population has negative net financial wealth, whilst the top quartile has over £9,050 of net wealth. Financial wealth tends to increase with age, education and income.

Figure A4.2: The distribution of wealth in 2000

Income decile	Savings	Investments	Debt	Net financial wealth
10th	£0	£0	£0	–£4,248
25th	£1	£0	£0	–£200
50th	£1,000	£0	£0	£600
75th	£6,000	£2,000	£2,000	£9,050
90th	£18,000	£15,000	£6,500	£35,000
Mean	£7,005	£7,445	£2,087	£12,363

Sources: IFS and BHPS.

4 *The Distribution of Financial Wealth in the UK: Evidence from 2000 BHPS Data*, IFS Working Paper 02/21, November 2002.

Figure A4.3 Individual characteristics from 1992–2000, by earnings level and pension choice in 2000, individuals aged 25 to 59 only

Pension status in 2000	No private pension in 2000				Has private pension in 2000				
Earnings level in 2000	Low	Middle	High	All	Low	Middle	High	All	**All**
% in each earnings/pension category	14.1	10.4	2.1	26.6	10.8	36.3	26.4	73.4	**100.0**
% never a member of a private pension	68.3	43.6	26.0	55.3	0.0	0.0	0.0	0.0	**14.7**
% occasionally member of a private pension	31.7	56.4	74.0	44.7	73.7	45.6	24.8	42.2	**42.9**
% always a member of a private pension	0.0	0.0	0.0	0.0	26.3	54.4	75.2	57.8	**42.4**
Average periods with private pension	1.0	2.3	3.2	1.7	6.1	7.4	8.2	7.5	**6.0**
% experiencing a period out of employment	64.2	48.4	38.0	56.0	38.6	23.8	12.8	22.0	**31.0**
Average periods in employment	6.7	7.5	8.1	7.1	8.1	8.5	8.7	8.5	**8.1**
Median earnings when employed	£5,236	£13,017	£21,635	£9,018	£7,151	£15,341	£26,978	£17,876	**£15,378**
% occasional low earner	71.6	54.8	20.0	61.0	65.6	31.7	5.2	27.2	**36.1**
% occasional high earner	4.1	18.4	78.0	15.5	3.5	28.6	50.8	32.9	**28.3**
% who are owner occupiers (outright)[1] in 2000	13.0	12.0	12.0	12.1	19.3	11.6	10.3	12.2	**12.2**
% who are owner occupiers (mortgage)[1] in 2000	52.7	47.2	76.0	52.4	64.1	70.0	81.4	73.2	**67.7**
Median financial wealth[2] in 1995	£300	£300	£1,140	£400	£2,000	£1,400	£4,010	£2,028	**£1,500**
% with <£1,500 in financial assets[2] in 1995	65.4	64.8	52.0	64.1	46.3	50.4	33.4	43.7	**49.1**
Sample size	**338**	**250**	**50**	**638**	**259**	**871**	**634**	**1,764**	2,402

Source: IFS calculations using data from BHPS, 1992–2000.

Notes: Includes individuals in paid employment or self-employment in wave 10 who were aged 25 to 59 (inclusive) and present in waves 2 to 10 of the BHPS.
Care should be taken with the column of high earners who do not have a private pension since the sample size is very small.
[1]Owner-occupier applies to the individual and, where relevant, his or her partner. Earnings over time have been deflated using an average earnings index.
[2]Financial wealth refers to savings and investments and excludes pension wealth and any debts held by the individual or the individual and their partner.

Housing assets

21. The IFS has also looked at the extent to which people have other forms of savings or assets, notably housing wealth, which they may draw on in retirement. Figure A4.3 shows that among middle-earners without pensions, 12 per cent already own their own homes outright and a further 47 per cent are owner-occupiers with mortgages. The BHPS also provides some information on the value of these properties.

22. Housing might provide a limited source of income in retirement, either through moving to a smaller property or through equity release. Equity release enables people to gain access to the equity in their home without moving – this is discussed in **Chapter 5**.

23. Home ownership increases with people's age. Figure A4.4 shows that only 21 per cent of people aged 35–59 do not own their own home, compared with 61 per cent of those aged under 35.

24. The vast majority of people aged 35–59 (around 90 per cent) have a pension or some housing wealth, but we cannot measure the extent to which housing may provide a partial substitute for pension wealth.

25. The Office for National Statistics (ONS) recently reviewed its pension contribution statistics. This review highlighted a number of new data sources that are currently planned or under way, including a survey of assets and wealth. As this Green Paper makes clear, it is essential to develop good-quality data about people's saving over time; their assets; and the savings and assets of partners. We will be considering how we can gather such data.

Figure A4.4: Correlation between housing wealth and pension status in 2000

		Percent of age group with each combination			
		Not an owner occupier	House value <£100,000	House value >£100,000	All
Aged under 35	No private pension	35.8	4.3	3.7	43.8
	Has private pension	24.8	9.4	22.0	56.2
	All	**60.6**	**13.7**	**25.7**	**100.0**
Aged 35 to 59	No private pension	9.6	4.9	6.3	20.7
	Has private pension	11.6	14.9	52.8	79.3
	All	**21.2**	**19.8**	**59.1**	**100.0**
All	No private pension	21.3	4.6	5.1	31.0
	Has private pension	17.5	12.5	39.0	69.0
	All	**38.8**	**17.1**	**44.2**	**100.0**

Sources: IFS and BHPS.

An assessment of under-saving

26. To produce an indicative assessment of retirement under-saving we matched the data from the Family Resources Survey on private pension provision by earnings with information from the BHPS over time. We restricted the analysis to people earning over £10,000 but included both employees and the self-employed. There are 17.5 million people in this category. From these two sources, we identified four main types of savings behaviour:

    - 2.2 million non-savers (saving in none of the years);
    - 3.3 million occasional savers (saving in four out of nine years);
    - 4.3 million frequent savers (saving in six out of nine years); and
    - 7.7 million constant savers (saving in all of the years).

27. The BHPS showed that half of the people in the bottom two categories of savers had partners who were saving more. Conversely, a third of those in the top two categories had partners who are saving less. Therefore, we looked at the total level of savings in a partnership, resulting in a reduction in the variation of replacement rates.

28. Choosing the most appropriate assumption to make about the role of non-savings assets is particularly difficult since, as discussed above, the most significant non-pension asset that people hold is their home. It is far from clear how far housing assets can or will be released to help fund retirement income. Other non-pension assets are expected to be of relatively low value as a source of retirement income compared to pension assets. Therefore, we have assumed that, for those people with significant assets in retirement, these assets would make up only 5 per cent of the total replacement rate. Significant assets were assumed to be held by a fifth of future pensioners.

29. Combining these assumptions and information on savings over time, we have estimated that, on current trends, around 3 million people could be seriously under-saving for retirement, retiring too soon, or both. We have defined this as having expected replacement rates of under 50 per cent in retirement.

30. Depending on people’s expectations in retirement and their circumstances, we estimate there could be a further 5 to 10 million people with estimated replacement rates at the lower end of our range of a half to two-thirds. This group might wish to alter their savings behaviour to improve their replacement rates. For example, if individuals increased their savings rates by around 1 per cent to 2 per cent, and this was matched by their employers, then many of this group would raise their replacement rates towards the upper end of the benchmark range. Or they might wish to work slightly longer to improve their income in retirement.

31. Although we cannot arrive at a definitive assessment on the scale of under-saving, we conclude that there is a small but significant minority of serious under-savers. The great majority of the working-age population is either saving enough already or would have to make relatively small changes to their working and savings patterns to achieve replacement rates that are quite high up our benchmark range.

Annex 5: Assumptions underlying the analysis

1. The following assumptions were used to generate Figures 2.7, 2.8, 3.1 and 6.1. Not all the assumptions were needed in all figures.

2. In making projections, it is necessary to make a large number of assumptions about the evolution of many variables, such as earnings growth and investment returns. Here it is assumed that the rates and limits of the tax and benefit systems continue to be uprated according to the rules currently in place, or already announced. A full list of the specific assumptions made is given below.

Price and earnings growth, and the rate of return

- Price growth of 2.5 per cent a year from 2002/03.
- Real earnings growth of 2 per cent a year from 2002/03 (equivalent to nominal earnings growth of 4.55 per cent).
- Rate of return on savings above earnings of 2 per cent a year from 2002/03 (equivalent to nominal rate of return of 6.55 per cent).

Labour market behaviour

- Earnings are expressed in 2002/03 earnings terms.
- Earnings are assumed to increase in line with average earnings. Such a working life is not assumed to be representative of any particular person in the real world. However, someone described as earning below £150 a week in all years could be considered indicative of a low earner, and someone earning above £600 a week a high earner.
- Working life assumed to start at age 16 and in general continue uninterrupted until State Pension age.
- Where an individual is assumed to retire at an age older than the State Pension age, their total income after State Pension age, which comprises earnings and state pensions, has the same earnings value as their total earnings pre-State Pension age.

Savings behaviour

- Saving assumed to take place in stakeholder-type product, characterised by 1 per cent annual charge on the fund value.

- Contributions are made at the start of each financial year and are continuous (excluding career breaks) up to point of retirement.
- Rate of saving expressed in gross terms, unless otherwise stated, such that a rate of saving of x per cent implies that money flowing into fund is x per cent of gross earnings in that year, and this flow includes any tax relief. Or, alternatively, that a level of saving of £x a week includes tax relief.
- Levels of saving, such as £x a week, are expressed in 2002/03 earnings terms and are assumed to increase in line with average earnings.
- Full 25 per cent tax-free lump sum assumed taken on all private pensions.

State pensions

- Basic State Pension uprated by the higher of price growth or 2.5 per cent per annum from 2002/03.
- State Pension age for women is assumed to increase from 60 to 65 from 2010 to 2020.
- State Second Pension is assumed to retain its current structure.
- State Pension is assumed to be taken at the State Pension age.

Income-assessed benefits

- The Pension Credit uprated as described by scenario 1 in *The Pension Credit: Long-term Projections* such that guarantee credit (formerly the Minimum Income Guarantee) is uprated in line with earnings and the savings credit threshold is uprated with prices.
- The Pension Credit entitlement is calculated out of post-tax retirement income.

Tax rules

- All allowances and limits for tax and National Insurance uprated with prices from 2003/04 except the age-related personal allowances, which are uprated by earnings until the end of this Parliament (2006/07) and thereafter by prices.

Presentation of results

- Results are presented in 2002/03 earnings terms. This means that income in future years is deflated by earnings growth to show the movement relative to average earnings. This gives a better indication of the relative value of the future pensioner income in comparison to average earnings.
- Replacement ratios are expressed in gross terms. In other words, they describe gross retirement income as a proportion of gross pre-retirement income.

Annuity rates

- Annuity rates as per the Annuity Bureau website at 6 November 2002 and assumes that these do not change over time.
- The modelling assumes level annuities have been taken out.

Annex 6: Contact details for organisations providing information on pensions

Department for Work and Pensions

Website: **www.dwp.gov.uk**
Telephone: 020 7712 2171

The Department for Work and Pensions offers information on the state and private pension systems on its website and through a series of information leaflets. Questions about State Pension entitlement should be addressed to The Pension Service.

The Pension Service

Website: **www.thepensionservice.gov.uk**

The Pension Service is the Executive Agency of the Department for Work and Pensions that administers the State Pension scheme, including the basic State Pension, the State Earnings-Related Pension Scheme (SERPS), the State Second Pension and the Minimum Income Guarantee. It offers state pension forecasts and information on pensions through leaflets and on its website.

Local contact details for The Pension Service can be found in the phone book or on the website.

Inland Revenue

Website: **www.ir.gov.uk**

The Inland Revenue is responsible for giving tax relief on contributions made to pension schemes. It is also responsible for administering the system of contracting out of the State Second Pension.

Inland Revenue Enquiry Centres are the first point of call for taxation queries – their details can be found in the phone book or on the website.

Questions about contracting out of the State Second Pension can be answered by National Insurance Services to the Pensions Industry, a directorate of the National Insurance Contributions Office.

National Insurance Contributions Office
Services to Pensions Industry
Chillingham House
Benton Park View
Benton Park Road
Longbenton
Newcastle Upon Tyne
NE98 1ZZ

Telephone: 08459 150150

Or, in Northern Ireland:

National Insurance Contributions Office (Northern Ireland)
24–42 Corporation Street
Belfast
BT1 3DP

Occupational Pensions Regulatory Authority (Opra)

Website: **www.opra.gov.uk**
Opra Helpdesk: 01273 627600

Opra was established by the Pensions Act 1995 and began operating in 1997. Its role is to protect the interests of occupational pension scheme members by ensuring that schemes comply with the relevant legislation. Trustees and scheme professionals are required to report instances of non-compliance to Opra for investigation. Opra also regulates some aspects of stakeholder pensions, including holding a register of approved schemes, and supervises employers who make employer or employee contributions to personal pension schemes.

Opra is also responsible for maintaining the Pension Schemes Registry, which provides a free pension scheme-tracing service to members of the public.

The Pension Schemes Registry
PO Box 1NN
Newcastle upon Tyne
NE99 1NN

Telephone: 0191 225 6316

The Pensions Advisory Service (OPAS)

Website: **www.opas.org.uk**

The Pensions Advisory Service is a non-profit organisation which seeks to help any member of the public who has a problem, complaint or dispute with their occupational or private pension arrangement.

OPAS
11 Belgrave Road
London
SW1V 1RB

Telephone: 08456 012923

Financial Services Authority (FSA)

Website: **www.fsa.gov.uk**

The FSA regulates the financial services industry in the UK. It is responsible for maintaining confidence in the UK financial system, promoting public understanding of the financial system, securing the right degree of protection for consumers and helping to reduce financial crime. It produces comparative tables and decision trees to help people choose savings products.

Financial Services Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

Telephone: 08456 061234

Citizens Advice Bureaux

Website: **www.nacab.org.uk**

Citizens Advice Bureaux are often able to offer money advice. Local contact details can be found in the phone book or on the website.

National Association of Citizens Advice Bureaux
Myddelton House
115–123 Pentonville Road
London
N1 9LZ

Annex 7: Consultation criteria

All UK national consultations are governed by the Government's Code of Practice on written consultation. The Code is intended to improve the effectiveness of written consultation and give a wide range of people and organisations access to the decision-making process. The Code is built around seven criteria.

1. Timing of consultation should be built into the planning process for a policy (including legislation) or service from the start, so that it has the best prospect of improving the proposals concerned and so that sufficient time is left for it at each stage.
2. It should be clear who is being consulted, about what questions, in what timescale and for what purpose.
3. A consultation document should be as simple and concise as possible. It should include a summary, in two pages at most, of the main questions it seeks views on. It should make it as easy as possible for readers to respond, make contact or complain.
4. Documents should be made widely available, with the fullest use of electronic means (though not to the exclusion of others) and effectively drawn to the attention of all interested groups and individuals.
5. Sufficient time should be allowed for considered responses from all groups with an interest. Twelve weeks should be the standard minimum period for a consultation.
6. Responses should be carefully and open-mindedly analysed and the results made widely available, with an account of the views expressed and reasons for decisions finally taken.
7. Departments should monitor and evaluate consultations, designating a consultation co-ordinator who will ensure the lessons are disseminated.

If you have any comments, suggestions or complaints about the way in which this consultation exercise has been conducted, please contact the Departmental Consultation Co-ordinator:

Geoff Ashton
Department for Work and Pensions
Consultation Co-ordinator
5th floor South
1 Trevelyan Square
Leeds
LS1 6EB

Telephone: 0113 232 7107
Fax: 0113 232 7221
Email: geoff.ashton@dwp.gsi.gov.uk

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