A new contract for welfare: PARTNERSHIP IN PENSIONS

Cm 4179

SOCIAL SECURITY 50 YEARS
CELEBRATING THE PAST
LOOKING TO THE FUTURE

A new contract for welfare: PARTNERSHIP IN PENSIONS

Presented to Parliament by
the Secretary of State for Social Security
by Command of Her Majesty
December 1998

CELEBRATING THE PAST
LOOKING TO THE FUTURE

Cm 4179

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Contents

Foreword

from the Prime Minister

Welfare reform is a crucial part of our programme to build a modern and fair society.

Our welfare reforms are more ambitious and far-reaching than any since the Second World War. We are making work pay, through the minimum wage, the Working Families Tax Credit. The New Deal is helping people back into work – long-term youth unemployment is down almost 40 per cent since the election.

And we have taken tough decisions, such as reform of student finance to put universities on a secure footing and raise the number of university places.

We have proposed reforms to disability and bereavement benefits to bring more help to those with the greatest needs. Changes to benefits for single parents, to bring them into line with those for couples. The largest-ever rise in Child Benefit. Reform of the Child Support Agency. Changes to legal aid to increase access to justice. A renewed campaign against benefit fraud.

This Green Paper sets out our plans for radical reform of the whole pension system, to rebuild trust and ensure that everyone can look forward to a secure retirement.

We are building a new contract for pensions between the State, the private sector, and the individual. We believe that those who can save for their retirement have the responsibility to do so, and that the State must provide effective security for those who cannot.

Our partnership approach will deliver:

- **an assurance of a secure and decent income in retirement for all through the new minimum income guarantee. This will be increased year by year as resources allow. Over the longer term our aim is that it should rise in line with earnings so that all pensioners can share in the rising prosperity of the nation;**
- **dramatically better pension provision for those on low incomes, and those unable to work because they are caring for children or a relative who is ill or disabled; and**
- **a better deal for middle and higher income earners through low-cost and flexible personal stakeholder pension schemes backed by extra Government support and better regulation of pensions as a whole.**

These reforms mean that the total income of pensioners will rise in years to come, mainly fuelled by rising private contributions. Public spending on pensions will rise too in real terms, but less sharply, and will fall as a proportion of national income. This will ensure that the pension system remains both fair and affordable.

This is our New Insurance Contract for pensions. This Contract will deliver the security we all want, now and for the future.

Tony Blair

Prime Minister

Summary

Our commitment to reform

1 The Government is reforming the welfare state, based on the principle of work for those who can and security for those who cannot.

2 Pensions are all about security. We all want to be able to retire on a decent income, and as we live longer and healthier lives, we want to be able to save more, so we can make the most of our retirement.

Today's pensioners

3 Our proposals for pension reform are designed to ensure that tomorrow's pensioners can retire in security. Today's pensioners stand to benefit from these and other welfare reforms.

- **A minimum income guarantee for all pensioners.**
- **Almost £1 billion for Winter Fuel Payments over this Parliament.**
- **Free eye tests.**
- **New travel concessions on public transport.**
- **An extra £21 billion for the NHS to raise standards and cut waiting lists further.**

4 We are also working hard on other issues which matter to older people, such as long-term care and reform of social services.

5 But for future pensioners, the pension system we inherited – public and private – will not guarantee a decent income in retirement for everyone. On the contrary, it risks leaving up to a third of future pensioners facing poverty.

6 That is why pension reform is essential. That is why we need a **New Insurance Contract** for pensions.

Our New Insurance Contract for pensions

- **An assurance of a secure and decent income in retirement for all, through the new minimum income guarantee which will be increased year by year as resources allow. Over the longer term our aim is that it should rise in line with earnings so that all pensioners can share in the rising prosperity of the nation.**
- **Reforming state and private pensions so that far more people can retire with more than the minimum income guarantee.**
- **Dramatically better pension provision for those earning less than £9,000 a year, and those off work who are caring for young children, ill or disabled relatives, or who are ill or disabled themselves, through the introduction of a new State Second Pension (replacing the State Earnings Related Pension Scheme [SERPS]), building on the basic state pension.**
- **A better deal for middle and higher earners – from £9,000 a year upwards – through new low-cost and flexible stakeholder pension schemes backed by extra Government incentives to save, and better regulation of the pensions sector as a whole.**

Pensions today

7 Over the last 30 years, pensioners' average incomes have risen faster than the average incomes of those in work. This shows that the public sector, through the basic state pension and, since 1978, through SERPS, together with the private sector through occupational schemes and personal pensions, can deliver for pensioners.

8 But this story has a darker side. The 1980s saw the breaking of the link between rises in the basic state pension and average earnings; a reduction in the benefits which those contributing to SERPS will see; the Maxwell affair; and the scandal of millions of people being mis-sold personal pensions. People lost faith in all parts of the pension system.

9 Despite the welcome rise in average pensioner incomes, a large number of pensioners still live in poverty. The basic state pension alone does not provide security in retirement. Those who earn little or nothing will never be able to add to it. Those on very low incomes can save through SERPS all their working lives, and still need income-related benefits in retirement. This means they gain nothing from their years of saving. This is because SERPS, being earnings-related, gives least to those in greatest need.

10 Unless we change our pension system, many more people will retire into poverty. But if we reform it, building on its strengths, then we can all face retirement in security. This means everyone recognising their responsibilities.

- **Those who are able, should save what they can for their retirement.**

- **The Government should support those who cannot save and regulate the pension system effectively.**

- **The private sector should provide affordable and secure second pensions.**

11 We are building a new partnership to deliver security for future pensioners.

Delivering our New Insurance Contract

12 We believe that those who can, should save for their retirement, and that the State should provide greater security for those who cannot. Although people's ability to save will vary, we believe that, once our reforms are in place, those earning more than about £9,000 a year (£180 a week) will be better off saving through a funded second pension.

13 We will provide extra help to those on middle incomes (£9,000 – £18,500 a year) which will, for an interim period, be available to those in our new State Second Pension and those in private pensions alike. Once stakeholder schemes have established themselves as low-cost, value-for-money second pensions, we expect in about five years time, the new State Second Pension will become a flat-rate scheme for those with a significant amount of their working lives still remaining. The extra incentives for moderate earners will then only be available to those in stakeholder and other private funded schemes.

Those who cannot save – more help from the State

14 The New Insurance Contract will help more people to save for their retirement, but there will always be those who cannot save for themselves. Some simply earn too little; others cannot work, through no fault of their own, for example because they are looking after young children or relatives with an illness or disability, or are disabled themselves. And everyone who retires without enough savings, for whatever reason, should be entitled to a decent level of security.

Basic state pension

15 The basic state pension will remain as the foundation of retirement income for rich and poor alike. It will not be means tested. We will raise it in line with prices, to keep its real value over time.

State Second Pension

16 The basic state pension alone will not provide a decent income in retirement. Nor will SERPS. That is why we are replacing SERPS to give greater help to those in need. Our replacement – the **new State Second Pension** – will reward those who work even on low incomes, and also those who are unable to stay in work because of caring responsibilities, illness or disability.

17 All those earning less than £9,000 (but, as now, above the Lower Earnings Limit of £3,300) will receive an additional pension – on top of the basic state pension. This additional pension will be double the amount that SERPS now pays to someone earning £9,000 a year. This will mean a dramatic rise in pension entitlement for those on the lowest incomes – for many, much more than doubling their second pension.

18 As well as this, carers and long-term disabled people who are off work will, for the first time, receive 'credits' (in effect, pension contributions on their behalf) towards the State Second Pension. These people have a claim on our society which we believe should be recognised (as we made clear in our manifesto commitment to a citizenship pension, which these proposals will deliver).

19 Those disabled people who have no contact with the labour market and thus are unable to build up pensions of their own, are specifically catered for by other parts of the benefit system, both above and below state pension age. Our proposals for reforming these benefits were published in *A new contract for welfare: SUPPORT FOR DISABLED PEOPLE* (Cm 4103).

20 These reforms mean that anyone who works throughout their working life (including spells as a carer or off work through long-term illness or disability) will receive a total state pension above the rate of the minimum income guarantee. In this way, every bit that they save, however small and however infrequently, will count towards their final pension and will not need to be topped up by the new minimum income guarantee. This will reward both hard work and thrift.

Minimum income guarantee

21 We are introducing a minimum income guarantee for all those who still do not have a decent income in retirement. This provides a minimum income in retirement without the stigma which some people associate with Income Support. It will allow pension and Income Support administration to be streamlined. It will provide everyone who needs it with a decent income in retirement, while through the new State Second Pension we are giving those who work an incentive to save more. And we are acting to ensure that everyone who is entitled to it, receives it.

22 We are also seeking views on cost-effective ways of changing the detailed rules on the treatment of income and capital, so as to reward savings.

23 Our long-term aim is that the new minimum income guarantee should rise in line with earnings so that all pensioners can share in the rising prosperity of the nation. This will mean that we can increase the income of the poorest pensioners at a faster rate than by raising the basic state pension, because help will go to those in greatest need, rather than to rich and poor pensioners alike.

Those able to save – a public-private partnership

24 Those who are able to save for their own retirement should do so. For this, they need to have trust in the system; for the right schemes to be available and affordable; to be able to cope with flexible working and variations in earnings (for example for career breaks); and to know how much they should save to deliver the income they want in retirement.

25 The current pension system does not meet these needs.

- **Occupational pensions are usually good value and secure and are generally the best choice, but they are only available if the employer offers one, and can be unsuitable for those who move jobs frequently. Because of labour market changes, occupational pensions are, over a number of years, likely to decline in number.**
- **Personal pensions are good value for many people but can have high administrative costs, which makes them too expensive for many on low to middle incomes. And those costs keep eating up people's savings even if they cease paying in while between jobs, and so can be inappropriate for those with flexible careers.**
- **SERPS is very low-cost, but it gives least help to those on the lowest incomes, and members do not have their own 'fund' or pot of money, as in occupational or personal pensions. This makes SERPS inflexible: members who want to save more cannot do so.**

26 Our reforms will mean that many more people will be able to save what they can afford, when they want to, without the penalty of high administrative costs.

Stakeholder pension schemes

27 At the heart of our reforms are new stakeholder pension schemes. This new type of pension combines the low overheads and high security of occupational pension schemes with the flexibility of the best personal pensions, and will be available to all. They are particularly designed to help those on middle incomes (between roughly £9,000 and £18,500 a year) to start their own pension but will benefit those on higher incomes too. They will be:

- **secure – independent trustees will ensure that the rights and interests of scheme members are put first;**
- **low-cost – because all employers who do not provide an occupational scheme will be required to provide access to a stakeholder pension scheme and collect contributions through their payroll systems, advertising and administrative costs will be lower;**
- **flexible – if a member does not contribute for a period, no administrative costs will be levied to avoid existing savings being eaten up. Similarly, members of stakeholder schemes will not lose out if they change jobs.**

28 As part of our New Insurance Contract, we will provide new incentives to save in private schemes, including stakeholder schemes, for those on middle incomes.

29 Up to five million people stand to benefit from stakeholder pension schemes.

State Second Pension

30 Those earning above £9,000 a year but below about £18,500 a year will also gain from the State Second Pension, but in a different way than those on lower incomes. Initially, the State Second Pension will itself be higher than the current rate of SERPS. Moderate earners will be able to use the increased rebates available under the State Second Pension to take out a stakeholder pension if an occupational scheme is not available to them.

31 Once stakeholder pension schemes have become established (we expect in about five years time), the State Second Pension will become flat rate, paying all its members at a single rate which will be double the rate now paid to those earning £9,000 a year under SERPS. Those in stakeholder and other private funded schemes will continue to receive the increased rebates. This will mean that everyone on middle incomes will have an incentive – and extra state support of an initial £500 million a year, to move to a private funded scheme.

32 Those earning over £18,500 a year are almost all in private schemes. The support they receive from the State will remain the same.

Reforms to the private pensions sector

33 Many people who could save under the current pension system are deterred from doing so. The pensions mis-selling scandal and the Maxwell affair have knocked confidence hard. Many people are put off by the complexity of pensions, and many others by the difficulty of finding affordable and reliable independent financial advice.

34 That is why we are reforming the way the whole pension system works. We propose:

- **better regulation to restore confidence in the system, including a role for the new Financial Services Authority;**
- **better information on schemes, including the development of telephone information lines;**
- **better information on people's own need to save, including an annual statement for all those in public and private schemes detailing their current predicted pension, so they can see for themselves if they should save more for retirement; and**
- **wider recognition of the benefits of occupational pension schemes, and measures to encourage more people to join them.**

Alternatives

35 In drawing up our proposals, we have examined several alternative approaches.

36 Some have suggested tearing up the entire pension system and starting again. But our judgement is that the current combination of public and private provision will continue to deliver rising incomes for the majority of pensioners. Instead of wholesale change, we need new ways of saving for those whom the current system does not serve. That is what stakeholder pension schemes and the State Second Pension will deliver. We have also rejected changes that would cause massive disruption to present arrangements. And, above all, reform has to be affordable and manageable.

37 Some have advocated more compulsion. While we want those who can to save more, we do not believe we should force people to save more or that we need to. We already compel people to save an average of 5 per cent of their income towards a second pension. Raising this percentage would do nothing for those who do not earn enough anyway, and would affect those who want to save for retirement in other ways, such as buying shares or houses, or through the value of their business. People would not feel better off if they could not afford their mortgage payments because of higher compulsory pension contributions. Our new State Second Pension will give middle earners extra incentives to save.

38 Some want the State to take on a far greater commitment to future pension payments, for example by raising the basic state pension in line with earnings. We believe the State should spend more, but do not believe it would be right to commit enormous sums – over £30 billion – regardless of people's needs and the nation's ability to pay the bills in the future. That is why we are focusing extra state support on those who need it most, and are encouraging more people on middle and higher incomes to provide more for their own needs.

Outcomes

39 Our package of reforms is aimed squarely at the real problem – ensuring that we all have security in retirement. Every part of the pension system, from individual scheme members, through employers, to pension companies and the Government itself, has a part to play in our New Insurance Contract for pensions.

40 **Our proposals are fair.** Assistance from the State towards meeting the needs of future pensioners will rise. But that help will be targeted on ensuring that everyone has a decent minimum income in retirement, that those unable to work because of caring responsibilities do not lose out, and that those on middle incomes are encouraged to save for themselves.

41 **Our proposals are affordable.** Overall, these reforms mean that the total income of pensioners will rise in years to come, mainly fuelled by rising private contributions. Public spending on pensions will decline as a share of GDP, from 5.4 per cent today to 4.5 per cent in 2050. By 2050, the proportion of pensioner incomes coming from the State, now 60 per cent, will have fallen to 40 per cent, and the proportion coming from private pension provision will have increased from 40 to 60 per cent. This will ensure that the pension system remains both fair and affordable.

42 **Our proposals provide security.** The Government will also ensure that the whole pension system – private and public – is properly regulated, that the right kinds of flexible and affordable savings schemes are available, and that people understand the need to save and the best way for them to meet that need.

43 **Our proposals build a new partnership in pensions.** The private sector – pension firms and other businesses – will continue to offer pensions to the general public and to their employees, and should see this business grow as confidence in personal and occupational pensions grows. In stakeholder pension schemes, and in the proposed reforms to the regulation and operation of all second pensions, we should see a true partnership develop.

44 Finally, we look to every individual to recognise their own responsibility to do what they can to save for their own retirement. Our proposals will ensure that they can do so in the confidence that they will reap the benefits.

Consultation arrangements

45 We have already consulted on our plans for stakeholder pension schemes and the detailed proposals are in **Chapter Seven**.

46 We would welcome your views on issues raised in this Green Paper, particularly those areas on which consultation has not already taken place. Please write to the following address:

The Pensions Green Paper Consultation Team
Department of Social Security
3rd Floor
The Adelphi
1-11 John Adam Street
London WC2N 6HT

You can also respond by using the following email address:

pensionsgreenpaper@ade003.dss.gov.uk

Comments should reach us by 31 March 1999.

47 Responses will normally be available to the general public unless you specifically ask us to keep your views confidential.

48 This Green Paper is also available in Braille, audio cassette, large print and in Welsh (Cm 4179, price £13.25), from Stationery Office bookshops. A list of their bookshops is given on the back of this publication.

A summary version has been produced and is available free of charge from the following address:

Welfare Reform (Pensions)
Freepost (HA4441)
HAYES
UB3 1BR
Tel: 0181 867 3201
Fax: 0181 867 3264

A service for textphone users is available on:

0181 867 3217

The lines are open Monday to Friday, 9am–5pm. **Please quote code PGP.**

This Green Paper and the summary version can be accessed on the internet at:

http://www.dss.gov.uk.

Chapter One

The present position

The pension system we inherited – public and private – has some strengths but many weaknesses. It will not guarantee a decent income in retirement for everyone. It risks leaving up to one third of pensioners facing poverty. Even higher earners face problems.

1 This chapter describes the main trends in, and future prospects for, pensioner incomes and pension provision in the UK. It concludes that although there are some positive aspects, measures do need to be taken to improve provision for today's lower earners. Many younger people in particular are heading for a retirement on income-related benefits even if they work all their lives. There are also problems for higher earners who also benefit from state support through National Insurance rebates and tax relief. Doing nothing is not an option.

2 The problems of **today's** poorest pensioners and how they will be addressed are discussed in **Chapter Five**. **Chapter Two** gives a descriptive account of the main aspects of the UK pension system.

Past trends and future prospects for pensioner incomes

Pensioner living standards

3 Over the past 20 years, newly retired pensioners have had higher incomes than their predecessors. **Average** pensioner incomes have increased in real terms by over 60 per cent, more rapidly than for the rest of the population. More people have second pensions and are retiring with sufficient income to avoid having to rely on income-related benefits. A number of factors underlie these trends.

4 Occupational pension schemes have played an increasingly important role. Twice as many pensioners receive an occupational pension today as 30 years ago. For recently retired people (single pensioners and pensioner couples where the head of the household reached state pension age less than five years ago), the **average** occupational pension in 1996/97 was around £120 a week and continues to grow. But **many** pensioners only have small occupational pensions.

5 Many recently retired pensioners receive a significant second pension through the State Earnings Related Pension Scheme (SERPS). People retiring during the next few years will benefit from the provisions of the original SERPS scheme introduced in 1978 which is now starting to mature.

6 However, in 1988 and 1995, the previous administration reduced the value of SERPS which people would receive on their future contributions. People retiring now and over the next 25 years will still receive a significant benefit from SERPS but those retiring later in the next century will do less well. By 2025, projections

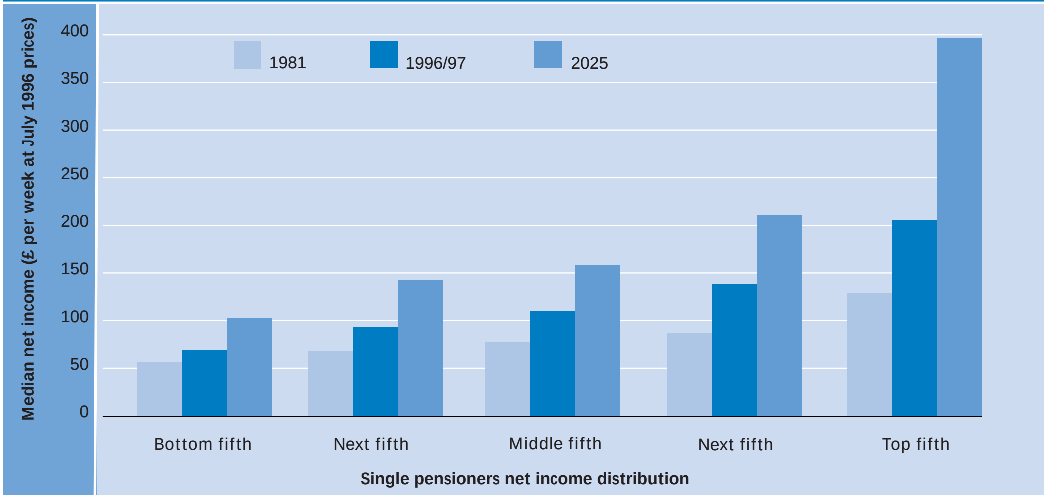
suggest that the State, through the basic state pension and SERPS, will provide a similar proportion of pensioners' incomes as now.

7 Over the next 25 years, on average, the value of the pension paid on retirement is expected to increase at least as much as the rise in earnings. But this growth in income will not be shared equally. Only the amount received by the richest fifth of pensioners is expected to grow by more than the growth in national prosperity.

8 The Government wants all pensioners to share fairly in rising national prosperity

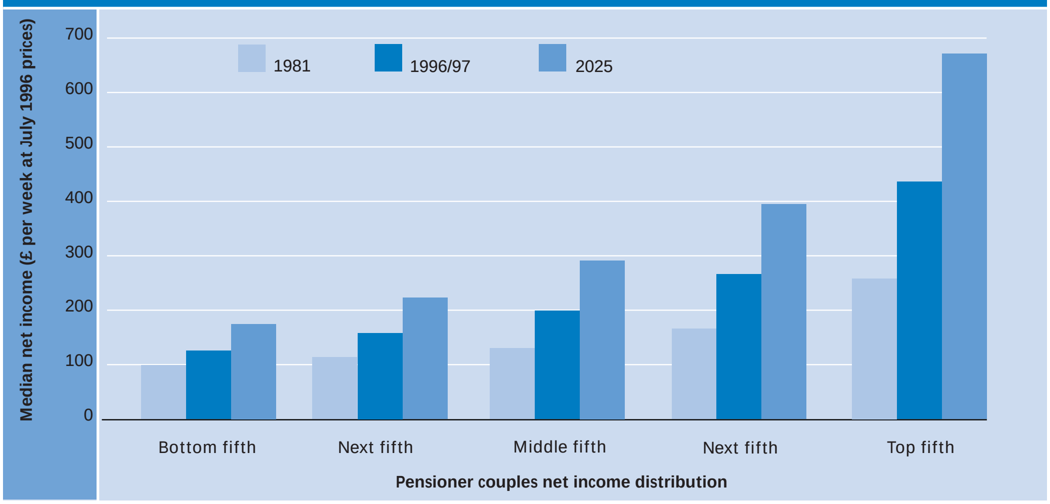
9 The charts below show pensioners' real income over time. They also show what, on current policies[1], pensioner incomes are expected to be in 2025.

Chart 1: Income of single pensioners, by position in the income distribution



Source: *The Pensioners' Incomes Series 1996/97* and PENSIM estimates

Chart 2: Income of pensioner couples, by position in the income distribution



Source: *The Pensioners' Incomes Series 1996/97* and PENSIM estimates

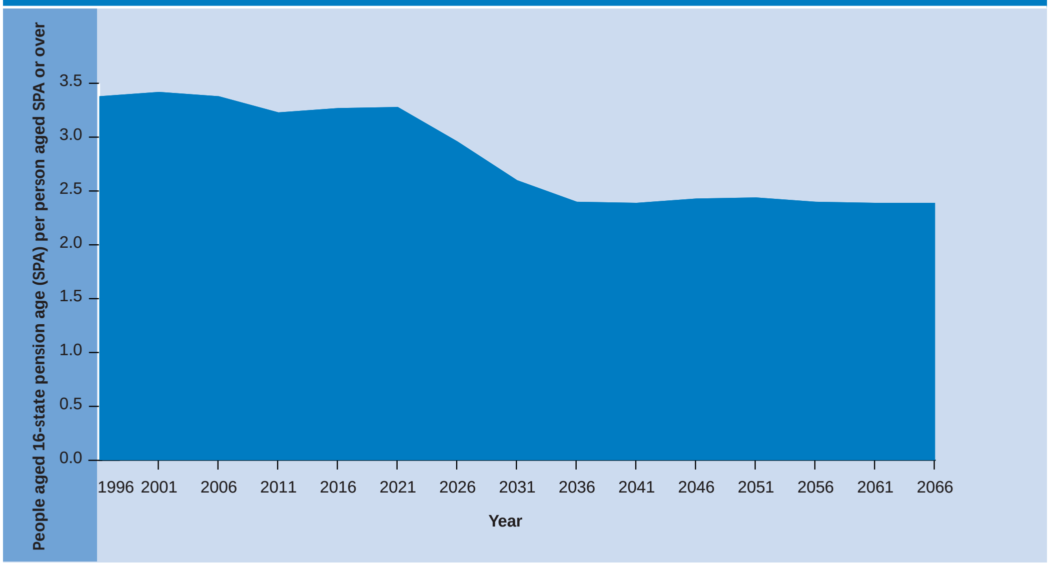
[1] In these charts, we have assumed that income-related benefits increase broadly in line with earnings, as has happened over the last 50 years.

The impact of changing demography

10 Over the first half of the next century, the number of people over state pension age in the UK is forecast to increase by over a third. This is due to the baby booms following the Second World War and in the 1960s, and significant improvements in life expectancy due to better health. In general, because of their greater longevity, women can expect to spend more years of their lives as pensioners than men.

11 By 2040, there are likely to be around 30 per cent fewer people of working age per person over state pension age. Chart 3 illustrates this trend. Broadly speaking, while there are over three people to support every pensioner now, by 2040 there will be closer to two.

Chart 3: Support ratio (UK)



Source: Government Actuary Department 1996-based population projections, UK

12 Although the change will largely come about at a steady rate, there will be a sharp increase in the number of pensioners between 2020 and 2030. However, demographic pressures in most other industrial countries are greater and more imminent than they are here. Their ability to pay for pensions will be affected to a far more significant extent.

The affordability of state provision

13 State spending on pensions will increase as the number of pensioners increases. But as Table 1 (overleaf) shows, based **on current policies**, the share of Gross Domestic Product (GDP) supporting pensioners will fall, despite the increase in the number of pensioners. These trends reflect the growing role of private pension provision and the linking of increases in the basic state pension to prices rather than earnings.

Table 1

Projected future UK state spending on pensions (basic state pension and SERPS)			
Year	2000	2025	2050
Spending as percentage of GDP	4.4	4.4	3.4
Millions of pensioners	10.5	12.7	14.3
State spending per pensioner in relation to GDP (Year 2000=100)	100	90	58

The problems of the poorest pensioners

14 Despite some positive trends, many people face a bleak retirement. The poorest 20 per cent of single pensioners received an average income of £68 a week (before paying housing costs) in 1996/97. This compares with the richest fifth of single pensioners who received average weekly incomes of £205. Over one third of single pensioners in 1996/97 retired on incomes of £100 a week or less, and nearly one third of pensioner couples had a joint income of £160 a week or less.

15 Since 1981, the gap between the richest and poorest pensioners has grown. The incomes of the poorest 20 per cent of single pensioners have risen by 21 per cent in real terms compared with 60 per cent for the richest 20 per cent. The pattern is similar for pensioner couples. Women tend to fare worse than men because of their different working patterns and greater longevity. The Government's Women's Unit is undertaking a detailed analysis of existing research into women's incomes, including the factors affecting income in retirement. The results of this will help to inform future Government thinking.

16 If we do not change current policies, serious problems will persist for pensioners who are dependent on the State for their income in retirement.

17 By 2025, without reform, well over half those reaching retirement age could have to rely on income-related benefits in their retirement.

Declining levels of pension provision after 2025

18 After 2025, average pensioner incomes are expected to fall relative to earnings, reflecting that, for today's 20–40-year-olds, SERPS will be of lower value and the basic state pension, though keeping its real value, will make up a smaller part of people's retirement incomes.

19 The current pension system needs to be modernised if the problems of the poorest pensioners are to be addressed and those who can are to be encouraged to provide a decent income in retirement for themselves.

Chapter Two

The current pension system

The UK pension system is a partnership between the State (providing the basic state pension and the State Earnings Related Pension Scheme [SERPS]), employers (providing occupational pension schemes) and private pension providers (providing personal pensions). Although the system needs to change, this partnership remains the right foundation.

1 At the start of the Pensions Review, the Government set up an independent Pension Provision Group, chaired by Tom Ross, to consider the current state of pension provision in the UK and likely future trends based on current policies. The Group's report, *We all need pensions – the prospects for pension provision* was published in June 1998.

2 The report provides an authoritative analysis of the issues which should be addressed in considering reform of the pension system and which in turn has set the scene for this Green Paper. The report sets out many of the strengths in the current system whilst also identifying that it has not served all pensioners equally well.

A diversified system

3 Today's pension system has many distinctive features. It combines a contributory state system, which includes a State Earnings Related Pension Scheme (SERPS), also known as 'additional pension', with a funded private system which provides many ways for people to make their own provision for retirement.

4 This system has largely grown up during this century, most significantly over the last 50 years. This has led to a large increase in the proportion of people receiving a pension income both from the State and private sources.

The growth of state and private provision

5 The State's role in providing pensions in old age emerged at the start of this century. The first state old-age pension was introduced in 1908. In 1948 the creation of the welfare state brought with it the contributory-based basic state pension we have today. Since then, the basic state pension has provided a foundation for retirement, supplemented with private pensions or, where necessary, by income-related benefits. People who have spells of unemployment or caring receive credits towards their basic state pension.

6 Occupational pension schemes were already firmly established by the turn of the century. By 1936, 2.5 million people were already members of occupational schemes. Occupational provision has thrived throughout this century, given much impetus by the introduction of tax reliefs on pension contributions and investments in the 1920s. In the 1950s and 1960s in particular, membership of occupational schemes grew substantially, peaking in 1967 with over 12 million members. In the late 1980s, personal pensions became much more prominent as another source of second-tier provision.

7 The state and private pension systems became more closely linked in the 1960s and 1970s when earnings-related second pensions were brought into the state system. The introduction of SERPS in 1978 (succeeding the earlier Graduated Pension Scheme introduced in 1961) provided a second pension for those who previously had none and a baseline for occupational pension schemes. At this point, for the first time, contributing to a second pension became compulsory for most employees.

8 Another important development was the ability of those occupational schemes, which could provide benefits at least as good as the state scheme, to be able to contract out of SERPS. This has been a factor in leading to the UK having a much higher proportion of funded pension provision than in most other European countries.

Key features

Three tiers of pension provision

9 Today's pension system is composed of three tiers.

- **The first tier is the basic state pension.**
- **The second tier is a mix of state and mainly private pensions which are additional to the basic state pension. The second tier comprises SERPS, occupational and personal pensions.**
- **The third tier comprises voluntary private provision above the compulsory minimum. Some 14 million workers make such extra provision.**

10 The combination of the first-tier basic state pension and a second pension helps provide many people with a good degree of security in retirement. An income-related minimum income guarantee provides for those who have not been able to build up a decent second pension.

The compulsory element

11 People are already compelled to save towards a pension. All employees and self-employed people, except the very lowest paid, must pay National Insurance contributions. These give entitlement to basic state pension. In addition, employees have to pay towards a second-tier pension – SERPS – unless they opt out and make their own provision. This is known as contracting out. If people are contracted out of SERPS into a private scheme then they pay a lower rate of National Insurance contributions and the Government pays a National Insurance rebate to the employee's own scheme.

12 The minimum that must be paid to a second pension is an average of 4.6 per cent of earnings – 1.6 per cent from employees and employers pay 3 per cent on top. While employees are required to contribute to a second pension, self-employed people are not. The only second pension choice for them is a personal pension, but many self-employed people make some provision for their retirement through other savings vehicles and investments.

The first tier – the basic state pension

13 The basic state pension is a pay-as-you-go pension scheme which provides the foundation of pension provision. The pay-as-you-go pensions of today's pensioners are paid for by the contributions of people currently working. The basic state pension provides about a third of all pensioner income and is the largest single source of support. It is a flat-rate pension – £66.75 a week from April 1999 for single pensioners and £106.70 a week for couples – paid to all who have met the minimum contribution requirements.

14 In most cases, to receive a full pension, men must have paid National Insurance contributions for 44 qualifying years and women 39 years, although by 2020 both men and women will need the same number of qualifying years once the state pension age is equalised. Currently, 86 per cent of men and 49 per cent of women qualify for a full basic state pension. About 10.6 million pensioners currently receive a basic state pension at a cost of about £32 billion a year.

Second-tier pensions

15 Some facts about second-tier pensions.

Of 35 million people of working age in Great Britain:

- **some 10.5 million are members of occupational schemes;**
- **around 10 million personal pensions are held (just over half of which are appropriate personal pensions, that is, they are used to contract out of SERPS); and**
- **over 7 million belong to SERPS.**

The state second-tier pension – SERPS

16 SERPS is the second-tier pension provided by the State. SERPS is a pay-as-you-go contributory pension scheme for those who earn enough to pay National Insurance contributions and who are not contracted out into an occupational or personal pension.

17 SERPS is a good value second pension for lower earners for whom private pensions are poor value, unless their employer is contributing to an occupational scheme on their behalf. The amount paid out through SERPS depends on the level of earnings. The maximum SERPS payable to someone retiring today is £120 a week. The average award for those reaching state pension age, who were contracted in to SERPS at some point since 1978 is £20 a week for men and £11 a week for women.

18 SERPS is based on an average of earnings between a lower and upper earnings limit over a person's whole working life, increased in line with earnings inflation up to state pension age and by price inflation once it is in payment. Some 5.5 million people currently receive SERPS as part of their retirement income at an annual cost of about £4 billion.

The private second tier – occupational pensions

19 Occupational pension schemes are one of the great welfare success stories of this century. They are run voluntarily by employers, or groups of employers for their staff, and provide a pension on retirement and often other benefits, such as a death-in-service lump sum. Employers pay contributions to add to the employee's contribution and also meet the scheme's administrative costs.

20 Membership requires little action on the part of the employee, either to join or once signed up to the scheme. However, many employees fail to join their employer's scheme, and some confidence in occupational schemes has been lost since the Maxwell scandal. Occupational schemes can also be unsuitable for people who frequently change jobs.

21 Occupational pension schemes may be established on either a defined benefit basis (also known as salary-related schemes) where benefits are related to members' earnings or on a defined contribution basis (also known as money purchase schemes) where benefits are related to members' contributions and their investment value. The vast majority of members are in salary-related schemes, although the number in money purchase schemes has grown from 100,000 in the 1970s to over 1 million now. The market value of the financial assets of occupational pension schemes is estimated to be about £640 billion.

22 Over 4.25 million people are members of public service schemes. These cover, for example, national and local government, the NHS, armed forces, the police and fire services, and teachers. Pensions under some public service schemes are provided on a pay-as-you-go basis, that is directly from taxation, while others are fully funded by members' contributions.

The private second tier – personal pensions

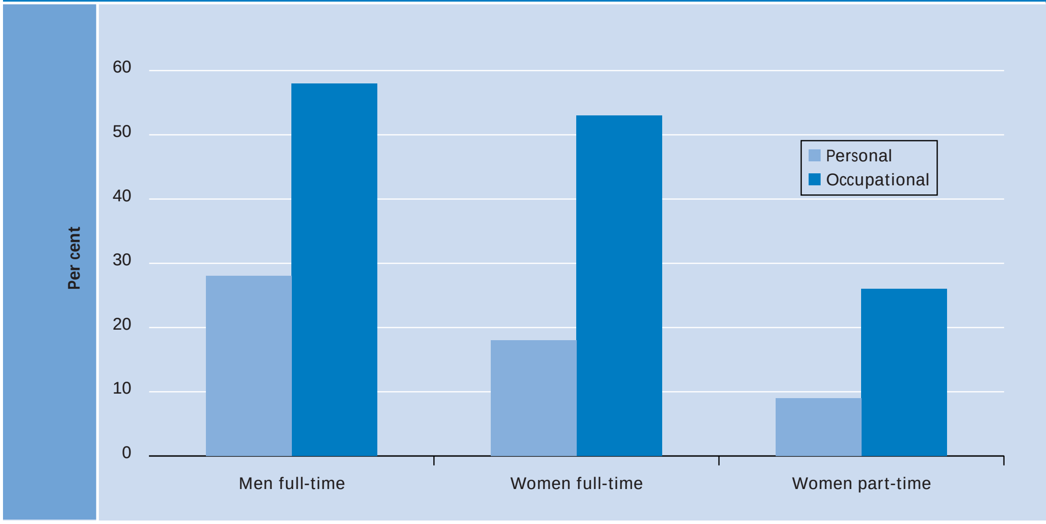
23 Personal pensions are open to anyone who is working. There are two main types: an appropriate personal pension (not available to the self-employed, because they are excluded from SERPS) and an ordinary personal pension (open to the employed and self-employed alike).

24 A group personal pension is an arrangement made for the employees of a particular employer, or a group of self-employed people, to take out a personal pension on a grouped basis.

25 There are about 10 million personal pensions held (5.6 million appropriate personal pensions and 4.6 million ordinary personal pensions), although this includes some to which contributions are no longer being made and some people have more than one. The market value of the financial assets of personal pensions is about £190 billion.

26 Personal pensions can be poor value for those who cease contributing in the first few years, or who have extended periods when they cannot contribute. Charges continue to reduce the value of the fund and therefore reduce the final pension. About a third of the people who buy personal pensions cease contributing within three years.

Chart 4: Proportion of employees with non-state pension provision



Source: *General Household Survey 1996*, Office of National Statistics

Minimum income in retirement

27 Income-related benefits help ensure a minimum income in retirement and help with some housing and council tax costs. The minimum income guarantee is provided through Income Support, which from April 1999 will be £75.00 a week for single pensioners and £116.60 a week for couples. Pensioners are entitled to higher minimum amounts than non-pensioners. Single non-pensioners receive a minimum of £51.40 a week and non-pensioner couples receive £80.65 a week.

Pensioners aged between 75 and 79 will receive £77.30 a week (single) or £119.85 a week (couples). Disabled and pensioners aged 80 and over will receive £82.25 a week (single) or £125.30 a week (couples).

28 Housing Benefit and Council Tax Benefit can be paid on top of Income Support. The average Housing Benefit for a person aged 60 and over is £36.50 a week. The figure for Council Tax Benefit is £7.30 a week. Presently about 1.7 million pensioners have their incomes topped up by Income Support, another 1.3 million get help with council tax and almost 1 million with housing costs.

Savings

29 Many people make additional savings for their retirement in ways other than through a pension. This may be through property, where older people can release some of the equity tied up in their homes. It may be through savings accounts and life assurance and other vehicles such as shares and securities.

Pensions and employment

30 There is an essential link between work and building rights up for a decent income for retirement. Rights to future pension income are earned through paid employment. In turn, pensions replace earnings and provide security in retirement. Of the 33 million people aged between 20 and state pension age, nearly 22 million are paid employees and 3 million are self-employed. The remainder are either looking for work or are outside the labour market.

31 Most employees contribute to state pensions through National Insurance contributions and many to a private pension through their employer, with tax relief allowed on the latter. In 1996 some 75 per cent of men and 65 per cent of women in full-time work had either an occupational or a personal pension or both.

32 Almost everyone of working age builds up rights to a basic state pension. Some people not in paid work, or on very low earnings, can receive credits towards their basic state pension. They do not build up any second pension because making provision for a second pension is tied to being in work and its coverage is less universal.

33 Of all those in paid work, more than a third are making no private pension provision at all and will rely on the basic state pension and SERPS to provide an income in retirement. Of self-employed people, only half are currently making contributions to a personal pension and more than a third have never contributed to a personal pension. Many people are not putting enough aside for their retirement.

Supporting and paying for pensions

The cost of pensions

34 The total costs of pensions paid today is shared between the State and private provision. Broadly the same amount – about £30 billion – is paid out in private pensions to those of state pension age, as is spent on the basic state pension. In addition, the State spends up to a further £36 billion supporting pensions.

35 The cost of the current state pension system – the basic state pension and SERPS – is met on a pay-as-you-go basis. Most private occupational pension schemes and personal pensions are funded.

Key elements of state support for pensions (1996/97)

- **£12.2 billion in tax relief on pension contributions.**
- **£7 billion on National Insurance rebates to people contracted-out of SERPS.**
- **£30 billion on the basic state pension.**
- **£17 billion in other social security spending – SERPS, income-related and disability benefits.**

36 The amount of expenditure which supports pensions and goes to pensioners can also be shown as a proportion of the country's wealth (Gross Domestic Product [GDP]). Estimates made for 1993[1] show that:

- expenditure on pensioners[2], excluding medical services, was about 10 per cent of GDP (around £60 billion in 1997 prices);
- expenditure on pensions from the National Insurance fund was about 6 per cent of GDP; and
- about 4 per cent of GDP was directed to pensioners through other sources such as occupational personal pensions.

37 Apart from pensions, there are many other ways in which the State helps support older people's lives. These include health services where, for example, older people will particularly benefit from the extra £21 billion of resources that the Government is investing in the NHS. In addition, much Government support goes on older people through social services, public transport concessions, housing improvements and anti-crime initiatives.

[1] Eurostat estimates (statistical body of the EC). Last year for which figures are available.

[2] This comprises basic state pension, SERPS, Graduated Pension Scheme, Christmas Bonus, occupational pension, Income Support and payments from friendly societies and local authorities.

The value of pension scheme assets and rights

38 The value of private pension assets and rights are significant. For example, the market value of the financial assets of all funded occupational pension schemes and personal pensions is about £830 billion. With such amounts at their disposal pension funds are a major player in domestic and overseas financial markets and are an important element in the stability and growth of the wider UK economy.

Chapter Three

The need for change

The current pension system does not provide adequate security for people who cannot afford to save and does not have the trust of people who can afford to do more to help themselves. We need a New Insurance Contract for pensions to restore trust, to encourage saving and focus help where it is most needed.

Objectives

1 The Government's objectives are to provide security for those who cannot provide for themselves and to make it easier for people who can save, to do so.

Failing those who cannot save

2 The current pension system fails to provide security for those people who cannot provide for themselves in retirement either because they are outside the labour market or because their earnings are low.

- **Those who currently earn less than approximately £3,300 a year do not pay National Insurance contributions and therefore are not entitled to either the basic state pension or the State Earnings Related Pension Scheme (SERPS). They therefore depend on the minimum income guarantee to give them security in retirement. Some people fall into this group because they work very low numbers of hours; others have very low hourly rates of pay. The introduction of the national minimum wage will ensure that those working substantial numbers of hours are paid at levels which mean they are able to build up entitlement to a basic pension. However we recognise that there still remains a group of people, mainly women, who are active in the labour market but whose access to contributory pensions is affected by the fact that they work part-time, on low earnings for long periods. We will be considering whether more needs to be done to assist this group within the National Insurance scheme.**
- **Lower earners, earning between approximately £3,300 and £9,000 a year, are not generally in the market for private, funded pensions. The administrative costs and charges of private, funded pensions mean they too have to rely on state provision, which is declining in relation to average earnings, unless they are fortunate enough to belong to an occupational pension scheme. The small contributions which people in this group could afford to make to**

a personal pension would be eaten up by fees and charges and they may not see the benefits of those savings.

- **Carers and disabled people who have to give up paid employment tend to be in a similar position to lower earners. They usually find it impossible to make pension provision or other savings once they leave the labour market.**

3 For lower earners, carers and disabled people who can no longer work, only the State can really provide them with a secure second pension. But the current State Second Pension, SERPS, gives least help to those on the lowest earnings.

Failing those who can save

4 The current system also fails to provide the best framework for those who can work and provide for themselves. There are a number of reasons for this:

- **changes in the nature of occupational pension schemes;**
- **changes in the labour market which require different pension products;**
- **the shortcomings of personal pensions; and**
- **poor information and the lack of trust in the pension system.**

A decline in employers' occupational pension provision

5 For those who have access to them, occupational pension schemes are an excellent means of providing for retirement. The commitment of employers to provide pensions remains substantial. Many recognise the positive advantage to recruitment, retention and commitment which good pension schemes can provide – even those who do not provide an occupational scheme at present. In a recent survey[1] just under a fifth of employers who do not currently provide a pension scheme expressed a willingness to be actively involved in setting up a stakeholder pension scheme for their employees. If we are to strengthen this part of the pension system we need to retain and build on the support of employers for good provision.

6 But the growth of occupational pension scheme coverage may have peaked. Over the past 20 years or so, the proportion of men in occupational schemes has fallen by around 10 per cent though more women have joined schemes. This reflects:

- **a decline in the number of people employed in large companies and in the public sector – where there is a strong tradition of occupational pension provision;**
- **changes in the regulation of occupational schemes. For example, since 1988, employers have not been allowed to make membership of occupational pension schemes a condition of employment; and**

[1] *Survey of Employers Pension Provision 1998.* Hales, John; and Stratford, Nina; *Social and Community Planning Research,* forthcoming in 1999.

- **the restructuring of occupational schemes involving a switch from salary-related to money purchase schemes. Although a change to money purchase provision is not a bad thing in itself – indeed money purchase schemes are often the best type of scheme for people who need to change jobs regularly – some employers have also taken the opportunity to reduce their own contributions to the scheme.**

Changes in the labour market and modern society

7 The current pension system has not adapted to changes taking place in the labour market and wider society. A modern, competitive economy requires a flexible and efficient labour market but greater flexibility and mobility of labour and changes in society can make it more difficult for people to build up pension rights. We need to modernise the pension system to meet the needs of the modern world. The changes taking place include the following.

- **There are fewer people entering work expecting lifetime employment with one or two employers. More people are self-employed and many more can expect to be self-employed at some time in their lives. More jobs are part-time, or on short-term contract.**
- **There is continuing growth in employment in small- and medium-sized companies, which have traditionally been less likely to provide occupational pension schemes.**
- **The role of men and women is changing. Women are becoming less dependent on men for their income, both during their working lives and in retirement. As more women work, more are building up rights to pensions in their own right and achieving greater financial independence. It will become increasingly important to adapt the pension system to enable both men and women to develop good pension rights if they are to enjoy a comfortable retirement, whether as individuals or as couples.**
- **Women have often lost out on divorce when a higher earning husband has retained all rights to his private pension built up during the marriage. The pension system needs to take account of this. The Government has already announced plans to introduce provisions to make it possible to share pension rights at the time of divorce. Sharing pensions will allow some couples to achieve a fairer settlement of assets on divorce, and it will provide a more secure pension income in retirement for those receiving a share of pension rights. We published draft legislation on this in June 1998. Following public consultation, and scrutiny by the House of Commons Social Security Select Committee, we propose to include the measures in the forthcoming Bill on welfare reform.**

- **Over a whole working life, more people are experiencing periods on both lower and higher incomes. There will be times when they will be able to make their own pension provision and times when they will need extra help. There may be periods when they are out of the workforce because of caring responsibilities. The system needs to enable people who change job frequently not to be penalised. It needs to allow low earners, the self-employed and those with caring responsibilities to build up better, secure, flexible and value-for-money provision. At the moment, the pension system is not allowing that to happen. As a result, many people are failing to make enough provision to ensure a decent retirement income.**

The shortcomings of personal pensions

8 Personal pensions can be an attractive alternative for people who do not have access to an occupational scheme, or who frequently change jobs. People who often move jobs can do less well in an occupational pension scheme. However, high up-front charges mean that some types of personal pension are unsuitable for people who have low or intermittent earnings or who cannot maintain the regular contributions required. This is due to the high costs of distributing and selling personal pensions which can account for up to two-thirds of their total costs. Typically, these costs can take a quarter of a member's savings, even if the person remains in the scheme for life.

9 Mis-selling has tainted personal pensions and put some people off pensions altogether. The Government has taken firm action to ensure that companies clear up the problem and compensate those who have suffered so that confidence can be restored. Some better value schemes are now available, though the market for personal pensions has not produced the reductions in cost which might have been expected ten years after they first went on mass sale. However, appropriately regulated, personal pensions will be the right option for some, mainly higher paid people.

10 It is estimated that up to four million people earning between £9,000 and £20,000 a year are not contributing anything to their pensions above the compulsory minimum. Other people spend the majority of their working lives in work and trying to save for their old age, but they do not always find a pension scheme which suits them or get a good deal from what is on offer at the moment. There is a need for a new framework for pensions which encourages the development of value-for-money, flexible second pensions and suits people's modern working and living patterns. The main features of these new pensions must be that they do not penalise people who change jobs or have to suspend contributions; that they enable the buying power of members to get the best value-for-money; and that they should be efficient and cost effective to run, promote and regulate.

Poor information and lack of trust in the pension system

11 Few people really understand pensions. Few know about their own pension position and the action they need to take to improve it. Added to this lack of understanding, the Maxwell affair and the mis-selling of personal pensions has left many people lacking confidence and trust in any type of pension arrangement. People are not sure where to get advice and who they can trust. Much of the information that is available is of poor quality. Because of this, many people run the risk of making the wrong pension choices, their confidence and trust in pensions may be undermined and they may be put off saving altogether.

12 If people do not trust any type of pension scheme it can become a reason to do nothing, even though pension savings made early are worth far more than those made late in a working life. If people do not know their own position they cannot judge whether and how to make better provision, or be confident of finding the best way to improve their position.

13 To overcome these problems action needs to be taken to educate people about pensions and provide better, more secure pension schemes which give them confidence and restore trust.

Chapter Four

A new framework for pensions

The Government's overall approach to pension reform is to build a modern and affordable pension system which ensures that everyone has the opportunity to achieve a decent income in retirement; enables people who can save to see the benefits of saving for their retirement; and provides security for those who cannot save.

The Government's objective

1 The pension system should reward work. It should also reward saving. People who work and people who save should know that they will see the benefit when they retire. People who work all their lives should not have to rely on means-tested benefits when they retire.

2 Those who can save have a responsibility to do so. The State should ensure that they have access to secure, good value pensions. And the State should give particular support to those who cannot be expected to save.

Problems that need to be addressed

3 The current system does not meet the needs of the modern labour market; some private pensions give poor value; and many people do not understand how pensions work and what their own position is.

4 For many people who are unable to save, because they have low earnings or cannot work, the system as it stands will not provide adequate security in the future. What they can expect from the basic state pension and the State Earnings Related Pension Scheme (SERPS) has been reduced. And hundreds of thousands of people who are entitled to Income Support do not claim it.

Options

5 The pension system should have both state and private provision working together in partnership to ensure everyone can achieve an adequate income in retirement.

6 We have considered, but rejected, two extreme alternatives:

- **privatising the pension system entirely so that over time state pensions are wholly replaced by funded provision; and**
- **attempting to build a pension system on the continental model where the State is the pre-eminent pension provider.**

7 Wholly privatising the existing pension system is not practical because people on low incomes could not afford to make sufficient contributions to produce a decent income in retirement once the administrative and other costs of private, funded pensions were taken into account. State support for private, funded pensions for people on low incomes would be expensive.

8 Relying on universal state provision to provide decent pensions would be unaffordable and poorly targeted as the number of pensioners increase.

9 Both state and private provision have their strengths and weaknesses. The State is the most efficient mechanism for giving help to those on the lowest incomes. Funded, private pensions can be efficient, flexible and effective savings vehicles for those who can make sufficient contributions but would be expensive and unsuitable for others. Funded pensions are, however, a great strength of the UK pension; they work well for millions of people and many more people would like to benefit from them.

10 The Government has also rejected extra compulsion as a simple answer to the pension problems that we face. No amount of extra compulsion would help low earners as the amount of extra savings they could afford to make would not be sufficient to give them security in retirement or take their pension income above income-related benefit levels.

11 For example, someone earning £100 a week for their whole working life would need to contribute an extra 8 per cent above the current compulsory contribution to receive a pension that would take them above the minimum income guarantee. They would need to save even more to have a pension that took them above all income-related benefits.

A New Insurance Contract for pensions

12 The key features of the Government's approach are set out below.

- **A new public-private partnership building on the best features of state and private provision.**
- **The basic state pension will remain a key building block of the pension system and will continue to be increased at least in line with prices.**
- **All pensioners will be guaranteed a decent income in retirement through the minimum income guarantee.**
- **The replacement of SERPS by a new State Second Pension which will ensure that everyone with a lifetime of work behind them (or credits from caring) builds up rights to a pension which lifts them above the minimum income guarantee in retirement.**

- **Together, the minimum income guarantee and the new State Second Pension will provide security for those who cannot save enough themselves to produce a decent income in retirement.**
- **For those who can save, we will create a new framework for flexible, secure and value-for-money stakeholder pension schemes. These will better meet the needs of changes in the labour market and wider society.**
- **Increased National Insurance rebates for people who contract out of SERPS into a stakeholder pension scheme, making it more worthwhile for moderate earners to join a scheme. Once stakeholder pension schemes have established themselves as low-cost, value-for-money, funded second pensions, we expect the new State Second Pension to become a flat-rate scheme for those on lower earnings with those on moderate and higher earnings joining a private, funded pension.**
- **Improved pensions education and awareness including the provision of an annual pension statement to every adult.**

Outcomes

13 We expect the result of our pensions strategy to lead to a number of changes in future.

14 There are likely to be fewer people on income-related benefits than under current policies as far more people are able to develop a good second pension from the state or a private scheme. The reforms will offer security in retirement for tomorrow's pensioners, with extra help for everyone earning up to £18,500 a year, focused in particular on the poorest.

15 More people will secure, good value, funded private pensions through joining a stakeholder pension scheme or through joining their employer's occupational scheme.

16 Understanding of pensions will improve, ensuring that people can make the right pension choices for them. As they do so, we expect more people to save for their retirement.

17 A higher proportion of state support will go to those who need it most.

18 Over time, the share of national income devoted to pensions will increase, but a higher proportion will come from private, funded pensions. State spending will increase but income from private pensions will increase even more as stakeholder pension schemes become established and occupational pension schemes are strengthened and supported. Currently, about 60 per cent of pension income is accounted for by the State and 40 per cent by the private sector. As a result of the reforms set out in this Green Paper, the State's share is expected to fall to around

40 per cent by 2050. This will allow us to meet the demographic challenge of much higher numbers of pensioners whilst delivering a decent income in retirement for everyone and maintaining public expenditure at prudent levels.

Chapter Five

Help for today's poorest pensioners

Many pensioners on low incomes need support from the State. We are targeting help on those who need it most through a new minimum income guarantee for pensioners. We are improving ways to deliver help to pensioners and providing a range of other support through, for example, Winter Fuel Payments, concessionary transport and free eye tests.

What is wrong with the current situation?

1 A significant number of today's pensioners were unable to build up good second pensions during their working lives. Many of those whose wages were low, who had caring responsibilities, or who had long periods out of work, had little opportunity to save to see them through a secure retirement. Some older pensioners find that the pension which was adequate when they retired is no longer sufficient. For these pensioners, the additional support provided by the State through income-related benefits is essential.

2 Over a quarter of all pensioners may be eligible for Income Support – almost two million claim and many more may be entitled but do not claim. Two out of three pensioners who claim Income Support are single women. They tend to be older women – most are aged between 70 and 85.

3 Whilst Income Support as it currently exists provides a measure of security for the poorest pensioners, there are significant weaknesses in the current system. There are two distinct groups we need to address.

- **Pensioners entitled to Income Support but not claiming it. Hundreds of thousands of pensioners, mainly women, are entitled to Income Support but do not claim it. They are missing out on around £15 a week on average.**
- **People just above Income Support level. Many people with incomes just above this level feel that the rules regarding the treatment of savings penalise them for having saved during their working lives. Not only do they miss out on help from the benefits system, but they can also lose out on other help, including some help with NHS charges which people receiving Income Support get automatically.**

4 We need to tackle these failings in the current system.

Action we will take

5 Starting from April 1999, we will implement a £2.5 billion package of measures as part of a new approach to tackling the problem of pensioner poverty. The package will contain three elements, outlined below.

The minimum income guarantee

6 From April 1999, we will introduce a minimum income guarantee through Income Support of at least £75 a week to single pensioners, and £116.60 a week to couples. This represents almost three times the increase they would have got under the usual Income Support uprating rules. Pensioners aged between 75 and 79 will receive £77.30 a week (single) or £119.85 a week (couples), whilst those over 80 will receive £82.25 a week (single) or £125.30 a week (couples).

7 All pensioners living independently who currently receive Income Support will gain. A further 65,000, whose incomes are currently just above Income Support level, will become newly entitled.

8 The minimum income guarantee will be increased year by year as resources allow. Over the long term, our aim is that it should rise in line with earnings so that all pensioners can share in the rising prosperity of the nation.

Extra help with fuel bills

9 We will extend the help with fuel costs for pensioners beyond the initial two years. From the winter of 1999/2000, all eligible pensioner households will be guaranteed a £20 Winter Fuel Payment. Nearly 10 million pensioners will gain. This new payment builds on the £400 million already allocated for fuel costs in November 1997.

10 These payments are in addition to measures the Government has already taken to cut fuel costs and make homes easier to heat. These include the reduction of VAT on domestic fuel to 5 per cent and action to promote better and cheaper insulation.

11 This extra help is also in addition to that already provided through the Cold Weather Payments scheme. This provides £8.50 a week towards extra heating costs for vulnerable groups on Income Support, including pensioners, when there is a particularly cold spell in their area.

Measures to increase take-up of the minimum income guarantee by current pensioners

12 The Government is also taking action to find more effective ways of encouraging eligible pensioners to claim their entitlement to the minimum income guarantee.

13 We have commissioned research which is part of the most comprehensive approach ever undertaken to examine why pensioners fail to claim their entitlement to Income Support. We will be able to quantify the extent and relative importance of different barriers to claiming, specifically among poorest pensioners. Much is yet to come but our earliest findings have already confirmed that:

- **some pensioners feel that there is a stigma attached to claiming;**
- **some pensioners are unaware that they are entitled; and**
- **some think that claiming is more difficult and complex than it actually is.**

14 We have also recently completed nine pilot exercises in Glasgow City, East Renfrewshire, Preston, York, South Staffordshire, Torfaen, Stroud, Lambeth and Torbay, aimed at testing the most effective means of identifying the pensioners who are not claiming, and finding the best ways of encouraging them to claim. The highest award to arise from the pilots was £77 a week. One pensioner said that now instead of buying one apple, she would be able to buy a pound.

15 We are still evaluating the results of both the research and the pilots. However, we have already made real progress in establishing the main reasons why people do not claim, and identifying a strategy to begin to overcome the barriers. Our immediate priorities are to:

- **refine our techniques to enable us to pinpoint those who may be entitled more accurately. We expect to have made improvements in this area by April 1999;**
- **identify pensioners who we think are entitled, and encourage them to claim in a way which they find acceptable and which helps to overcome stigma and uncertainty about the claiming process. We will bring forward proposals early in 1999 for the best ways of doing so; and**
- **trigger claims to Income Support automatically at points where pensioners are likely to become entitled to the minimum income guarantee. These include reaching the ages of 75 and 80, and the award of Attendance Allowance. We will start this service in 1999.**

16 We plan to run a publicity campaign in 1999. This will help to:

- **tackle the problem of stigma. We need to emphasise that the minimum income guarantee is an entitlement; and**
- **begin to educate people about the system – the research has shown that some pensioners perceive the system to be more complex and difficult to access than it actually is. The publicity campaign will help them.**

17 The minimum income guarantee is an entitlement, not a hand-out for those on low incomes. It is crucial that we get this message across to pensioners. We hope to achieve this through a combination of publicity and the more automatic delivery systems described above. But we need to go further and make some fundamental changes to the benefit and the ways in which it is delivered if we are to tackle the deep-rooted problems attached to claiming the minimum income guarantee.

The future

18 In the longer term we have two priorities.

- **To continue to modernise and improve the ways in which we deliver support to the poorest pensioners, so that it becomes more automatic.**
- **To give greater rewards to those who have made provision for their own retirement.**

Modernising and improving how we deliver help to pensioners

19 Over the coming years we will make a series of improvements to the delivery of the minimum income guarantee which will provide a modern service for pensioners that they will find simple and easy to use. We want to build an integrated and more automatic service for pensioners both when they reach retirement age and as they get older and their lives and needs change.

20 There are some specific improvements we want to make in addition to those described above.

- **Helping to overcome the complexity and stigma involved in claiming. Pensioners may have to deal with different organisations to claim different benefits and give financial details more than once. We aim to make it easier for pensioners to claim their key benefits. We want to enable pensioners to claim the basic state pension and the minimum income guarantee in one go rather than separately, and to make it simpler for them to claim Housing Benefit and Council Tax Benefit.**
- **Helping to overcome difficulties in completing claim forms. We want to provide access to the claims process by telephone, using our technology to minimise the number of questions we need to ask. We have already started this for state pension claimants in the London area. In the future, we want to make this service available nationally and expand it to include other key pensioner benefits.**
- **Working with others. We want to learn from local authorities and voluntary organisations, many of whom have been committed to providing better information to the most vulnerable pensioners for many years. We want to share best practice with them and work in partnership with them to help those in the greatest need.**

A fairer minimum income guarantee that rewards savings

21 Savings below £3,000 are ignored when calculating entitlement to the minimum income guarantee. People with savings between £3,000 and £8,000 have their benefit reduced on a sliding scale. Those with savings of more than £8,000 are excluded from claiming. These capital limits have been in place since 1988. Higher limits apply to those in residential care or nursing homes.

22 Those who qualify for the minimum income guarantee may not, therefore, see any gain from their savings, whilst some with a modest second pension do not qualify for the minimum income guarantee at all. We recognise that these rules can appear unfair to those who have saved. People resent the fact that voluntary saving can disqualify them from benefit, while non-savers get support.

23 There are a range of options for reform, from increasing the amount of savings which people can hold before entitlement is reduced or extinguished, to introducing some form of disregard on pensioners' income. We would welcome views on the most cost-effective way of tackling this issue, with a view to bringing forward proposals later in this Parliament.

Chapter Six

The future of state second pensions

The State Earnings Related Pension Scheme (SERPS) has served some pensioners well and has strengths, but it gives least help to those who need it most. We are therefore replacing SERPS with a new State Second Pension which will boost the pension entitlements of those on low incomes and carers. The new State Second Pension will cut the number of people who need to rely on income-related benefits in retirement. It will also help moderate earners build up better second pensions.

1 The previous chapter described our plans for helping today's poorest pensioners, including the minimum income guarantee. This chapter sets out our plans for helping pensioners of the future through state second pensions.

SERPS

2 **Chapter Two** describes how SERPS works indicating that one of its strengths is the low administrative costs involved. This means that SERPS is already an efficient and cost-effective second pension for lower earners for whom funded pensions are often unsuitable.

A new State Second Pension

3 Although SERPS is an efficient second pension, it is earnings-related. It does least for those on low incomes who have most difficulty in building up a good second pension. Many people on modest incomes will also receive limited benefits from SERPS or from the private provision they may make instead.

4 As a first stage, alongside our proposals for stakeholder pension schemes, we intend to replace SERPS with a new State Second Pension to meet two priorities. Our first priority is to give more help to those for whom private second pensions are not an option, either because they have low earnings or because they are, for a good reason, not working or seeking work. Our second priority is to help moderate earners to build up better second pensions, with as many as possible joining funded pension schemes. This will ensure that it is worthwhile for low and moderate earners to save for their retirement.

5 We expect most low earners to choose to remain in the new State Second Pension unless they can join an employer's scheme which offers a better deal. To begin with, moderate and higher earners will have the choice of remaining in the new State Second Pension or joining a funded scheme (those already in good occupational schemes, funded or unfunded, would be expected to remain in them).

6 In the second stage, when stakeholder pension schemes have established themselves as low-cost, value-for-money, funded second pensions, we expect the new State Second Pension to become a flat-rate scheme for those on lower earnings, with those on moderate and higher earnings joining a funded pension (with contracted-out rebates continuing to be earnings-related).

7 We do not believe it would be prudent to move to a new flat-rate State Second Pension in one step. It would cause significant disruption to existing provision, require millions of people to change their pension arrangements, and be costly. It would also be better to allow time for our new pension framework to become established.

8 We envisage that the move towards a new flat-rate State Second Pension might begin, for those with a significant part of their working lives still remaining (for example, those aged under 45 at the point of change), five years after the introduction of stakeholder pension schemes.

Our proposals

9 **We want to raise the pensions of the lower paid.**

To do this the new State Second Pension will:

- **double the value of SERPS on earnings up to £9,000 a year; and**
- **treat contributing employees earning up to £9,000 a year as if they had earned £9,000 when their new State Second Pension is calculated.**

10 **We want to help moderate earners.**

Moderate earners will also be helped by the doubling of the value of SERPS on their first £9,000 of earnings. We will set the value of the new State Second Pension so that they continue to gain some benefit until their earnings reach £18,500 a year. The position of higher earners, most of whom have already left SERPS, will remain unchanged.

11 **We want to encourage more people to take out funded schemes.**

Most people who can afford it want to have their own pension. Rebates will be increased for those earning between £9,000 and £18,500 a year, making funded pensions – occupational, personal or stakeholder schemes – more attractive. In time, we expect funded pensions to replace the new State Second Pension entirely for these moderate and higher earners.

12 **We want to help carers and disabled people with broken work records.**

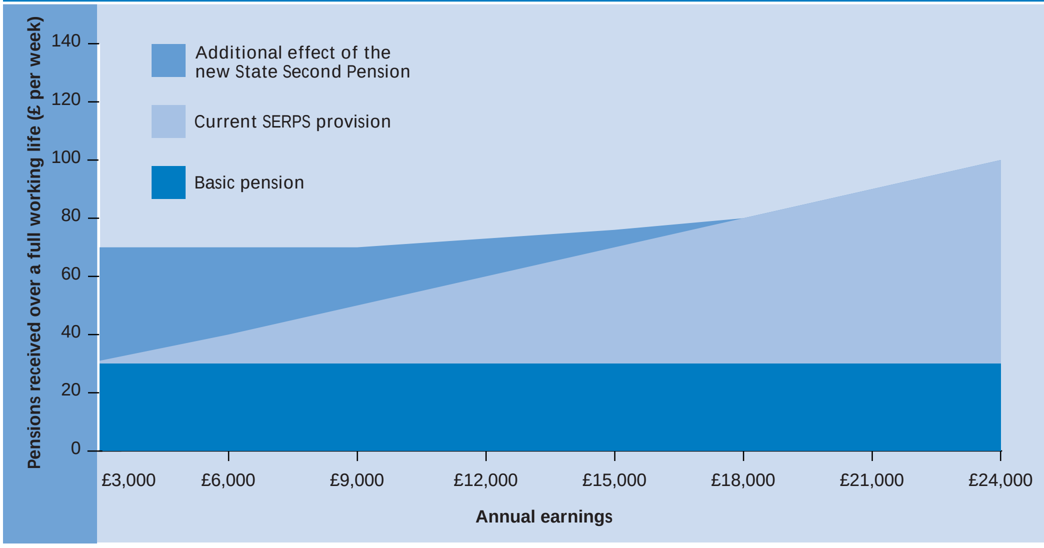
They will be credited into the new State Second Pension as if they had earnings of £9,000 a year.

13 The Annex to this chapter sets out how the new State Second Pension will work in more detail.

Impact

14 The following chart broadly captures the impact of the new State Second Pension in 2050, once individuals have experienced a full working lifetime under the new scheme.

Chart 5: Impact of new State Second Pension



Notes:

(1) The Chart is in earnings-equivalent terms. The cash value of the pensions received in today's prices would be roughly double those shown in the chart. With higher living standards in 2050, the figures shown give a better feel of what it will be like to live on those pensions.

15 The chart shows that:

- **lower earners earning up to £9,000 a year get a substantial boost to their second pension to the equivalent of almost £50 a week for a full working life (in earnings-equivalent terms), delivered through the new State Second Pension;**
- **moderate earners earning above £9,000 up to £18,500 a year (about the level of average earnings) receive a more modest increase in their pensions, delivered either through the new State Second Pension or increasingly through privately funded alternatives including the new stakeholder pension schemes; and**
- **all employees with earnings above £18,500 a year will get the same as they would under the current system.**

16 Our new State Second Pension will ensure that no one receives less under the new system than they do now. All those people earning up to £18,500 a year will gain. The proposed changes will have broadly the same effect as raising the rate of compulsory pension saving for lower and middle earners.

17 We are conscious that to be successful as part of a coherent pensions strategy, people must understand how the new State Second Pension will work. We will take steps, as part of the wider initiatives set out in **Chapter Ten,** to improve awareness and understanding of the new State Second Pension and its relation to funded schemes.

The impact on occupational and personal pensions

18 Any changes to the existing pensions framework will have an impact on occupational pension schemes and personal pensions. Around 14 million people are currently contracted out of SERPS. We want our new proposals to work alongside private arrangements so that they continue to flourish. We want to minimise the impact of our proposed changes on existing arrangements.

19 Our proposals will, in partnership with private provision, lead overall to better pension coverage. State pensions will complement private provision to give people a decent income in retirement. To establish exactly how state and private provision should work together we will want to consult widely with the pensions industry on a number of key issues.

20 We will need to consider, for example, how we can ensure that members of salary-related schemes earning between £9,000 and £18,500 a year will benefit appropriately from the increased rebates. We will want to establish the best and most efficient means of advising individuals whether to remain in the new State Second Pension or to contract out. In particular, we will want to discuss with occupational pension scheme and personal pension providers how they, and their members on low incomes, should be advised to respond. There will also be important technical issues to consider.

21 Our aim is to work with pension providers to resolve these and other issues.

Recognising the role of carers

An entitlement to a second pension

22 There are millions of carers in the UK, most of whom are women. While many carers undertake paid work, either full- or part-time, the majority are not able to combine their caring responsibilities with paid employment to a sufficient extent to build up an adequate entitlement to a second pension. We believe there is a strong case for helping them.

Coverage

23 We will consult on entitlement conditions, but our initial proposals are that carers will receive credits if they are within the categories below, provided they have insufficient earnings to cross the annual National Insurance Lower Earnings Limit (currently £3,300 a year).

- **Recipients of Invalid Care Allowance.**
- **Carers of people receiving Attendance Allowance or Disability Living Allowance, who qualify for Home Responsibilities Protection.**
- **Child Benefit recipients where the youngest child for whom the benefit is received is aged 5 or under.**

24 We believe entitlement should include carers of children below school age.

25 We also think there is a strong case for introducing similar arrangements for long-term disabled people who have had, but lost, their links with the labour market, and may be unable to complete their pension provision for retirement. We therefore propose that the new State Second Pension should be extended to those who are incapable of work for a substantial period of time as a result of illness or disability, who have had a labour market attachment in the past (and may have one in the future) and hence may already have built up some second pension rights. The labour market attachment would be determined through a simple contribution test applied at the point of award.

26 Those disabled people who have no contact with the labour market and thus are unable to build up any pensions of their own are specifically catered for by the non-contributory parts of the benefit system, both above and below state pension age. Our proposals for reforming these benefits were published in *A new contract for welfare: SUPPORT FOR DISABLED PEOPLE* (Cm 4103).

Impact

27 We estimate that by 2050 at least four million people, mainly women, will gain from this aspect of the new State Second Pension. Pensions would be increased by up to the equivalent of almost £50 a week in today's terms. This will include both long-term carers, who could receive up to almost £50 a week in today's terms, and the short-term carer whose missing years of pension provision will be covered (thus making it more worthwhile to save for retirement in the years when they are not caring).

Timing and costs of the new State Second Pension

28 Implementation will require primary and secondary legislation. Given Parliamentary timetables and the need to make changes to departmental computer systems, the earliest date for implementation is April 2002.

29 The public expenditure effects of these proposals would build up slowly from about £100 million in 2003/4 reaching about £5 billion by 2050 (after savings from lower income-related benefit payments). Contracted-out rebate costs would be increased at the outset by about £0.5 billion a year, after allowing for the return of some lower earners to the new State Second Pension.

Annex

A broad outline of the new State Second Pension proposals is set out below. The figures are indicative and may be revised following the consultation period.

- **All contributing employees earning less than £9,000 a year would be treated in the new State Second Pension as if they had earnings at that level.**
- **The rate at which employees' rights to the new State Second Pension build up on the band of earnings up to £9,000 a year would be 40 per cent for a full working life (compared to 20 per cent currently for most employees).**
- **The rate on the band of earnings £9,000 to £18,500 a year would be 10 per cent.**
- **The rate on the band of earnings £18,500 a year to the Upper Earnings Limit would remain at 20 per cent (for most employees).**
- **The new thresholds at £9,000 and £18,500 a year would be uprated in line with average earnings.**
- **Contracted-out rebates would be based on an individual's earnings and reflect the new three part pension rate structure.**
- **The new scheme would apply to future earnings from a given implementation date.**

Chapter Seven

Stakeholder pension schemes

People on middle incomes want to save more for retirement but current pension arrangements are often unsuitable or expensive. Our new secure, flexible and value-for-money stakeholder pension schemes will help many more middle earners to save for a comfortable retirement.

1 **Chapter Six** described our proposals to replace the State Earnings Related Pension Scheme (SERPS) with the new State Second Pension. This will boost the second pensions of the lowest paid and give some additional help to those on modest earnings. Those earning below £9,000 a year are likely to be better off in the new State Second Pension. At higher earnings levels, however, we want to see an extension of funded pensions. Individuals who can save should do so. To achieve this, people need to understand the importance of saving for their retirement, and be confident they will benefit from anything they do save. Crucially, those who can save for their retirement need to have access to pension schemes that enable them to do so.

2 This country already has a well-developed framework of funded pensions. Occupational pension schemes sponsored by employers are one of the great welfare success stories. The growth of occupational provision is one of the main reasons for the improvement in pensioner incomes over recent decades. Nearly half of all current employees are in an occupational scheme. The market value of the funds held in occupational schemes is £640 billion. Personal pensions, and their predecessors, also hold an increasingly significant amount of retirement savings. The value of personal pension funds stands at about £190 billion.

3 Taken together, funded pension rights in the UK represent around 40 per cent of all pension rights. This balance of funded and unfunded provision is a key strength of the UK pension system. It is one of the reasons we face less severe public finance pressures than many other industrialised countries which are also experiencing an ageing of their population.

4 We are determined to build on this sound framework by supporting and strengthening funded pensions. The key to this is an effective partnership between the public and private sectors.

Stakeholder pension schemes

5 **Chapter Three** showed that not everyone can join a good second pension scheme. Occupational pension schemes continue to provide some of the best arrangements, reinforced by valuable contributions from employers. They are not an option for the 35 per cent of employees whose employers do not offer a scheme, nor for the self-employed.

6 Personal pensions do not always meet their needs. The costs of contacting potential customers and convincing them to take out a pension typically account for two-thirds of the total charges of personal pensions. These charges can cause a significant reduction in the value of a member's savings by the time they retire. Someone who has to stop contributing within a few years can often find they have lost most or all of their savings. Yet a third of the people who buy personal pensions cease contributing within three years.

7 Individuals can find personal pensions difficult to understand and nearly impossible to compare. Many are put off by the prospect of seeking financial advice; those who do can find it difficult to get impartial and cost effective advice. And mis-selling has tainted the whole sector.

8 We need to:

- **modernise the pension system to introduce more flexible, value-for-money, pension schemes;**
- **ensure people have confidence to entrust their savings to the schemes, in the knowledge that the schemes are secure and well-run;**
- **provide more efficient access to pensions; and**
- **promote the habit of saving, both in long-term pension schemes and through Individual Savings Accounts (ISAs), and provide the right flexibility between them.**

9 Our manifesto said we would create a framework for secure, flexible and value-for-money stakeholder pension schemes. We consulted widely on our proposals at the end of 1997. There was widespread agreement on the need for better value second pension schemes for those who cannot join occupational schemes. We have taken the consultation responses into account in developing these proposals.

Target group

10 Stakeholder pension schemes will be open to everyone. They are likely to be a cost-effective alternative to the new State Second Pension for those earning more than £9,000 a year. Those who earn above £20,000 a year are in most cases already making additional pension provision. But many people earning over £20,000 a year will be able, now and in the future, to take advantage of the lower charges, greater flexibility, and simpler tax regime which stakeholder pension schemes will introduce.

11 Around 10.75 million people – both employees and self-employed people – currently earn between £9,000 and £20,000 a year.

- **Half of these are in occupational schemes. Occupational pensions will usually be the best second pension option for that group. Our proposals to encourage take-up of occupational scheme membership will lead to an increase in the numbers in occupational schemes.**
- **About 5.3 million people are not in an occupational scheme. Of these, we estimate around 2.5 million contribute to a personal pension. Around 1 million people are in a personal pension but only pay in their National Insurance rebate and make no additional savings of their own.**

12 While stakeholder pension schemes will provide a better value option than most personal pensions, many people have already committed themselves to a personal pension. Under the terms of their contract, it may not be advisable for them to switch to a new arrangement. In the short term, we expect those who are not currently contributing to an occupational pension scheme or to a personal pension to be most likely to join. We will be looking to the personal pensions industry to facilitate transfer into stakeholder pension schemes where it is in the client's interest.

13 Those in today's workforce who are most likely to join stakeholder pension schemes are predominantly in full-time work. Nearly half work either in manufacturing or in the retail and hospitality industries. One in five are self-employed. Most will be under the age of 50. Roughly two-thirds are men and a third are women.

14 Over time, we can expect stakeholder pension schemes to cater for new generations of workers, including those on higher incomes who might otherwise have taken out personal pensions. Many people who have periods of part-time and lower paid employment will be likely to join stakeholder pension schemes when they are in full-time work. They will be able to continue making additional voluntary contributions to their stakeholder scheme even during periods when they are in the new State Second Pension.

Who would benefit from a stakeholder pension scheme?

- *25-year-old construction worker, self-employed, moving from site to site depending on where the work is.*

  His work is seasonal. He could afford to build up a good pension but he cannot find a scheme that offers the necessary flexibility to stop and start contributions. He cannot contribute to SERPS because he is self-employed.

- *30-year-old graduate working under contract for an independent TV production company.*

  She may stay in the same job for years, moving from one contract to the next, earning a decent wage. She has no access to an occupational scheme at present but believes she may join a company which offers a good occupational scheme and is worried she might lose out if she takes out an inflexible personal pension.

- *40-year-old chef, working for a restaurant chain.*

  He knows he should be building up a pension. His employer has suggested a group personal pension to him but will not contribute to it; he has heard about mis-selling and is worried about making the right choice.

- *35-year-old lone parent with one school-age child. Works through an agency as a temporary secretary.*

  She has changed jobs several times recently to fit in with her childcare arrangements. There is no occupational scheme on offer and she has never got around to finding out about a personal pension because she did not think it would be appropriate to her circumstances. She thinks she could afford to save around £10 a week into a pension and does not expect a financial adviser would be interested in people who can only save a small amount.

Outline of proposals

15 The features we propose for stakeholder pension schemes will work together to deliver a better deal for future generations of pensioners.

- **The costs of stakeholder pension schemes will be kept low, by:**
  - **using a collective structure, like occupational schemes, to get the best value-for-money for scheme members;**
  - **reducing the costs of marketing and collecting contributions, by ensuring access to schemes at the workplace;**

  - **reducing the need for individual financial advice; and**
  - **having simple tax rules.**
- **There will be minimum standards for charges and no penalties if people stop contributing, or choose to move to another arrangement.**
- **Members' rights will be secure and properly protected.**

16 The proposals set out here are designed to address four basic problems with the second pension options currently available to those who cannot join an occupational scheme. These are the:

- **complexity of personal pensions;**
- **difficulties individual buyers face in getting a good deal;**
- **costs of regulation; and**
- **costs of distributing and marketing pensions.**

17 **Firstly**, most current personal pensions are difficult products for people to understand. People find it hard to know whether a pension offers them a good deal and are unable to make easy comparisons between them. There are complex charging structures, with different types of charges and quite different effects depending on how long the pension is held for.

18 We believe this can be addressed for stakeholder pension schemes by defining a number of minimum standards which schemes must meet in order to be stakeholder pension schemes. These will promote standardisation across schemes, allowing consumers to compare what is on offer more easily. They will give a minimum level of protection and reassurance to potential scheme members that a stakeholder pension scheme will provide them with a good basic deal.

19 **Secondly**, individuals have limited power in the pension market. Personal pensions are complex. Individual consumers have no real power to negotiate with pension providers. Shopping around effectively is difficult. When they join, they have no influence on the terms of their contract and no power to press for improvements after they have joined. Pension providers similarly have little incentive to improve the contracts of existing members. A few members may move to other providers who offer a better deal, but most do not.

20 Stakeholder pension schemes need to be run with much greater emphasis on the interests of their members. They need to be able to use the buying power of the scheme members as a whole to get the best value-for-money, to improve the terms of the scheme and to go beyond the minimum standards set for all schemes. And they need to ensure that all scheme members receive a good service and that they all benefit from improvements to the scheme.

21 **Thirdly**, we need to address the costs of regulation. The regulation of personal pensions focuses on the way they are sold and the advice people receive. It is clearly right that people should get proper advice on significant financial investments like pensions. But advice has a cost.

22 We believe we can change the way we regulate stakeholder pension schemes, both to reduce the overall costs of regulation and to provide more security than the existing arrangements. We intend to move the focus of regulation from the sales process to the administration of the schemes. The reassurance provided by the minimum standards and by ensuring schemes are run in their members' interests will reduce the need for detailed financial advice when people join schemes.

23 **Fourthly**, personal pensions are expensive to distribute to potential customers.

24 We want to make access to stakeholder pension schemes as simple and cost-effective as possible. Two-thirds of employees are offered an occupational scheme by their employer. We will provide access to a pension scheme to the other third, at their place of work, by requiring employers to provide access to a stakeholder pension scheme and to pass on contributions from their employees' wages. Employers who already offer an occupational scheme to all their employees will not be affected.

Defining stakeholder pension schemes

25 A stakeholder pension scheme will have two key features. Firstly, stakeholder pension schemes will need to meet the minimum standards we shall set out for them.

26 Secondly, stakeholder pension schemes will need to be set up with an approved governance structure. The governance structure will need to ensure schemes are run in the interests of their members and are able to deliver an appropriate outcome in terms of value-for-money and service to the scheme members. We propose to legislate initially for one such model, where schemes are established under trust law and run by a board of trustees, but other structures may be approved later.

27 Stakeholder pension schemes will be required to register when they are set up. By registering, they will be undertaking to comply with these requirements, as well as all other conditions set for stakeholder pension schemes in relation to, for example, contracting-out and tax approval.

28 Most private sector occupational schemes are already set up under trust, with a controlling trustee board. It will therefore be open to occupational schemes which offer money purchase benefits to be designated as stakeholder pension schemes if they also meet the other requirements.

29 Although personal pensions are also often set up under a trust, the nature of the trust deed generally does not provide for the trustees to control the scheme. The personal pension provider retains overall control. Existing personal pensions will not therefore be able to describe themselves as stakeholder pension schemes.

30 Personal pensions will have the option to meet the minimum product standards for stakeholder pension schemes and to describe themselves accordingly in their promotional material. Indeed we expect that many personal pension providers will seek to match the stakeholder pension scheme standards.

Minimum standards

31 The minimum standards for stakeholder pension schemes will build on the 'CAT' standards (cost, access and terms), which are to be used for Individual Savings Accounts (ISAs). But compliance with the ISA CAT standards is voluntary. For stakeholder pension schemes, compliance with the standards will be a requirement for the scheme to be designated as a stakeholder pension scheme. We see no advantage – and potential confusion – in allowing stakeholder pension schemes which do not meet the standards to be established.

32 We propose to set minimum standards in a number of areas. We will require:

- **a simple charging structure, which members can understand and which allows ready comparisons between schemes. To avoid penalising those with small savings and those who stop paying into their scheme, we think charges should be levied in the form of a percentage, rather than a flat-rate sum. Charges could be levied as a percentage of the members' accumulated funds, or as a percentage of the contributions paid in. These will have different implications for scheme members and for scheme providers. We will consult on which of these two structures would be most appropriate;**
- **a limit on the permitted level of charges. There are risks in setting a maximum, which can become a minimum and discourage competition to get below it. But we think the reassurance of a fixed standard is needed to enable stakeholder pension schemes to meet their aims. The governance arrangements of schemes will ensure there is pressure to improve on the standard. The permitted charge level will be set later, following consultation. The limit on charges will cover all normal operating costs of the scheme. Schemes will be able to make extra charges only in respect of any additional services which they offer to members on a discretionary basis (for example, individual financial advice). There will be no additional entry or exit charges;**

- **that schemes which require minimum contributions should not set these to be more than a specified amount. Schemes would undertake to accept either one-off or regular contributions above this level;**
- **that schemes allow members to stop and re-start contributions without penalty;**
- **that members are able to transfer their funds to another scheme, at any time, and without any additional charge on their funds;**
- **that schemes should accept transfers of members' pension rights from other schemes; and**
- **that schemes provide members with at least annual information about the value of their pension, the contributions which have been paid in and the charges deducted by the scheme.**

33 Legislation for stakeholder pension schemes will at this stage provide the powers to specify the details of the minimum standards. We propose to consult on the minimum standards before setting out the final details. **We would welcome views on whether standards should be set in any other areas and on the specification of the standards discussed here.**

Governance

34 We need stakeholder pension schemes to be clearly run in the interests of their members and to be capable of acting on their behalf. Schemes will therefore need to adopt a structure which ensures this can happen.

35 The structure must be able to:

- **use the power of the members' contributions to ensure they get the best value-for-money;**
- **ensure the scheme complies with the minimum standards and other regulatory requirements; and**
- **provide the members of the scheme with high standards of service and with good-quality information about the scheme and about the members' pension rights within it.**

36 The well established means of meeting these aims in pension schemes is by using trust law, with a board of trustees responsible for overseeing the conduct and operation of the schemes. The great majority of private occupational pension schemes in the UK adopt this structure. Trustees in those schemes appoint the commercial companies who invest the scheme's funds on their behalf and provide administration services to the scheme. They also monitor regularly the performance of these organisations and may switch providers from time to time. The trustees in occupational schemes normally include the employer, but may also include representatives of scheme members. They normally appoint professional advisers to assist them.

37 We consider that trust law provides an appropriate framework for stakeholder pension schemes and that the presence of trustees in the schemes will ensure they are capable of meeting the aims we have set out for them. The legislation for stakeholder pension schemes will provide for schemes to be set up under trust law. The trust deed will need to give the trustees effective control of the scheme, so they can ensure it is run in the primary interest of its members. Many of the protections and benefits currently enjoyed by members of occupational schemes will therefore be available – for the first time – to those who work for employers who do not offer an occupational scheme and to the self-employed.

38 It is possible, however, that other arrangements could be capable of producing a comparable outcome for scheme members. And we would not want to rule out the development of new governance structures in the future. In order to provide sufficient flexibility, therefore, we will take the power to define, in secondary legislation, alternative governance arrangements which would be approved by the Secretary of State for Social Security as meeting the requirements to be stakeholder pension schemes. **We would welcome views from the pensions industry on alternative structures which could provide comparable benefits for stakeholder pension scheme members.**

39 The Treasury will also publish shortly a consultation document outlining proposals concerning investment by pension schemes. The proposals are designed to allow stakeholder pension schemes run under such alternative governance arrangements to invest funds in units in pooled investment schemes, in a transparent way. Such alternative investments could also be used by personal pension schemes. (Schemes run by trusts can already invest in that way.) This will increase the flexibility of such schemes, in that it would be straightforward for scheme members to adjust their investment exposures or indeed to move from one scheme to another as their circumstances change.

Regulation

40 We judge that the governance of trust-based stakeholder pension schemes would fall most naturally under the regulation of the Occupational Pensions Regulatory Authority (Opra). Opra already has considerable experience in regulating the conduct of occupational pension schemes and could regulate the conduct of trustees in stakeholder pension schemes in broadly the same way, dealing with reported problems as they arise.

41 As with personal pensions, the Financial Services Authority (FSA) will regulate the marketing of stakeholder pension schemes and advice on whether to join them, using powers under the Financial Services Act or its successor. The FSA will also authorise and supervise the firms responsible for managing the funds invested in stakeholder schemes.

42 The legislation for stakeholder pension schemes will therefore give Opra a role to regulate the governance of trust-based stakeholder pension schemes. As part of this, we propose also to apply to stakeholder pension schemes the main relevant provisions of the 1995 Pensions Act. Amongst other things, these will require the trustees of stakeholder pension schemes to:

- **produce an annual report and accounts;**
- **appoint professional advisers;**
- **draw up a statement of investment principles; and**
- **put in place procedures for dealing with internal disputes.**

43 Opra will also regulate the timely payment of contributions by employers, where we are proposing to introduce a common requirement across all pension schemes.

44 Members of stakeholder pension schemes, like members of occupational schemes, will have access to the Pensions Ombudsman as the mechanism for individual redress in the event of maladministration by the trustees and to the Financial Services Ombudsman for complaints about inappropriate advice or promotional material.

45 The proposed division of responsibilities reflects the current roles and expertise of both existing regulators. It does mean, however, that stakeholder pension schemes would have to deal with two regulators. **We do not expect this to lead to any significant problems, but we would welcome views on this choice**. We will consult on the regulatory arrangements for any alternative scheme structures which may be approved in the future.

46 The Inland Revenue would, as now, oversee the registration of stakeholder pension schemes to verify that schemes which register for favourable tax treatment do, in practice, satisfy the conditions. The Inland Revenue register would be shared with Opra.

47 For many people, joining a stakeholder pension scheme will involve similar decisions to those involved in joining a personal pension. The FSA will therefore have an important role in overseeing the quality of advice given, by setting the training and competency standards for those involved and ensuring compliance with their rules. This will be essential to avoid future mis-selling problems.

48 We intend to reduce, as far as possible, the need for individuals to seek financial advice when they consider joining a stakeholder pension scheme. We will work with the FSA to develop an information and advice regime for stakeholder pension schemes which meets these requirements. The fact that stakeholder pension schemes have to meet a number of minimum standards on charges and flexibility will play an important part in simplifying the decisions people have to make, particularly when leaving SERPS.

49 We propose to develop a 'decision tree' approach. The decision tree will allow potential members to work through a number of key questions about their own circumstances and it will clearly set out their options and encourage them to take advice when necessary. This would be a key part of the information provided by a scheme to any potential member. It should allow people to make an informed decision without advice in many cases. There will be a duty on the trustees of schemes to ensure that the required information is made available to potential members. The application of the FSA rules on financial promotion will ensure schemes are promoted in a way that does not mislead. Where employers agree to contribute to stakeholder pension schemes, the decision for the employee to join will be considerably easier.

50 Where people do need or want advice, we see scope for schemes to make arrangements to offer general advice to members and potential members, perhaps through telephone 'hotlines' or by having advisers visit the workplace. Collective schemes are also likely to be able to offer relatively low-cost individual advice from qualified financial advisers.

51 The process by which personal pensions are sold will also need to reflect the presence of stakeholder pension schemes. The FSA will consider how anyone giving advice on a personal pension should take into account the alternative offered by stakeholder pension schemes.

Workplace access

52 Much of the cost of providing most personal pensions arises from the process of contacting and recruiting potential customers, and then collecting contributions from them. To help stakeholder pension schemes achieve the aim of better value provision and to encourage people to join schemes, we propose to make significant changes to the way people come into contact with second pensions.

53 We want everyone in work to have access to a good value pension scheme through their workplace. This is already the case for those whose employers offer an occupational scheme. We propose to introduce a new requirement on other employers which will ensure that employees who cannot join an occupational scheme have access to a stakeholder pension scheme at their place of work. At this time, there will be no compulsion on employers to contribute to stakeholder pension schemes, but it will of course be open to them to do so.

54 The requirement will have two elements.

- **Employers who do not offer an occupational scheme will be required to identify a stakeholder pension scheme and to facilitate access to it for their employees. This will mean providing information to employees and allowing the nominated scheme a reasonable degree of access to the workforce to promote the scheme.**

- **Employers will be required, at the request of their employees, to deduct pension contributions direct from their pay and to pass that money to the nominated scheme within a specified period. We recognise that to contain costs this would need to be subject to a limit on the extent to which employees could opt to change the level of their contribution.**

55 We propose that employers will be exempted from these requirements in respect of employees who are eligible for an occupational scheme and any employees whose earnings fall below the National Insurance Lower Earnings Limit. So, for example, employers who already offer an occupational scheme to all their employees will not be affected.

56 While our aim is to provide access for all those who could benefit from joining a stakeholder pension scheme, we are concerned about the potential burdens on employers with very few employees who are mostly low-paid and likely to be better off in the new State Second Pension. **We would welcome views, therefore, on whether access should be on a voluntary basis for some groups of employers. We would also like to hear views on how best to incorporate employers who currently offer group personal pension arrangements, or who make contributions to personal pensions, so as to ensure that employees are not disadvantaged by any change.**

57 We propose to require employers to consult their workforce (or their representatives) on the choice of nominated scheme. The identification by employers of their nominated stakeholder pension scheme will be an important part of the process. Where employers make no existing provision, the choice of a stakeholder scheme should be uncomplicated. They may wish to engage independent advisers in selecting a stakeholder pension scheme that is suitable for their employees. Where employers already contribute to personal pension arrangements, they will need to consider whether they will offer the same contributions to employees who join a stakeholder pension scheme.

58 The requirements will come into force as soon as possible after the introduction of stakeholder pension schemes. We will, however, want to allow employers a reasonable period of time to make the necessary arrangements.

59 We are committed to minimising the impact on business from this new requirement. We believe the requirement set out here strikes a reasonable balance between the small additional burden on employers and the need to ensure wider access to good value pension schemes. Many employers will welcome the chance to give their employees access to a good value pension scheme.

60 There is also much that the schemes and their service providers can do to minimise the burden on employers. We would hope to see stakeholder pension schemes following the example of schemes in the USA, which offer software packages to employers to facilitate payroll deductions.

A clearing house

61 The initial requirement in respect of payroll deductions will require employers to pass contributions only to the single nominated scheme. Employees choosing to join other schemes would need to make their own arrangements, although it would be open to employers to provide this facility if they wished.

62 In time, however, we would look to extend the payroll deduction requirement so that contributions would be passed to any stakeholder pension scheme. But we wish to avoid imposing undue administrative responsibilities on employers. Before extending the scope of the requirement we believe it might well be desirable to have in place a suitable 'clearing house' arrangement which would allow employers to make a single payment in respect of all stakeholder pension schemes. The clearing house would then pass the money on to each scheme.

63 The Government will consult further on a clearing house and will look to develop ideas with the pensions and financial services industry and with employer groups, considering the main options for its development, its governance and how its costs would be recovered from those using it.

Development of stakeholder pension schemes

64 Stakeholder pension schemes will develop in a number of ways. All are likely to involve a partnership with financial service companies, but we expect schemes to fall into three main categories.

- **Those based on representative and membership organisations.**
- **Those set up by financial service companies.**
- **Those set up by employers.**

65 We have already seen a number of schemes set up under the personal pension framework, with the involvement of employers, to cater for people working for a number of different employers in the same industry. Others have been developed by trade unions. These schemes reflect the aims of stakeholder pension schemes, but we need to provide a statutory framework for such schemes which provides proper regulatory protection of their members and enables their costs to be reduced.

66 Schemes which develop around existing groups offer a number of advantages. The membership or affinity connection provides a means of recruiting scheme members without the need for expensive advertising or sales-forces. The link with a known organisation can also increase people's confidence in a pension scheme. And the organisation itself provides a source for scheme trustees who can be expected to represent the interests of scheme members. Trade associations and representative organisations could also provide a basis for schemes catering for the self-employed.

67 We also want to consult further on the scope for schemes to be set up by other organisations. Local government interests have suggested, for example, that appropriate councils with pensions expertise could be empowered to provide stakeholder pension schemes. These could be available for people not catered for by other schemes, or for those who may have a local or regional affinity. However, any prospect for local government being involved commercially in the provision of stakeholder pension schemes would need detailed analysis and assessment, taking full account of the financial and legal context within which local authorities must operate, and the statutory safeguards that would be required in connection with such an option.

68 Financial service companies may opt to establish their own schemes, subject to putting in place the necessary governance structure. Existing brand names could be a strong selling-point. Such schemes could also be directed at those self-employed people who are not catered for by schemes set up by representative organisations.

69 Single employers, or groups of employers, may set up stakeholder pension schemes for members of their workforces. These could be employers who do not offer occupational pension schemes at present. We expect many employers who currently offer group personal pensions, for example, will elect to offer stakeholder pension schemes in future.

70 We also see scope for employers to incorporate a stakeholder pension scheme into their occupational pension arrangements. There is already a trend within occupational provision for schemes to offer more of a mix of salary-related and money purchase arrangements. These reflect employers' aims to offer provision which better meets the needs of their workforce – traditional salary-related schemes can be relatively poor value for those who stay with the employer for a short time.

71 We envisage, for example, that employers might see advantages in having a stakeholder pension scheme for employees who do not qualify for membership of the main occupational pension scheme. The stakeholder element might then cover casual employees or others who have been with the employer only a short time. As these people became eligible they could switch to membership of the main occupational pension scheme. Or, if they moved on to a new employer, they could take their stakeholder pension fund with them.

72 The legislation for stakeholder pension schemes will therefore allow occupational schemes which comply with the requirements of a stakeholder pension scheme to be designated as such.

73 The advent of stakeholder pension schemes will be both a significant challenge and a business opportunity for the financial services sector. It is clear from other countries, such as the USA and Australia, and from the experience of occupational schemes in the UK, that the private sector can deliver highly efficient funded pensions. The Government will deliver the right statutory and regulatory framework. In turn, we look to the private sector to set up and run the new schemes.

Benefits

74 We expect stakeholder pension schemes will provide money purchase benefits, in which the pension is linked to the contributions paid in by individual members. This will mean accumulating a fund of savings which is normally used to purchase an annuity at retirement. Schemes may choose to offer within this a targeting arrangement, which allows members or their employers to aim for a particular pension level in relation, for example, to their earnings. It is also consistent with schemes which choose an insurance arrangement, to offer some elements of guaranteed benefits, or for pensions to be paid by the scheme itself, subject to meeting any charging limit. We do not propose to legislate to enable stakeholder schemes to offer salary-related benefits. Such arrangements require a person or organisation to provide a funding commitment and are more appropriate, therefore, for occupational schemes.

75 Stakeholder pension schemes will also be a means of contracting out of SERPS. This will not require schemes as a whole to take on contracted-out status, as in occupational schemes, but they will allow individual members to elect to contract out and to have a rebate paid to their scheme. We have said that we plan to review the structure of contracting-out rebates in the light of stakeholder pension schemes. One of our aims in that review will be to make the contracting-out decision in respect of stakeholder pension schemes as straightforward as possible and not one which normally requires individual financial advice. Under the proposals set out in **Chapter Six**, the contracting-out rebates would be increased, on the introduction of the new State Second Pension, to reflect the higher levels of benefit foregone by those earning under £18,500 a year.

76 It is not our intention to prescribe all the details of stakeholder pension schemes. Many key decisions will be for the sponsors of the scheme, the providers and the trustees to take when the schemes are set up. This will allow them to reflect the needs of the particular scheme.

77 These will include:

- **the benefits to be provided by the scheme;**
- **the scheme's normal retirement age;**
- **its investment strategy;**
- **the investment choice offered to members; and**
- **any restrictions on membership.**

78 Some schemes may elect, for example, to offer members a degree of investment choice. Others may elect to adopt a fully collective approach to investment, with all members' funds held in the same portfolio overseen by trustees. We would, however, expect stakeholder pension schemes to offer their members an appropriately simple and understandable arrangement and also to take steps to protect the value of members' funds as they approach retirement.

79 There will be some limitations on the benefits which can be provided, in line with existing tax and contracting-out rules. We propose that the benefit restrictions for stakeholder pension schemes should follow those for personal pensions, that is, pension age will be between 50 and 75, a tax-free lump sum will be available, and income drawdown will be allowed. For those who contract out of SERPS and receive National Insurance rebates, any protected rights held by the scheme will not be available until the age of 60 and may not be taken as a lump sum. The existing contracting-out requirement to provide a survivor's benefit for a legal spouse will also apply.

80 We also want to consult further on the extent to which stakeholder pension schemes could provide access to other additional benefits. As collective schemes with bargaining power, we would expect stakeholder pension schemes to be able to offer good value access to other arrangements, such as life insurance cover to provide for survivors and 'waiver of premiums' cover which allows contributions to the pension to continue if the member becomes ill or disabled.

The tax regime

81 As with other pension schemes, contributions to stakeholder pension schemes will qualify for tax relief. Investment income and capital growth within the schemes will also be exempt from tax. The resulting pension will be taxable, except that part of the fund (excluding protected rights deriving from National Insurance rebates) may be taken as a tax-free lump sum.

82 Additionally, however, we propose some simplification of the tax regime for stakeholder pension schemes.

- **Contributions to the scheme will be limited to a fixed sum of £3,600 a year, or 100 per cent of the member's earnings, whichever is lower. Therefore, it will not be necessary for schemes to check contributions against earnings for the great majority of scheme members. This will help to reduce administration costs and will also be clearer for scheme members with low earnings than contribution limits expressed as a percentage of earnings. The contribution limit will apply to the sum of any individual and employer contributions, but will not include the value of any National Insurance rebates.**
- **Scheme members who stop working will be able to continue to contribute, with tax relief, up to the annual limit, for a period of up to five years. This is a simpler alternative to the arrangements in personal pensions which allow contribution relief to be carried forward and contributions to be carried back to earlier years. It will provide – in a simple form – considerable flexibility for carers and those who take career breaks to have children, to keep building up their pension, where they can afford to do so.**

83 Both these changes will help to reinforce the complementary relationship between stakeholder pension schemes and ISAs. By allowing people to transfer money from ISAs into stakeholder pension schemes both when they are in and out of work, with tax relief, they will provide flexibility between different forms of saving. People who are reluctant to commit their savings initially to a pension will be able to use tax-privileged ISAs as a holding fund for their savings and to transfer them into a pension, within the set contribution limits, when they feel it is right to do so.

84 The changes will also make it easier for partners to contribute to each other's pensions, again within the overall contribution limits, should they choose to do so.

85 More detailed aspects of the tax regime for stakeholder pension schemes will be decided in due course.

Timetable

86 The primary legislation needed to put in place the basic framework for stakeholder pension schemes will be included in the Bill for welfare reform to be presented to Parliament in the current session. As is normal, many of the detailed aspects will be set out later in secondary legislation once the Bill has received Royal Assent. We intend to consult fully on the detail of the proposals, through responses to this Green Paper, the further specific consultation exercises referred to in this chapter, and by consulting on the detail of the secondary legislation.

87 We are determined to make progress as quickly as possible in introducing stakeholder pension schemes. That is why we are introducing the framework legislation now. The precise timing of the further stages will depend on a number of factors, but our aim is to enable the first stakeholder pension schemes to be set up from April 2001.

Chapter Eight

Strengthening the framework for occupational pension schemes

Occupational pension schemes provide an affordable and secure pension for millions. We want to build on this success by strengthening the framework for occupational pension schemes and encouraging those who can to join them.

1 Occupational pension schemes are the great welfare success story of this country. They are provided voluntarily by employers, and many millions of people benefit from them now and will continue to benefit.

2 Our aim is to support employers who provide occupational pension schemes and encourage them to do so. Those employers who do provide schemes make a significant contribution, paying over £12 billion in 1996[1]. Moreover, among larger employers in particular, the provision of a pension scheme is very widespread. The 1994 *Employers' Pension Provision* research report[2] found that nearly 90 per cent of larger employers with over 100 employees provided pension schemes.

Commitment to occupational pensions

4 In our manifesto, we promised to support and strengthen the framework for occupational pensions. We are committed to create an environment in which they can flourish in line with our wider economic strategy of promoting national and international economic stability and improving productivity performance.

5 Our proposals to create a framework for stakeholder pension schemes are not intended to change the commitment that employers already have to providing occupational pension schemes. Only those employers who do not offer a pension scheme will be required to offer access to a stakeholder pension scheme and the regulation of stakeholder pension schemes will be comparable to that which applies to occupational pension schemes. Stakeholder pension schemes will be aimed at opening new doors for people who do not at present have the opportunity to join a good value and affordable pension scheme.

[1] *United Kingdom National Accounts, The Blue Book*, 1997 edition. Government Statistical Service (figure includes DSS rebates).

[2] *Employers' Pension Provision 1994*. Casey, Bernard; Hales, Jon; and Millward, Neil; Department of Social Security Research Report No 58.

6 It is important to make the regulation of occupational pension schemes as simple as possible. We are aiming to simplify where that can be done without jeopardising the security of members' pension rights. We have, as a first stage, identified a package of changes. These are important, but many of them are by their very nature detailed and, in some cases, technical. We are, therefore, issuing a separate consultation paper to enable all of the practical implications to be considered. This is, however, only a beginning. We will continue to work with the pensions industry on simplifying procedures and removing regulatory burdens where appropriate.

7 The separate consultation paper includes proposals on ways of simplifying the contracting-out and member-nominated trustee procedures and relaxing regulatory burdens from certain types of pension schemes. A brief outline is set out later in this chapter. We have also identified further measures to strengthen the framework for occupational pension schemes and further protect pension rights. They are also set out later in this chapter.

Encouraging membership of schemes

8 We want to do more to encourage people to join occupational pension schemes. Until 1988, employers could require employees to join their occupational pension schemes as a condition of employment. Since then, some employees have chosen not to join an occupational pension scheme, even though it would be in their best interests in the longer term.

9 There has been a distinct decline in the proportion of employees who are members of occupational pension schemes. A survey conducted by the National Association of Pension Funds earlier in 1998 suggested that up to a third of employees eligible to join their employer's pension scheme on starting a new job choose not to do so. Some have personal pensions, but most are unlikely to have made any private provision. A continuation of this trend would be counter to our objective of increasing occupational pension coverage in the future.

10 Estimates vary, but there are at least 1.5 million employees who could be enjoying the benefits of an employer's scheme, but choose not to do so. We want to reverse this trend and achieve a significant reduction in the number of non-joiners. To achieve this we have considered a number of options. We expect some increase in the take-up of occupational pensions to result from improvements to pensions education. We have already taken steps to ensure that people are better informed about pension issues generally, and about the options available to them as individuals in particular. It is highly desirable that individuals are given the clearest possible statement of the value to them of joining their employer's occupational pension scheme. This could include an estimate of the cash value of an employer's contribution, as well as the pension rights resulting. We expect the Quality in Pensions accreditation scheme to encourage the provision of this information.

11 Some employers put their employees into their scheme automatically, leaving it to the employee to make a decision to opt out. There is evidence that this results in higher participation rates and we will encourage employers to adopt this approach. However, we recognise that some employers will want to go further.

12 We have considered whether we should re-instate the pre-1988 position, where employers could make scheme membership an absolute condition of employment. However, although this would benefit many employees, there would be some who would be better off making alternative arrangements. This group might include those employees who do not expect to stay with an employer in the long term or those with an existing personal pension. There is no simple test that would guarantee to identify which employees would benefit from joining an employer's scheme. We have therefore decided that we would need to allow employees to opt out, although the opt-out could be available only under specified conditions.

13 Where an employer wishes to make membership of an occupational pension scheme a condition of employment we could require that the employee:

- **will be given a clear statement of the rights he or she is giving up and has to confirm explicitly his or her wish to opt out of the employer's scheme; or**
- **has to certify that he or she has adequate alternative provision; or**
- **has to show that he or she has taken advice about his or her pension arrangements; or**
- **has to show that his or her advice confirms that his or her's alternative provision is adequate or equivalent.**

14 **We are seeking views on whether we should allow employers to require employees to be members of their occupational schemes, subject to a right for employees to opt-out. We are also seeking views on what conditions employees should satisfy in order to be permitted to opt out.**

Recognising quality in pensions

15 To further strengthen and support occupational pension provision we need both to reinforce the employer's role in pension provision and provide employees with more confidence in the quality of that provision. We believe this can be achieved by introducing a Quality in Pensions accreditation scheme.

16 We propose a scheme which will raise standards and reward best practice. Those occupational schemes that set high standards and provide a benchmark against which employers, employees and trustees can measure their own scheme will be eligible for accreditation.

A Quality in Pensions accreditation scheme

- **The Quality in Pensions accreditation scheme will be open to all occupational schemes, large and small, in both the public and private sectors.**
- **Members of schemes that achieve accreditation will be confident that their scheme is well run and meets defined standards for benefits, scheme governance and communications.**
- **Employers running Quality in Pensions schemes will be able to use accreditation to encourage new employees to join and take full advantage of membership of their scheme.**
- **New employees will look for accreditation when they make important decisions about joining an employer's scheme.**

Criteria

17 Occupational schemes already have to meet regulatory standards set down by the Pensions Act and regulated by the Occupational Pensions Regulatory Authority (Opra). The Quality in Pensions scheme will set standards over and above the regulatory requirements to demonstrate that a pension scheme exceeds minimum standards across a range of criteria.

18 We propose that one set of criteria should apply to all schemes, regardless of size or whether in the private or public sector. The criteria will include high standards in scheme governance and communications, good quality benefits and good employee access to the scheme.

Proposed Quality in Pensions criteria

- **Ability to build a pension targeted at, for example, 50 per cent of final salary.**
- **Scheme open to all permanent employees.**
- **Trained and involved trustees.**
- **Proper representation of members' interest on trust boards.**
- **Regular and clear communication with all scheme members.**
- **Automatic information on individual pension positions.**

19 We shall be conducting a detailed consultation on the key criteria that need to be met for accreditation to be given. We anticipate that schemes will need to show that they are both well run and have adequate member representation on the trustee board. The effectiveness of scheme communications should also be a key criterion. Schemes will need to provide clear and timely information so that, for example, employees can make informed choices about whether or not to join. Schemes will need to show that their regular communications with both active and retired members are of high quality. Clear information also needs to be provided on current and prospective pension rights. We also think that a benefit and scheme coverage criterion is appropriate. The benefit standard might be that the scheme at retirement provides half of final earnings after a full working life.

Assessing standards

20 To achieve accreditation, all schemes will need to meet the proposed standard for benefits. If this initial criterion is satisfied, an expert assessor will appraise the scheme against the other criteria and judge its overall performance against agreed standards and whether accreditation can be given. We propose that the assessor will visit the scheme, carry out a limited audit of casework and discuss the scheme with individual trustees. In addition to providing feedback to schemes on good and bad practice we anticipate that it might be helpful for examples of good practice to be made available to encourage higher standards in all schemes. After start up, we expect the accreditation scheme to be self-financing so the schemes concerned will pay a fee to cover the costs of administration and assessment.

Consultation

21 We have already consulted interested parties in the pensions industry about the establishment of a Quality in Pensions accreditation scheme. We will set out our detailed proposals in a separate consultation paper, which we intend to publish in early 1999.

Minimum Funding Requirement

22 We know that one of the areas of concern to employers is the Minimum Funding Requirement (MFR). The concept behind the MFR is a straightforward one – that is, people who have built up pension rights should be able to draw their pensions in full, even if the employer is no longer there to pay extra contributions. But devising a method of securing pension rights without imposing too much of a burden on employers is not so straightforward. We are asking the actuarial profession to look again at the present valuation method, and consider whether there are different ways of delivering the level of security we feel is right. There will need to be full discussions about any proposals.

23 We are also considering the viability of a Central Discontinuance Fund to which pension rights might be transferred when a scheme has to wind up because the employer is insolvent. We will be looking at this as part of our review of the MFR.

Simplification of regulation and procedures

24 The following measures are covered in more detail in the separate consultation paper mentioned at the beginning of this chapter.

Contracting out

25 We are aware of widespread concern about the complexity of the contracting-out regime and will be consulting on what might be done to simplify it. In particular, schemes sometimes have difficulties in assimilating Guaranteed Minimum Pension (GMP) rights within the overall pension. This can give rise to problems in complying with the Equal Treatment requirements, notably in respect of past service. We are therefore exploring the option of allowing GMPs to be converted into pension benefits of an equivalent value, in order to ease the administrative burdens faced by schemes holding GMP rights. We will be seeking to establish the level of interest in such a proposal, and the method by which this may be achieved.

26 There are areas of duplication between specific contracting-out requirements and those which apply to schemes generally, particularly in relation to monitoring and supervision. The result is increased adminstration both for schemes and the Contributions Agency (CA). We are considering removing the requirement for schemes to provide separate statements regarding their level of solvency to the CA once the first MFR valuation has been completed and the certified schedule of contributions is in place. We will consider dispensing with the provision that requires schemes, when electing to contract out, to provide information relating to financial propriety such as confirmation that proper books and records are being kept. These measures should also help reduce the administrative burdens on schemes.

27 We will be proposing further flexibilities in the contracting-out regime, for example, allowing salary-related contracted-out rights to be held outside a salary-related environment and permitting money purchase protected rights to be commuted on grounds of serious ill-health.

Member-nominated trustees

28 We believe that member-nominated trustees help give members a proper feeling of ownership and commitment to their scheme, and we want to ensure that all schemes have member-nominated trustees. We also want to sweep away the prescriptive rules that have been found too difficult to interpret, and too complex and inflexible to operate effectively.

29 We propose that all schemes should be required to have a third member-nominated trustees (subject to existing exemptions); and that large, mature schemes should have a reserved place on the trustee board for a pensioner member. This will remove much of the complexity of the existing legislation and, by removing the need for a statutory consultation exercise, it will, in many schemes, reduce costs. While some schemes will now be required to have member-nominated trustees for the first time, all schemes will enjoy far lighter regulation and the flexibility to develop structures which meet their particular needs.

30 We have decided to consult on three options for giving effect to these proposals with the aim of finding the most workable method. The options are set out in detail in the separate consultation paper. In each case the requirement for one-third member-nominated trustees and a pensioner trustee would be set down in primary legislation. All three options would do away with the employer opt-out and the need for a statutory consultation exercise. This will mean a considerable reduction in the volume of legislation and make it much simpler to understand and operate. In brief, the three options are to:

- **specify nomination and selection procedures in regulations;**
- **put minimum requirements in legislation, with nomination and selection procedures in statutory guidance. This would give trustees more flexibility to tailor arrangements to the circumstances of their particular scheme; and**
- **put minimum requirements in legislation and leave trustees free to devise their own nomination and selection procedures. Opra would have the authority, in the event of complaint, to rule on their suitability.**

Removing regulatory burdens from certain types of scheme

31 We have received a number of suggestions that the Pensions Act places unnecessary burdens on certain types of scheme, particularly small schemes. We are keen to do everything we can to simplify where possible, but we must make sure members are properly protected. We have looked very carefully at all these suggestions and, whilst we see no justification for treating small schemes any differently from larger schemes – members of small schemes are entitled to expect the same protections as members of large schemes – we do see a case for easements in the following specific types of scheme.

32 **Schemes where all the members are trustees.** Schemes where all the members are trustees, or where the trustee is a company, or all the members are directors, come into this category. The members themselves bear full responsibility and liability for running the scheme and for investing its assets. They have full control of, responsibility for, and influence over their own pension arrangements and do not need the protections offered by the Pensions Act. We propose, therefore, to exempt such schemes from the bulk of the provisions.

33 **Ear-marked money purchase schemes.** We also propose to introduce easements for other types of scheme. We shall reduce costs in money purchase schemes which have all their assets invested in insurance policies, by removing the need to appoint a scheme auditor to give an end-of-year statement about contributions paid into the scheme. Instead insurance companies will be required to provide the trustees with a statement and to report to Opra if contributions have not been made in accordance with the scheme's schedule of payments.

34 **Frozen schemes.** These are schemes which admit no new members and where existing members accrue no new rights. Where all the rights in these schemes have been secured with guaranteed insurance annuities we accept that the requirements to appoint a scheme actuary, meet the MFR, produce audited accounts and the availability of the compensation scheme have no added value for members. The benefits in these schemes are fully secured, there is nothing for the actuary to do in relation to the MFR and, moreover, there are often no surplus assets from which to meet the costs of complying with the Pensions Act. We propose, therefore, to exempt them from these requirements.

35 **Money purchase schemes in wind-up**. We also propose to simplify the administration and reduce the costs for money purchase schemes which are in the process of winding-up. When a scheme is winding-up it ceases to have active members and there are no further contributions going into the scheme. The schedule of payments therefore becomes redundant and we propose that, once a money purchase scheme begins to wind-up, it should no longer be required to maintain a schedule of payments.

36 **Industry-wide schemes.** Under current tax rules, members of industry-wide schemes are unable to continue contributing to the scheme if they become self-employed or join a non-participating employer. We will consult about amending the legislation to allow trustees of industry-wide occupational schemes to set up and run personal pension schemes. This should make it easier for members to keep up pension contributions to schemes which offer this option, despite changes in their employment status.

Measures to strengthen the framework

37 We will take steps to:

- **improve the pensions compensation provisions available when an employer becomes insolvent and funds have been removed dishonestly;**
- **protect personal pension rights on bankruptcy to bring them into line with occupational pensions;**
- **propose new protections to ensure payments to occupational, personal and stakeholder pension schemes are made on time;**
- **introduce changes to the tax system to allow people flexibility to phase in their retirement;**
- **consider the practicality of changing the provision of survivor benefits in public service pension schemes where the general membership wishes to see a change and is prepared to pay for it;**
- **look at whether to amend the Transfer of Undertakings (Protection of Employment) Regulations 1981 (the TUPE regulations) to cover occupational pension rights when a business changes hands; and**
- **encourage improvements in transparency and accountability.**

Protecting pension rights

38 The Pensions Act clarified the role of trustees, employers and scheme advisers in occupational pension schemes. It set up Opra and the Pensions Compensation Board.

39 We are continuing to monitor the ways these provisions work in practice. We can see no reason to make changes at this stage. We want to avoid making change for its own sake or unless it is clear that it is needed. In general the provisions are working well, but there are three specific areas where improvements should be made, and we intend to include them in the Bill for welfare reform. They are:

- **improvements to the compensation scheme;**
- **protection of pension rights in bankruptcy; and**
- **ensuring prompt payments of contributions by employers to occupational, personal and stakeholder pension schemes.**

Compensation scheme

40 The compensation scheme is a final safety net. It provides protection for members of occupational pension schemes where the employer is insolvent and assets of the scheme have been lost because of theft or fraud. Where that happens, the scheme would be wound up and assets allocated to meet individual members' pension rights.

41 At present, in salary-related schemes, compensation is limited to 90 per cent of the loss, or the amount needed to bring the scheme back to 90 per cent of the benchmark funding level set by the MFR, whichever is less. In money purchase schemes, it is limited to the lesser of 90 per cent of the amount lost or the amount needed to bring the scheme back up to 90 per cent of the funding level that applied prior to the loss taking place. Compensation is only payable if a scheme has lost at least 10 per cent of its assets or is below 90 per cent of the MFR.

42 The present compensation rules could produce potentially very unfair results for members of salary-related pension schemes. When such a scheme winds up, pensioners generally have priority over other members. Therefore in a mature scheme, where many of the members are pensioners, active members could receive very little of their expected benefits.

43 It is an important principle that consumers should exercise care in the choices they make. This principle applies to pension scheme members who have access to information about how the scheme is run, the ability to nominate trustees and to complain if they think things are going wrong so that investigations can be carried out. It would not, therefore, be appropriate to provide 100 per cent compensation. But we believe it is possible to introduce a more equitable scheme consistent with this principle, which would be of particular benefit to members of mature schemes.

44 For salary-related schemes, we propose that the calculation of the amount of compensation payable should be based more closely on the age profile of the members. So instead of limiting the funding to 90 per cent of all the scheme's liabilities, we will increase it to 100 per cent in respect of pensioner members and those who are within 10 years of the scheme's pension age (who have to be identified already for the MFR valuation).

45 That means that, when the scheme's assets are allocated to meet individual pension rights, there would be a greater chance of providing younger members with a fair value of their basic pension rights, whilst preserving in full the level of pensions that are already in payment.

46 In money purchase schemes, compensation will be limited to 90 per cent of the loss, but claims may be made in respect of any misappropriation of assets, not just where the loss is worth more than 10 per cent of the fund.

47 We do not propose to extend the circumstances in which compensation can be paid. The compensation scheme is not a catch-all protection.

Pension rights in bankruptcy

48 The pension rights of a member of an occupational pension scheme who becomes bankrupt are usually protected from seizure to pay off creditors. Personal pension holders do not enjoy the same protection. We believe that this is unfair. It is only reasonable to expect that everyone who has made a genuine attempt to save for their retirement should have their rights protected, regardless of the type of pension arrangement they have. We therefore propose that all tax-approved private pension rights should be exempt from the bankruptcy process, thus falling outside the jurisdiction of the trustee in bankruptcy.

49 At the same time we need to prevent people from using a pension scheme to put money deliberately beyond the reach of their creditors. There will therefore be a mechanism to allow a court to order that excessive contributions paid into the scheme can be recovered from the pension fund and paid to the trustee in bankruptcy. In this way there will be a fair and proper balance between the interests of creditors and the principle that people should be encouraged to save for their retirement.

Ensuring contributions are paid on time

50 Although it is important that contributions to pension schemes are paid on time, there have been many instances when they have been paid late.

51 All late payments of employee contributions, whatever the amount or whether it is the first occurrence, are criminal offences. In fact, four-fifths of the 7,000 late payments reported to Opra since April 1997 have been the result of schemes failing to pay on time on one occasion only, three-quarters involve amounts of £1,000 or less. Thus criminal investigation by Opra is often not cost-effective, and makes it more difficult to take swift action to deal with the failure. The procedures involved

in making investigations under the Police and Criminal Evidence Act are labour-intensive and time consuming. If Opra had to mount a full investigation for every failure to pay an employee contribution on time, they would need to quadruple their number of investigating officers. Given the small amounts of money involved, often for first time offences, it is doubtful that penalties imposed by magistrates' courts would act as a deterrent.

52 We have therefore concluded that we should move away from the blanket use of criminal proceedings, although they will be retained for the most serious delays and where there is a clear history of repeated offences. For the less serious failure, we will replace the criminal sanction with a civil breach, with civil sanctions. This move has been agreed with Opra, who will be able to investigate more cases under civil law and provide more effective protection of members' rights.

53 All pension schemes need to have contributions paid promptly. We therefore believe it is right that similar requirements should apply to stakeholder pension schemes and personal pensions. So employers who have accepted responsibility for passing employee contributions to stakeholder and personal pension providers, will be under similar obligations to those that apply to employers who provide occupational pension schemes.

54 The trustees of stakeholder pension schemes and the providers of personal pensions will be under a duty to report to Opra any breaches of the requirements to pay contributions. Failure to do so could result in an Opra sanction. A similar regime will also apply to the payment of employer contributions.

Changes to the tax regime for pensions

55 We will also make changes to the tax rules to improve their flexibility to better reflect contemporary working patterns. Many people now want to phase in their retirement. At present, pensions can normally only be drawn when an employee retires from his or her company completely. The Inland Revenue has now conducted a public consultation on three proposed reforms which would allow people to arrange a smoother transition between full-time work and retirement, rather than the existing 'all-or-nothing' approach.

The three proposals would permit:

- **payment of retirement benefits at any age between 50 and 75, irrespective of whether the member has actually retired;**
- **additional voluntary contribution benefits to be taken at any age between 50 and 75, irrespective of when the corresponding benefits under an employer's pension scheme are taken; and**
- **members of an insured money purchase arrangement to take income drawdown, from the age of 50, and postpone the purchase of an annuity up to the age of 75.**

56 These changes will offer greater flexibility for individuals and will also encourage wider economic benefits. Making it easier for older workers to combine part-time work with partial retirement may enable companies to benefit for longer from the valuable skills and experience that older workers can offer.

57 The Inland Revenue's consultation sought to identify any technical or practical difficulties with these proposals before being incorporated in the tax rules. No significant problems arise with the second and third proposals and the Inland Revenue will shortly be announcing further details. But the first proposal does give rise to some difficulties for social security law and, before this proposal can be brought into effect, changes to legislation will be needed.

Survivors' benefits

58 Since 1978, all occupational pension schemes and personal pensions used to contract out of SERPS have had to provide for a survivor's pension for a widow, and from 1988 this requirement was extended to a surviving widower. The same provisions will apply to stakeholder pension schemes.

59 Beyond these minimum requirements the precise package of survivors' benefits provided by occupational pension schemes depends on what the sponsoring employer finds it worthwhile to provide (for example in terms of recruitment and retention), given the views of members. Most large occupational pension schemes in the private sector now provide survivors' benefits for the unmarried partners of the opposite sex of scheme members, although in the overwhelming majority of cases this is at the discretion of the trustees. In a minority of schemes, same-sex surviving partners are also eligible, again usually at the trustees' discretion.

60 The public service schemes at present provide survivor's pensions only for the legal spouse of a deceased member. If the general membership of a public service scheme wanted, in future, to extend eligibility for survivors' pensions to unmarried partners and were prepared to meet the additional costs, the Government would be prepared to consider how practicable arrangements could be devised for achieving this in the context of a statutory scheme. In many cases, this would be most effectively achieved by developing a new pension scheme.

61 The Pensions Act 1995 requires schemes to advise members whether, and if so under what conditions, survivors' benefits are payable by the scheme.

62 We welcome the trend to improve the information that members are given about their scheme's eligibility conditions. Inland Revenue rules allow survivors' benefits to be paid to anyone who was either financially dependent on, or financially interdependent with, the deceased and we do not believe that any new provisions are needed in either Department of Social Security or Inland Revenue legislation. Improved information on survivors' benefits could form part of the qualification criteria for Quality in Pensions accreditation.

Protecting pensions when businesses change hands

63 Most occupational pension rights are currently excluded from the terms and conditions of employment that are protected under the Transfer of Undertakings (Protection of Employment) Regulations 1981 (the TUPE regulations) when a business changes hands. This means that transfers leave many employees vulnerable to having detrimental changes made to their future pension entitlement. In June 1998, the UK (when holding the Presidency of the EU Council of Ministers) managed to secure member states' agreement to a revision of the Acquired Rights Directive, which the Regulations implement in the UK. Amongst other things, the new Directive makes it clear for the first time that member states have the option to include such rights within the coverage of their national legislation.

64 In the Government's White Paper *Fairness at Work*[3], we have already indicated our commitment to amending the TUPE regulations to improve their operation. The revision of the Directive has provided a much sounder basis for doing so than would otherwise have been the case. Consideration is currently being given to the detail of the changes that might be made. This includes possible ways in which occupational pensions might be brought under TUPE. The Government plans to place new regulations before Parliament in 1999.

Encouraging improvements in transparency and accountability

More transparency in objective setting

65 An important new initiative was set out in the Chancellor's *Pre-Budget Report*. The chapter *'The Productivity Challenge'* stated:

> *"Britain's equity markets are widely regarded as one of its strengths. In recent years there has been useful progress in improving the clarity and effectiveness of dialogue between companies and their shareholders, enhancing the markets' role in directing capital towards its most efficient uses."*
>
> *"However, this is just one aspect of a broader system, not all of which operates as well as it might. The Government has an interest in effective communications and accountability between institutional investors and their clients, notably pension and life funds. These relationships set fund managers' incentives, and they determine behaviour and attitudes."*
>
> *"The Government believes there could be room for improvement here."*

[3] Cm 3968, The Stationery Office, 1998.

66 The *Pre-Budget Report* called for consultation on measures that built on, for instance, the existing requirements of pensions legislation, where:

> *"fund managers' institutional clients'… trustees were expected to set out, again publicly, their objectives and how they assess the performance of their investments;*
>
> *"including in particular, their attitude towards venture capital investments and how they evaluate them;*
>
> *"as well as how, and over what time period, they assess the performance of fund managers, and basis on which they remunerate them."*

67 These expectations support rational decision making. They will also aid the understanding of members of pension schemes as to how decisions are made, and how the repercussions of those decisions are considered by trustees. Such transparency will aid all involved in pension schemes.

How funds are invested

68 Pension funds must consider how their funds are invested. The Government believes that, subject to the overriding requirements of trust law in respect of the interests of beneficiaries, trustees should feel able to consider moral, social and environmental issues in relation to their investments.

69 We believe that it is right that all trustees should consider how far such issues should affect the way they invest the assets of the pension fund. We believe that the best way to achieve this is the introduction of a regulation under the Pensions Act 1995. Such a regulation would require pension fund trustees to set out their policy, if any, in their statement of investment principles.

Chapter Nine

Increasing the level of savings

People want to save more and our proposed reforms will enable them to do so. Those who can save for retirement have a responsibility to do so. People accept this. Our reforms will give them the confidence to do so and provide more affordable, flexible and secure ways to save.

The context

1 All employees and self-employed people, except the very lowest paid, must pay National Insurance contributions. These give entitlement to the basic state pension. Employees' National Insurance contributions also build up rights to the state second-tier pension – the State Earnings Related Pension Scheme (SERPS) (although self-employed people cannot join SERPS). Employees can choose to opt out of SERPS and make their own equivalent provision. Any extra a person saves above the basic compulsory rate into a private pension is on a voluntary basis.

The problem

2 The current compulsory pensions – basic state pension and SERPS – do not ensure a decent pension for many people. This is particularly true for lower earners, even if they contribute for a full working life. This is primarily because state pensions were cut back in the 1980s: the basic state pension is smaller than was envisaged when SERPS was introduced, and SERPS has been made less generous, particularly for those who have a number of years out of the labour market. In addition, demographic and labour force changes are resulting in lower pensions for some. People are living longer, so savings have to last longer. The period in which some people contribute is decreasing, as many men in particular are entering the labour force later and retiring earlier.

3 Not only do many lower earners fail to achieve a pension which is large enough to provide security, many people across the income spectrum do not achieve the level of pensions which they desire. A pensioner being interviewed for the Department of Social Security (DSS) talking about retirement planning illustrates this.

> *"When you're young you don't realise, you think it's not going to happen – but it does happen, obviously. You look back and think 'I wish I'd done this, I wish I'd done that' – that's the benefit of hindsight."*[1]

[1] *Pensions and Retirement Planning*, Alan Hedges, Department of Social Security Research Report No. 83, 1998.

Increasing voluntary saving

4 We believe that many people would benefit from making higher pension provision and could afford to do so. We propose a number of measures to help and encourage them.

5 Ensuring that voluntary saving is worthwhile is the first step to encouraging it. By providing a decent State Second Pension to all workers and carers, we will reduce the threat of means-testing in retirement. That means far more people will be able to make voluntary saving safe in the knowledge that these savings would not disqualify them from receiving other benefits in retirement.

6 As we outline in **Chapter Five**, we are also considering ways in which the current minimum income guarantee, which is provided through Income Support, can be improved so voluntary savings are penalised less.

7 The second element of our strategy is to ensure that people are more aware of their need for pensions. We will improve the information people receive about their pension provision and how they can make higher provision. **Chapter Ten** outlines the details, including our plan to provide everyone with annual statements of their pension provision.

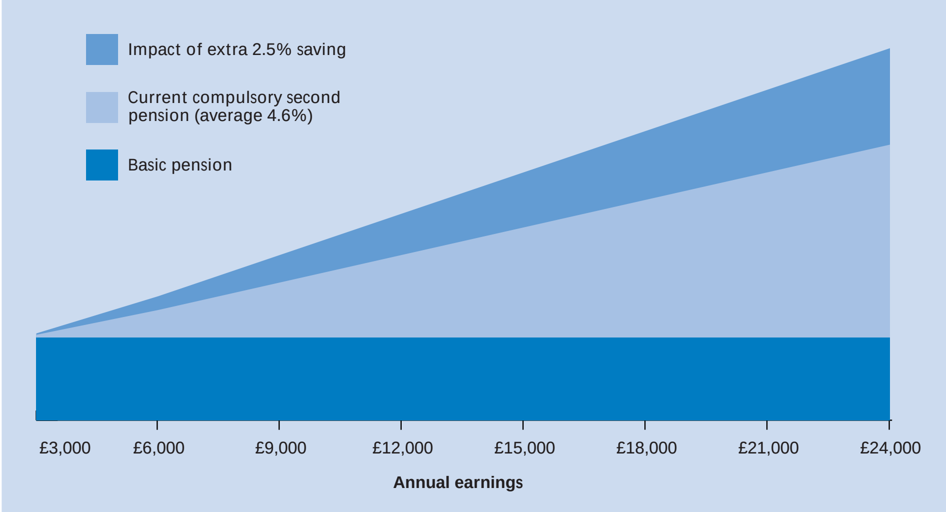
8 Thirdly, we are encouraging more people to have funded pensions, as funded pensions are easy to supplement with voluntary provision. In contrast, state pensions cannot be supplemented with voluntary provision. We are introducing stakeholder pension schemes, extending the range of people for whom funded pensions are suitable, and plan to improve the framework for occupational and personal pensions. Once stakeholder pension schemes are well established, we plan to ensure that all moderate and higher earners would be better off contracting out of the State Second Pension and instead contributing to a funded pension. They should all then have a pension to which it is easy to supplement with voluntary contributions.

9 These proposals are complemented by a range of initiatives to make all saving more attractive. Individual Savings Accounts (ISAs) will bring tax benefits to many savers for the first time, encouraging saving which could then be invested in a stakeholder pension scheme. Our improvements to the regulation of financial services should increase trust in pension provision and hence people's willingness to save.

The impact of extra compulsion

10 We have considered increasing the rate of compulsory saving. The chart below indicates, in a stylised way, the current contributions that people have to make towards a pension and what the effect of increasing this rate would be.

Chart 6: The impact of extra pension saving



Note: The chart gives a stylised feel of the impact of extra saving. Because the precise level of a pension will vary depending on individual circumstances, it shows the approximate relative impact and not exact amounts.

11 As the chart shows, increasing the compulsory rate for low earners leads to little extra pension, although affording the extra compulsory contributions could be difficult for them.

12 But higher earners would be forced to have a significantly larger pension. These people's compulsory pensions are already likely to be high enough to take them clear of relying on state benefits in retirement.

13 Two-thirds of those who earn more than £15,000 a year already save about an extra 5 per cent of their earnings voluntarily. Extra compulsion for these people would not reduce dependency on the State. Therefore, we do not believe higher compulsory saving is justified, even though we will encourage higher earners to make voluntary provision if they are not already doing so.

14 Our new framework for pensions will result in higher pensions for the very people that need most help – low earners – without the need for extra compulsion. We have set out our proposals for a new State Second Pension in **Chapter Six**. Our proposals will have broadly the same effect as doubling the rate of compulsory pension saving for low earners and a smaller increase for moderate earners. Up to half the workforce will gain.

The role of employers

15 We also recognise that employers have an important role in their employees' retirement provision. As we set out in **Chapter Eight,** we are seeking views on whether we should allow employers to be able to make joining their occupational pensions a condition of employment, subject to a right for employees to opt out. We also propose that all employers offer either an occupational pension scheme or access to a stakeholder pension scheme. We do not, however, believe that employers should be forced to contribute more than they already do via the National Insurance system.

Self-employed people

16 There are currently 3.2 million self-employed people in the UK. Many of these are not making any pension arrangements above the basic state pension. About 50 per cent of them contribute to a personal pension. Others build up a business or other assets which they sell to fund their retirement.

17 We have concerns about the number of self-employed people who are not making any pension provision. Since the 1980s, when the number of self-employed people grew rapidly, the nature of self-employment has diversified. Many self-employed people now work in service sector jobs and do not build up business assets that they can use later on for retirement. Others are on short-term contracts and have fluctuating earnings. Many new self-employed people are hardly different from employed workers – except for the terms of their contract. We can see that there is an argument for bringing self-employed people into line with employees and making them contribute to a second-tier pension.

18 We do realise, however, that self-employed people, especially those with small businesses, are different from employees. Their finances have to be organised differently. For example, tax and National Insurance are collected and assessed in a different way to employees. Self-employment can be less stable than employment, self-employed earnings vary more than employees' earnings and there is a greater spread. Many self-employed people are low paid with almost half of them reporting earnings below £9,000 a year.

19 We recognise the importance to the economy of small businesses and we want to encourage them to grow and flourish. We are determined to reduce the burdens placed on them.

Seeking views on self-employed people

20 The proposals for the new State Second Pension provide a good opportunity to help the many low earning self-employed people who would find it hard at present to make any pension provision. Access to the State Second Pension would require an increase in the National Insurance contributions rate for self-employed people and we would like views on whether this would be an appropriate way forward.

21 We would need to consider a number of issues before this could happen, including the detailed mechanics of how it would work. **We would welcome views on the proposal to bring self-employed people into the State Second Pension.**

Restructuring National Insurance

22 A number of other steps would have to be taken before we could consider bringing the self-employed into the State Second Pension. Firstly, the way the current National Insurance system is structured and collected for self-employed people makes it administratively very difficult to bring them into SERPS. Before we could even consider moving to a new system, we would need to merge Class 2 and Class 4 National Insurance contributions into a single profit-related charge. Martin Taylor in his report to the Government[2] on work incentives recommended this change and we are considering his recommendation.

23 We would also want to wait until the Contributions Agency and Inland Revenue merger has taken place.

Conclusion

24 We do not propose to increase levels of compulsion for employees. We are consulting on whether to require self-employed people to save more, but this would only bring them up to the level of compulsion which currently applies to employed people. We prefer to let people make their own choices and manage their financial affairs to suit their own circumstances. We believe the measures set out in this Green Paper will boost pension saving without the need for extra compulsion. They will provide security, information, and more effective ways to save.

[2] *The Modernisation of Britain's Tax and Benefit System – Number Two – Work Incentives* 1998.

Chapter Ten

Education and trust

People are confused by the many pension options and have lost faith in the system. We need to help people to understand how they can ensure they have the level of income in retirement that they want and which type of pension is best for them. We need to rebuild trust so that people will save with confidence.

Knowledge of the current system

1 Much of the current pension system is complicated and too much information on pensions is jargon-ridden. It is not surprising that most people do not understand the way the system works nor the choices available. Many also lack the basic knowledge and skills needed to understand general financial information. The result is that large numbers of people have unrealistic expectations, or no knowledge at all, of what future pension they can expect.

2 People need better and more accessible information about state and non-state pensions. They need to know where to get information and advice from sources they can trust. At the moment much of the general and personal advice given is of variable quality. People rightly want trustworthy, clear and impartial information and want the Government to facilitate access to simpler products and better and more meaningful advice. That is our challenge.

People say . . .

"I haven't got a clue, not a clue – because when my insurance man comes round he says, 'Oh yeah just pay this in' – and they don't want to explain to you."

"We've got to think about tomorrow and it's something we all put off, the Government have to keep shouting at us, giving us information, we have to be educated."

Quoted from *Pensions and Retirement Planning*, **Alan Hedges, Department of Social Security Research Report No 83, 1998**

Developing a new approach

An education philosophy

3 The key principles that need to underpin a pensions education and awareness programme are clear.

- **Pensions need to be considered as part of an individual's overall financial planning needs.**
- **Individuals need to be aware of their own pension position and the importance of making early and adequate pension contributions.**
- **Individuals need clear information and advice on alternative forms of pension provision to make the right pension choices.**
- **The public and private sectors should work in partnership to ensure that, wherever possible, people are insured against foreseeable risks and make provision for their retirement[1].**

4 We believe it is necessary to bring about a radical improvement in the quality and accessibility of information on pensions, both in general and in the information people are given about their own pension position. We will work closely with the Financial Services Authority (FSA) to improve the general quality and comparability of pensions information. We will take immediate action to improve the quality of the state pension forecasting system and work with employers and private pension providers to find the best ways to provide everyone with a personalised forecast of their complete pension position, state and non-state, which they can use in planning the savings and investments they wish to make.

5 The Government and the financial regulators have the central role to play in developing the long-term framework and for driving forward the specific initiatives needed to improve pensions information. In turn, we believe that the private sector can provide expertise, ideas and enthusiasm to make a significant contribution in many areas. In partnership, we can press ahead with a dynamic and effective programme of action to counter lack of awareness, interest and understanding of pensions.

Working in the wider financial context

6 **The Government is delivering an integrated strategy to improve regulatory control and public awareness of the financial system as a whole. The FSA has been charged with promoting public understanding of the financial system as part of their wider regulatory responsibilities. This is the first time a financial regulator has been given such a role.**

[1] Principle Two in *New ambitions for our country: A NEW CONTRACT FOR WELFARE,* (Cm 3805) The Stationery Office 1998.

7 Any improvement in pensions information and public awareness will only have maximum effect if individuals have the basic skills to interpret information and understand the overall financial context in which decisions are made. This will include promoting awareness of the benefits and risks associated with different kinds of investment and providing appropriate information and advice[2].

8 We will work closely with the FSA to ensure our action on pensions complements their wider consumer education role. The FSA does not consider that it would be appropriate, nor within its remit, to give advice to individuals recommending particular products or to specify how much people ought to be saving. The FSA will, however, be developing information and financial planning advice services to help consumers understand:

- **what different financial services and products can achieve;**
- **the choices and options available to them; and**
- **the pros and cons of alternative types of pension product or service, including channels and types of advice[3].**

The Pensions Education Working Group

9 The FSA and other bodies have already made a substantial contribution to the effectiveness of the work of the Pensions Education Working Group (PEWG) which is chaired by the Department of Social Security. The Government set up PEWG in 1997, to look at the most effective ways of improving education and awareness of pension issues. PEWG's report, *Getting to know about Pensions,* was published in June 1998. PEWG provides a valuable forum for bringing together interested parties and forging new partnerships to ensure that pensions education and awareness initiatives are properly targeted and co-ordinated.

10 The clear message from PEWG's report was that new pension schemes and better member protection need to be complemented by better education and awareness of individual needs and what each type of provision can provide. Trust in pensions also needs to be restored if individuals are to make sufficient provision for their future pension needs.

11 Further development of PEWG's recommendations for easier-to-understand products and information enabling easier comparison of different type of pension will be taken forward by the FSA, in line with the FSA's new statutory responsibility to promote public understanding of money matters.

Setting out a programme of action

12 There is a comprehensive programme of initiatives underway or planned which together should make a real difference. These fall naturally into three areas: personalised pension information; work-related advice; and general pension information.

[2] *Financial Services and Markets Bill,* published for consultation on 30 July 1998.
[3] *Promoting Public Understanding of Financial Services: A Strategy for Consumer Education,* FSA Consultation Paper 15/8 published on 11 November 1998.

Personalised pension information:

- **improving state pension forecasts, making them more automatically available and integrating them with private pension statements; and**
- **improving personal information provided by money purchase schemes.**

Work-related advice and information:

- **a workplace code of practice being developed with the Confederation of British Industry (CBI), the Trades Union Congress (TUC) and others;**
- **emphasising the importance of occupational schemes;**
- **targeting pensions information at those entering work;**
- **a Quality in Pensions accreditation scheme; and**
- **a CBI human resources benchmarking initiative including a pension benchmark.**

General pension information:

- **new DSS pension leaflets supported by a marketing campaign;**
- **promoting financial education in schools (the Personal Finance Education Group [PFEG]);**
- **supporting the piloting of pension information helplines; and**
- **the proposed Plain English Campaign guide to pension terms.**

Personalised information on individuals' pension position

13 People need good information to help them make informed decisions about the adequacy of their pension. They need to know both how much their current pension rights are worth and to have a reliable estimate of the likely levels of occupational, personal and state pensions they might receive in retirement.

14 We are already improving the current state pension forecast for the 600,000 people who ask for an individual forecast every year. The new version will be available early in 1999 and will be simpler and easier to understand. In the longer term, we are examining ways of providing state pension forecasts more automatically.

15 What most people would really value is a simple, clear and understandable statement of all their pension rights. With this information, individuals would clearly know what sort of retirement income they might expect. And, often for the first time, they would be able to make informed decisions about the level of savings they need to make to achieve a decent income.

16 We want to develop integrated personal pension statements, combining state and private pension rights. We can only achieve this outcome in partnership with the private sector. It will require changes to the way both the state and private schemes provide information at present. But we are certain that we should work together towards this outcome.

17 The combined forecast might be provided through employers, as part of an individual's annual statement of pension and other benefits, or through pension providers. An illustrative example of what a combined pension forecast might look like is set out below. We are also examining ways of providing individuals with state pension forecasts direct.

Combined pension forecast: illustrative summary

Name:	**A. Smith**
Age:	**58**

The contributions you have made so far have built up the following pension entitlements:

State pension	
Your basic pension	**£55.00**
Your State Second Pension	**£12.50**
Occupational/personal/stakeholder pension	**£62.30**
Total current pension earned so far	**£129.80 a week**

If you stay in your present job your pension at age 65 is forecast to be:

State pension	
Your basic pension	**£64.70**
Your State Second Pension	**£12.50**
Occupational/personal/stakeholder pension	**£85.70**
Forecast pension	**£162.90 a week**

If you increased your pension contributions by 5 per cent of your earnings from 1 January your forecast pension would increase to	**£170.20 a week**

18 To explore some of the practical issues which need to be tackled we will be running pilot exercises with a number of major employers and pension providers. These include Sainsbury's, Unigate, Marks & Spencer and EMAP. The pilots will assess what information needs to be provided and what would be needed to ensure that the most efficient method, perhaps electronic transfer of information, could be generally adopted.

To improve individual pension information we will:

- **produce a clearer version of the state pension forecast, with a supporting leaflet and an improved follow-up service for people who have queries by spring 1999;**
- **determine the best ways to provide people with an automatic forecast of their state pension entitlement and contributions record; and**
- **work in partnership with public and private pension providers to produce combined forecasts of an individual's pension position – state, occupational, personal and stakeholder.**

Improving information given by private pension providers

19 We are proposing immediate improvements to help people understand their private pension position. At the moment, members of money purchase pension schemes (both occupational and personal) must be given a benefit statement every year, but schemes are not required to give members a projection of their likely future level of pension. Some give illustrative projections, but this is not widespread. In contrast, members of salary-related schemes can have statements which show how much pension has been accrued to date and forecast how much members can expect to accrue by the time they reach pension age if they continue in the same job.

20 We are proposing that:

- **all money purchase schemes should be required to provide annual statements showing the projected value of the individual's fund at retirement age and the amount of pension it might buy at today's prices;**
- **the statement must be as simple and straightforward as possible. It must also be clear that it is only an estimate which depends on unknown variables that will inevitably change over time; and**
- **there will also have to be clear and evident warnings about the actuarial and economic assumptions used in the projections.**

21 Further details on these proposals will be included in the separate consultation exercise, referred to in **Chapter Eight**, which will enable all of the practical implications to be considered. Any proposals would need to be consistent with FSA guidelines.

22 The FSA's separate consultation paper on its proposed strategy for consumer education sets out further proposals to help people make informed and effective choices. For example, the FSA proposes to develop and publish, in discussion with industry and consumer representatives, a range of key indicators, comparing quality and cost data. The FSA will also work with government and others towards making financial services and products easier to understand, for example, by standardising and simplifying information on pension products.

23 Our proposals for stakeholder pension schemes include setting benchmark standards for the provision of clear information to scheme members. We will also require employers to provide access to stakeholder pension schemes in the workplace, by requiring employers who do not provide occupational pension schemes to nominate a suitable stakeholder scheme and operate payroll deductions.

24 As part of the strategy to improve understanding and support for occupational schemes we are also developing proposals for a **Quality in Pensions** accreditation scheme to recognise high standards provided by schemes. One of the key criteria will be the effectiveness, quality and range of information that is provided to scheme members or prospective members. This is discussed further in **Chapter Eight**.

Supporting pensions in the workplace

25 Providing good-quality pension information in the workplace forms a crucial part of a pensions education and awareness programme, particularly given the number of employees who still decide not to join occupational schemes. A **Good Practice Workplace Code for Pensions** would provide a valuable framework to help ensure that employees have the information they require to make an informed choice about what pension arrangements are best for them.

26 We are drawing up a draft code in consultation with the CBI, the TUC, the Association of British Insurers and the National Association of Pension Funds. We hope that other organisations will wish to endorse the principles covered in the draft code and agree a finalised version in early 1999. We welcome the moves by the CBI to develop a human resources benchmarking project called IMPRESS which will include a pensions benchmark.

■ The draft Good Practice Workplace Code for Pensions

- **General information on pensions, in plain language, including DSS leaflets, should be available to all employees and prospective employees.**
- **All employees and prospective employees should be provided with information, in plain language, on company pension schemes which they can join.**
- **Information on individuals' accrued and prospective pension rights and death benefits should be provided on an annual basis. This should include meaningful illustrations of what an individual can expect at retirement. Information on state pension rights should also be included where possible.**
- **Schemes should follow best practice in all their activities, particularly in communications with members, and should be encouraged to seek independent assurance of their standards together with appropriate awards.**

Information for those entering work

27 It is essential for those who are new to the workforce, or returning to work, to be more aware of the pension opportunities that are available to them. It is important, for example, that those joining employers who have occupational schemes are aware of the potential advantages of such schemes. We shall ensure that Jobcentre staff are equipped to provide appropriate information to those moving into employment and to indicate where detailed advice can be obtained. Individuals should then be better equipped to determine what pension arrangements are most appropriate for their financial circumstances.

Pensions telephone helpline

28 The Pension Education Working Group concluded that there was a clear need for pension information services that were readily accessible and which offered general and impartial advice. The Group proposed that a pilot pensions telephone helpline open to everyone should be run on an experimental basis. The line would be organised by the TUC and financially supported by Group members and other interested parties. The pilot will run from May 1999. We will evaluate the pilot to determine the demand for, and effectiveness of, such a service. This information will help in establishing how much untapped demand there is and how existing services which provide helpline support might be most effectively organised in the future.

New DSS pensions leaflets

29 PEWG recommended standardising and simplifying pension information and the need for government to issue a general introductory document. We published a new series of DSS pension leaflets in June 1998 which help to meet this need. The leaflets are concise, accessible and relate information directly to decisions individuals need to take at various life stages. The leaflets met the Plain English Crystal Mark standard and have been awarded the Money Management Council Quality Mark for providing clear and unbiased information on money matters. We are running a nationwide marketing campaign to promote the leaflets.

Educating children

30 The Government recognises the importance of developing basic financial literacy in schools. The FSA is now building on the work of the Personal Financial Education Group (PFEG) and pressing for financial literacy to be embedded in the National Curriculum. PFEG is carrying out pilot work to demonstrate ways in which teaching of personal finance could be introduced into schools.

The need for an independent body

31 The Pension Provision Group recommended the setting up of an organisation, independent of government, to have lead responsibility for accumulating, analysing and publishing information about current and future pension provision and its implications for pensions policy. We have asked the Pension Provision Group to consider further the possible role for such an organisation and to develop more specific proposals.

Chapter Eleven

Improved service delivery and the wider agenda for older people

Older people deserve high quality services that are easy to access and responsive to their needs. We will improve the service to older people in practical ways such as making it easier for them to fill out forms. This is part of a wider drive across government to improve older people's quality of life.

A modern service

1 We believe that older people have the right to welfare services which are of the highest quality, easily accessible and responsive to their particular needs.

2 Pensioners are by far the Benefit Agency's biggest single client group at about 11 million people. Almost 2 million pensioners claim the minimum income guarantee provided by Income Support. Improvements to the way we support people in retirement are crucial to delivering on our commitment to welfare reform. And we want to work with other organisations at local level where better co-ordinated services for older people can be developed.

A better service for older people

3 We want to provide a modernised service which is designed and structured to meet the needs of all pensioners. These changes cannot take place overnight, but we want to set out our vision of the future of our services to pensioners. We envisage that important elements could include:

- **a single contact point for claims to key benefits, for queries and to report changes of circumstance;**
- **enhanced information on a wider range of government services involving the Benefits Agency, local authorities and the voluntary sector, accessible through a community-based one stop service; and**
- **a service which helps to ensure that pensioners receive the benefit they are entitled to by identifying those who are entitled to the minimum income guarantee.**

4 Pensioners are a diverse group whose needs and attitudes differ. They need a flexible service that meets varying needs. Large-scale change across a wide group of people will take time. Experience tells us that such scale of change can best be delivered by taking a step-by-step incremental approach. We have already begun to make progress.

A more automatic way of getting help to those who need it

5 We believe that priority must be given to those who most need help **now**. While we are planning for the future we need to start delivering improvements to those who need it most – those poorest pensioners who may not be receiving all of the help they are due. Research has shown that hundreds of thousands of today's pensioners may be living without the extra benefit they are entitled to.

6 We want to ensure that older people who may be entitled to the minimum income guarantee get the benefit to which they are entitled now. We have been running a number of pilot exercises to look at the best ways of encouraging pensioners to claim. Starting in 1999, we will be introducing measures which try to reach these pensioners.

7 In the longer term we want to make sure that we have a benefit system which gets help more **automatically** to the poorest pensioners. We are looking at how this can be achieved.

8 Claims for state pension are automatically invited before the pension is due. But we do not do the same for the minimum income guarantee and we know that there is significant under-claiming. There appear to be a number of reasons for this. It is sometimes difficult for pensioners to judge whether (or when) they might be entitled, there is a perceived stigma attached to claiming and the effort required to make a claim can be, in itself, off-putting.

9 We want to build a more integrated and active service to help pensioners claim their key benefits. We would like to be able to invite claims for the minimum income guarantee and basic state pension together as a package rather than separately. We want to make it simpler for customers to claim Housing Benefit and Council Tax Benefit.

10 We also want to invite claims when pensioners' lives change. Pensioners do not necessarily become entitled to the minimum income guarantee just at the point of retirement. Many people become entitled **after** retirement because of changes in their circumstances. We want to design a benefit system which is able to respond positively when pensioners' lives change by considering further ways in which claims for the minimum income guarantee can be triggered.

Making it easier to make a claim

11 We not only want to encourage pensioners to claim their entitlement – we want to make it easier when they do. We know that many people need help to fill out benefit claim forms. Forms need to be able to deal with all kinds of people and circumstances. Because of this they can be lengthy, asking questions which could already have been ruled out, and would not need to be asked in a direct conversation. Increasingly, the best services in the private sector enable their customers to talk directly to someone who, using up-to-date technology, can deal with a wide range of business there and then.

12 In order to deliver a high-quality service, we would like to be able to offer enhanced telephone services to all pensioners for all their key benefits. We have made a good start. We have now introduced a new service for state pension claimants in the Greater London area. We have given them the option of making a claim over the telephone by talking to a specially trained operator who will take them through a claim and deal with all the necessary paperwork. This initiative has been a great success. In the future, we want to make this service available to all claiming their state pension and other key pensioner benefits.

Planning for the future – improving pensions information

13 In **Chapter Eight**, we set out proposals to improve the state pension forecasting service, as part of the longer-term objective to ensure that people have personalised pension statements of their state and private provision. This work is key to a modern pension service.

The international perspective

14 Everyone entitled to a UK pension should be able to get access to good-quality welfare services, wherever in the world they happen to be. Increasingly, many people who build up their pension entitlement in the UK move abroad when they retire. We mean to ensure that these customers also get the best possible service. We will improve liaison with foreign authorities. We will make better use of new technology.

Making better use of information technology

15 The benefits which pensioners can receive are delivered on nine different computer systems in the Benefits Agency, the Contributions Agency, the War Pensions Agency and numerous different local authority systems. This complex web of information technology does not make the best use of the data collected and held in the public sector and places an unnecessary requirement on pensioners to provide the same information over and over again. We will seek to modernize the information technology we use to deliver welfare benefits to improve service, increase efficiency and to ensure that benefits go to those who are entitled to them.

16 The Internet is growing in popularity. More people are using the Benefits Agency website to get information about benefits. People can now use the internet to access a pension forecast application form. Increasingly, our overseas customers use the internet to send us information about their claims or payments. As the current population ages, we expect this trend to carry through into our pension service. We are responding positively to this development and exploring ways in which we can make fuller use of email and Internet facilities to help enhance the service we provide.

Building a better Britain for older people

17 As well as ensuring that older people have the right services to meet their needs, we want to create an environment that gives increased opportunities for them to pursue active lives. Older people make an enormous contribution to national life, but this fact has not always been recognised by society or governments. We believe that their contribution should be valued so that all older people can play their full part in society. To achieve this aim, the Government has set up a Ministerial group to identify the needs and ambitions of older people. We shall work across government to respond to these needs. As the first step in this process, the Government launched, in November 1998, a consultation paper, *Building a Better Britain for Older People*. The Ministerial group will take forward the debate with older people and the groups that represent them. Much progress has already been made in a number of areas that affect older people. These are as diverse as health, home life, crime, employment, care, travel and leading active lives.

Healthy living

18 Many older people enjoy good health. The Government's aim, as set out in the paper *Our Healthier Nation*[1] is to increase the number of years that people can remain free from illness or disability. The Government already funds the Health Education Authority to promote healthy living and ageing. The new Health Action Zones will make older people's health a priority. We know that health needs increase as we get older. Older people will particularly benefit from the nearly £3 billion we are investing in social services and the extra £21 billion we are investing in the NHS. From April 1999, the Government is also abolishing the charge for eye tests for those aged 60 and over.

19 We have set out in our social services White Paper *Modernising Social Services*[2] a new agenda for promoting the independence of older people and other groups through greater emphasis on prevention and rehabilitation and making direct payments possible.

Travel

20 The needs of older people were an important concern in drawing up the Government's plans for transport announced in summer 1998. For the first time, there will be a national minimum standard for concessionary bus fares for all pensioners. The Government is working to make public transport more accessible to older people and has also set aside £50 million to improve rural bus services.

At home

21 A warm, comfortable home is essential for a secure and healthy life. We have already taken steps to make this possible. All pensioners have already benefited from the cut in VAT on fuel. Every eligible pensioner household receives a Winter Fuel Payment. We are also investing £5 billion to renovate properties and build new homes.

[1] Cm 3852, The Stationery Office, 1998.

[2] Cm 4169, The Stationery Office, 1998.

Tackling crime

22 Crime, or the fear of crime, can reduce older people's ability to lead active and independent lives. The Government is investing £250 million on crime reduction and wants older people to be consulted when local anti-crime strategies are set up. The Government has also given new powers to the police and councils to crack down on anti-social neighbours. The Government has announced plans to improve protection from unscrupulous door-step sellers.

Care and carers

23 The Government is developing policies for long-term care that meet the needs and wishes of older people and is working with local authorities and other organisations involved with care to achieve this. The Government has set up the independent Royal Commission on Long-Term Care to consider the future funding of long-term care, which will report in early 1999. The Government is consulting widely on a new national strategy which will recognise the contribution of carers and make sure future policies support them. The Government will publish a consultation draft of the *Long-Term Care Charter* and a *National Strategy for Carers* in 1999. We will publish a *National Service Framework for Older People* in April 2000.

Active lives

24 The contribution of older people to society is vital. The Government will consult on what can be done to increase their opportunities for volunteering. We will also ensure that people have the chance to learn and improve their skills in later life, and we have published proposals on lifelong learning. The Government is also encouraging libraries to meet the needs of older people by making sure they can take advantage of the new technology on offer.

25 The Government wants to allow older people to have as much choice as possible over their lives. We also want their positive contribution to society to be valued and acknowledged. Our Ministerial group on older people is the first step to making sure this can happen.

26 The Government wants to enable more older people to remain active and participate in the labour market. The new Performance and Innovation Unit will consider a number of issues over the next six to nine months, including those which affect the employment of older people. We explore two such issues below and invite comments.

Employment and retirement

Early retirement

27 The employment rate of older men has fallen very sharply over the last two decades, more as a result of their leaving the workforce than of higher levels of unemployment. This development has been caused by a variety of factors, including the structure of the benefit system, the growth in occupational pensions and the damaging effect of past recessions. To some extent, the trend also reflects changing national perceptions about retirement age.

28 The ability to build up a decent pension depends on people having the opportunity to save when in work. The Department for Education and Employment, the Department of Social Security and the Inland Revenue are therefore developing policies to ensure that more older people have the opportunity to work.

29 **First,** we are tackling the distortionary incentives that may exist in the tax and benefit system, encouraging people to leave work before retirement age.

- **We are working to ensure that disabled people who rely on disability benefits do not lose touch with the labour market.**
- **Inland Revenue tax rules for occupational pension schemes are being adapted to better reflect contemporary working patterns such as the fact that many people now want to phase in their retirement.**
- **We have announced changes[3] to Incapacity Benefit where people have to retire because of ill-health and receive an occupational pension. We propose to take some account in Incapacity Benefit of pension income above £50 a week. This reflects the fact that many more people who retire early on ill-health grounds receive a pension. The measures will achieve a fairer balance between state and private provision.**

30 **Secondly,** we are helping older people outside the workforce move back into work with new deals for older long-term unemployed and disabled people and policies to encourage self-employment. The New Deal for older long-term unemployed people, launched in 1998, provides £75 a week subsidy for six months for employers who recruit people from this group. It offers individuals opportunities to undertake full-time education and training whilst on benefit. It also provides help and advice, backed up by existing Employment Service and Training and Enterprise Councils' programmes, to improve people's prospects of finding work.

31 **Thirdly,** older workers bring experience and expertise to their work. But many face barriers in continuing their employment. We have proposed a series of measures to end age discrimination in the workforce. In November 1998, the Government published proposals for a code of practice, *Advantage, consultation on a code of practice for age diversity in employment*, and ended upper age limits on advertisements in Jobcentres.

32 It is widely acknowledged that particular problems exist in the public service pension schemes. The scale of early retirement in a number of these schemes has increased to the extent that the very financing of the services themselves could begin to be jeopardised. Reviews of the police and fire service schemes have been announced and the Government will undertake examinations of other public service schemes as necessary.

[3] *A new contract for welfare: SUPPORT FOR DISABLED PEOPLE* (CM 4103), The Stationery Office, 1998.

33 Some people welcome the prospect of early retirement. But others find it an unwelcome change in their lifestyle. What is certain is that it can seriously reduce people's ability to build up a good pension. The Government believes that people should be free to leave the labour market if they choose but that this decision should not be distorted by availability of social security benefits, unnecessary barriers or other perverse incentives. They and their employers should have enough information to enable them to make sensible decisions.

34 We will create an environment that enables people to build up sufficient pension funds and allows them to make their own choices to suit their own circumstances.

A choice about when to take basic state pension

35 Many people want to retire when it suits them. There is already a large degree of flexibility within the current state system. Firstly, people do not need to retire to draw a state pension at state pension age – they are free to continue working while drawing their pension. Secondly, individuals can currently choose to defer drawing their state pension for up to five years after their state pension age. For each full year of deferment, the amount of their pension is increased by about 7.5 per cent. This flexibility will be increased significantly from 2010 when the rate of enhancement will rise to 10.4 per cent a year and the number of years of deferral will become unlimited.

36 We have considered the case for a flexible decade of retirement. This is the ability to start drawing a state pension at any time between the ages of 60 and 70, rather than having to take it at 65. The taxpayer could not be expected to fund this personal flexibility, so those choosing to retire below their normal state pension age would receive a reduced rate of pension.

37 This would increase dependency on Income Support and conflict with our wider objective for welfare reform of increased self-reliance. These increased costs would in part offset any savings in expenditure on the state pension.

38 In addition, given that most people currently choose to draw their state pension at minimum pension age, it is likely that introducing a flexible decade starting at the age of 60 would simply have the effect that most people would choose to draw their reduced pension at the age of 60. It would also provide a signal that the State no longer wished older people to remain active in the labour force beyond the age of 60. This would conflict with our belief that older workers can make a significant contribution to the work force. We are not therefore convinced there is a need to increase flexibility.

Chapter Twelve

Financial implications

These reforms mean that the total income of pensioners will rise in years to come, fuelled mainly by rising levels of contributions to private, funded schemes. The amount that the State spends on pensioners will rise too in real terms, but less sharply, and will not rise as a proportion of government spending. This will ensure that the pension system remains both fair and affordable.

1 Currently, contracted-out rebates, plus public expenditure on state pensions and income-related benefits to pensioners cost about £55 billion a year. This will continue to rise in real terms.

2 The net effect of the State Second Pension will be to increase this by just over £0.5 billion per annum in the short term. The long-term effect will be to increase public expenditure, by around £5 billion, allowing for savings on income-related benefits.

Outcome

3 Stakeholder pension schemes and other measures to make funded pensions more attractive, should lead to more people contracting out of the state second pension. Such contracting-out necessarily leads to a loss of National Insurance revenue. We estimate that for every million people who contract out, £0.7 billion would be lost in lower National Insurance contributions. This cost would be recouped in the long term because people would no longer receive the State Second Pension.

4 Overall, the proportion of Gross Domestic Product (GDP) going to pensioners is estimated to increase from about 10 per cent now to about 12 per cent in 2050 at current levels of compulsory and voluntary savings. We expect the measures set out in this Green Paper to encourage a significant increase in the level of voluntary savings. Over the next 50 years, the balance spent on pensions by the State and the private sector will change. Currently about 60 per cent of total spending comes from the State and 40 per cent from the private sector. Over time, we expect this balance to change so that 40 per cent will come from the State and 60 per cent from the private sector.

Effects on individuals

5 All the following figures are presented in earnings equivalent terms. By 2050 average earnings are likely to be double those of today. The actual value of the pensions would therefore also be double the value shown in the table. We expect overall living standards to have risen, so the earnings equivalent figure gives a better feel of what it would be like to live on a pension.

6 A man starts work after leaving school at the age of 16. He works as a mechanic, earning £6,500 a year, which after ten years is increased to £8,500 a year when he moves to a new company. He works as a mechanic until he is aged 40, and then moves between a number of short-term jobs before, at the age of 45, he becomes a delivery driver earning £8,000 a year. From the age of 60 he works part-time in the same job, earning £4,000 a year. He does not hold any private pensions.

Current system (a week)	**New system (a week)**
State pensions: £49	State pensions: £82
Private pensions: £0	Private pensions: £0
Total: £49	Total: £82

7 A woman finishes university aged 22 and goes to work for an insurance company earning £14,500 a year. After marrying at the age of 25, she gives up work to raise a family, having three children in ten years. Returning to work at the age of 35, she works as an office manager for a local company, earning £12,000 a year until she retires at the age of 65.

She contracts out into a stakeholder pension when first starting work, and contributes 5 per cent of her salary when working.

Current system (a week)	**New system (a week)**
State pensions: £32	State pensions: £42
Personal pension: £65	Stakeholder pension: £74
Total: £97	Total: £116

8 A man leaves college at the age of 20 after training as a laboratory assistant. He joins a large multi-national company, and is employed in a number of positions throughout his working career with them, until he retires at the age of 60, with a salary of £15,000.

He joins his company pension scheme, which is a contracted-out money purchase arrangement, paying 10 per cent of his salary (5 per cent employee contribution and 5 per cent employer contribution).

Current system (a week)	**New system (a week)**
State pensions: £32	State pensions: £32
Company pensions: £119	Company pensions: £134
Total: £151	Total: £166

9 The table below broadly shows the pension provision which people can expect from the current system (basic state pension and SERPS) and the proposed system (basic state pension and the new State Second Pension for those earning under £9,000 a year [£180 a week], compulsory funded pensions for those earnings over £9,000 a year).

Lifetime earnings (per week) for someone retiring in 2050	**Current system**	**Proposed system**
£100	£42	£78
£200	£60	£81
£300	£77	£89
£400	£85	£94

Appendix One

Regulatory Impact Assessment

1 This Regulatory Impact Assessment (RIA) sets out the likely costs to business of proposals for regulatory changes arising out of the proposed changes. These changes are wide-ranging and inter-connected. Some of the changes are likely to have behavioural effects which are difficult to assess and which might impact on other proposals.

2 This RIA looks broadly at the overall effects of the proposals. It does not attempt to estimate the cost of behavioural changes although we would welcome views arising from this consultation. It provides an initial assessment of costs, benefits and risks of the regulatory proposals included in this Green Paper. Further work will be done to refine this assessment once proposals have been firmed up and a final RIA will be published alongside the legislation when it is presented to Parliament.[1]

3 The proposal which is likely to have the most significant impact on business is the development of stakeholder pension schemes, although the costs for individual employers should be quite small. Proposals for changes to state pension provision should have minimal impact on business. The proposed changes to the regulation of occupational and personal pension schemes would have some impact on pension providers. There could be additional costs for some employers to make changes to administrative procedures, but in a number of areas, where there are proposals to lighten the regulatory burden, there could be ongoing savings. This RIA concentrates on the likely effects of introducing stakeholder pension schemes and then considers the impacts of the other proposed measures.

Purpose and intended effects of the measures

Issues and objectives

4 The purpose of the measures is to develop a long-term framework for pensions which takes into account our manifesto aims that pensioners should have adequate income in retirement, that they should share fairly in the increasing prosperity of the nation, and that public finances should be both sustainable and affordable. The proposed introduction of stakeholder pension schemes, improvements to the minimum income guarantee, changes to state pensions, changes to tax rules governing contributions to private pension schemes and changes to the regulation of occupational and personal pensions are intended to:

[1] An analysis of the costs of the proposals on pension sharing on divorce is contained in the consultation document on the draft primary legislation (*Pension sharing on divorce: reforming pensions for a fairer future*). This analysis will be updated and included in the final RIA to be published alongside the legislation.

- **improve incentives for people to save for their retirement;**
- **provide new funded second pension schemes, to enable in particular the lower paid and those with intermittent working patterns to build up a secure retirement income on top of the basic pension;**
- **provide more automatic and generous help for today's poorest pensioners;**
- **improve portability of pensions;**
- **support and strengthen the framework for occupational pensions and improve security for members of personal pension schemes; and**
- **improve second-tier state pension provision for low earners.**

Risk assessment

5 If the proposed changes are not implemented, a significant number of pensioners may not have an adequate income in retirement and may not be able to share fairly in the increasing prosperity of the nation.

Options

6 For some of the proposals there are a number of options which may have varying costs for government and different impacts on businesses. These are taken into account in the discussion of costs and benefits below. In some areas there are other approaches that could be taken which do not involve regulation. However, although initiatives such as the provision of pension education and information have an important part to play, the wider policy objectives cannot be achieved without regulation in a number of areas.

Stakeholder pension schemes

Benefits

7 The benefit of the proposed stakeholder pension schemes is the provision of good value private pensions for many of those who do not have access to them at present, or for whom existing arrangements offer poor value-for-money. This applies particularly to those with intermittent working patterns or with earnings towards the lower end of the range. There are 4 million employees in the target group for these schemes (that is, those earning between £9,000 and £20,000 a year, and within this range are about 3 million who are at present in the State Earnings Related Pension Scheme [SERPS]). Additionally, there are around 1 million self-employed people within the target earnings range.

Compliance costs for business

Business sectors affected

8 Most employers will have a part to play in stakeholder pension schemes. If they do not already have an occupational scheme available to all employees they will have to provide access to at least one stakeholder scheme. Most businesses will be affected, particularly smaller employers, including a large number of 'one person' employers (for example those with nannies or domestic staff). It is estimated that there are around 1.2 million businesses with one or more employees of which over 800,000 have less than 5 employees and 1.1 million have less than 20 employees[2]. Many employees in businesses with 1 or 2 employees earn less than £9,000 a year and therefore fall outside the target range for stakeholder pension schemes. They will benefit from the replacement of SERPS by the new state second pension. We recognise, however, that the cost of providing access might impact disproportionately on those with few employees. **We would welcome views on whether it would be appropriate to apply the requirement in full to them.**

9 Not all employers will be affected. Where all employees have earnings below the Lower Earnings Limit and the employer does not deduct National Insurance contributions for any of them, there will be no requirement. There will only be an impact on those employers that are already required to make deductions from their employees' pay. Stakeholder pensions are mainly aimed at lower paid workers (earning around £9,000 to £20,000 a year) so the effects will fall particularly on those businesses with a large proportion of workers with salaries between those levels.

Compliance costs for a **typical** business

Ongoing costs

10 The main recurrent costs for employers should be the administrative costs of providing information about stakeholder pension schemes, making deductions of voluntary contributions from pay and passing them to a nominated stakeholder pension scheme, or to a central clearing house. It is estimated that the cost is likely to range from £10 to £25 a year for every employee who contributes to a scheme.

Non-recurrent costs

11 There could be some initial costs for employers in setting up the administrative arrangements for making deductions from pay and sending them either to a clearing house or directly to the scheme. However, it is likely that some providers of stakeholder pension schemes will offer employers a payroll deduction service in order to attract business. If an employer takes up such a service the additional costs should be minimal. Where an employer needs to change an existing payroll system the cost would depend on how sophisticated the employer's current system is.

[2] DTI *InterDepartmental Business Register*, 1996

12 For many small employers it may simply require a minor change to a simple clerical system, whilst for others there may need to be changes to payroll software. It is likely, however, that most of those with computer payroll systems will be able to cope with such changes without a substantial cost. It is estimated that the cost for an employer could be from £20 to £1,000, depending on the size of the employer and how much work is required to change their systems. In most cases it is expected that the costs will be at the lower end of this range.

13 Employers will also be required to nominate a stakeholder pension scheme and pass information about the scheme (and stakeholder pension schemes in general) to employees. Although they will have to consult their workforce about the choice, the cost of selecting a scheme should be almost entirely within the control of the employer. It will largely depend on whether the employer simply accepts an approach from a provider or scheme, when the cost would be negligible, or if the selection is made more actively, possibly with research into the suitability of a number of different schemes. It is estimated that the cost for an employer could vary from £25 to £2,000 depending on the size of the employer and how active their selection process is.

14 It is expected that for most employers, costs are likely to be towards the lower end of this range. It is likely that most providers will produce leaflets and other materials to publicise and promote their stakeholder pension schemes, and that they will use these packages as a means of 'recruiting' employers. The impact on employers themselves of publicising stakeholder pension schemes should therefore be very small as the only costs incurred should be for leaflet distribution and handling general queries.

Other proposed changes

Advantages

15 The advantage of the other proposed changes include:

- **provision of more automatic and generous help to the poorest pensioners through improvements to the minimum income guarantee;**
- **improved second-tier pension provision for low earners by replacing SERPS with the new state second pension;**
- **improved portability of pensions through changes to pensions tax rules; and**
- **changes to the regulation of occupational and personal pension schemes.**

Compliance costs for business

16 The proposed changes to the regulation of occupational pension schemes would affect employers who provide occupational pension schemes and those that contribute to personal pensions. Not all schemes would be affected by all the proposed measures and some would be only marginally affected. Employers who provide certain small schemes where reductions in the regulatory burden are proposed should have some cost savings. There could also be some savings for employers who run contracted-out schemes through simplification of the contracting-out requirements.

17 The other proposed changes – including improvements to the minimum income guarantee, restructuring of the state second pension and improved portability of pensions through changes to tax rules – should not have a significant impact on the costs of businesses.

Occupational and personal pension changes

18 Most of the proposed changes will not affect the full range of pension schemes. Some will affect employers who contribute to personal pensions, particularly group personal pensions. Others will affect contracted-out occupational pension schemes or certain types of occupational scheme.

Ongoing costs

19 There are likely to be ongoing administrative costs for some pension schemes and savings for others. Many schemes will be unaffected by the proposed changes. Where there is a cost it should generally be relatively low because the changes are limited in scope and are largely designed to minimise the burden on schemes.

Non-recurrent costs

20 There will be some initial costs in those areas described in paragraph 28 where administrative changes will need to be made.

Compensation levy costs

21 The proposed changes could impact on the costs of the compensation levy in several different ways. If stakeholder pension schemes were to be regulated by the Occupational Pensions Regulatory Authority (Opra) they would be subject to the levy. Regulation of payments made by employers to personal pensions would impose additional costs on Opra. It is not likely that there would be significant costs for employers. Levy costs would have to be met by scheme providers and are estimated at around £500,000 a year.

22 It is estimated that improving the compensation scheme could increase the maximum costs of the levy by about 25 pence per scheme member or a total of £2.5 million a year. However, it should be borne in mind that no claims for compensation have been made since the provisions came into force in April 1997 and there is therefore no compensation levy on schemes this year.

Total compliance costs

23 The total compliance costs in respect of stakeholder pension schemes will depend on the take-up of membership, which cannot be accurately predicted. We estimate that for every 1 million employees who join stakeholder pension schemes and contribute through their employer, the ongoing cost is likely to be around £15 million a year. The estimates also assume that employers who do not have occupational pension schemes will incur some initial costs in nominating a stakeholder pension scheme, consulting their employees and making arrangements to forward deductions from pay. The costs and savings from the occupational and personal pension changes are assumed to fall on the pension schemes affected by them.

Ongoing costs:

- **for employers – costs arising from the introduction of stakeholder pension schemes of around £15 million a year for each 1 million employees who join schemes;**
- **for pension schemes – net savings arising from the occupational and personal pensions changes of around £30 million a year;**
- **for occupational pension schemes – an increase in the compensation levy of, at most, around £2.5 million a year; and**
- **for scheme providers – additional levy costs for regulating personal pensions and stakeholder pension schemes of around £0.5 million a year.**

Non-recurrent costs:

- **for employers – costs arising from the introduction of stakeholder pension schemes of around £140 million; and**
- **for pension schemes – costs arising from the occupational and personal pension changes of around £60 million.**

Other costs

24 The costs to government are described in **Chapter Twelve.**

Conclusions and summary

25 **As part of the consideration of the proposals set out in this Green Paper comments on the estimates of the potential costs would be welcome.**

26 The table below summarises the costs and benefits of the proposals.

	Expected costs	Expected benefits
Business	i) recurring costs to employers of around £15 million for each 1 million employees who join stakeholder pension schemes; and £3 million additional levy costs. ii) non-recurring costs of £200 million.	i) recurring savings of £30 million.
Charities	Nil	Nil
Citizens	(i) up to 5 million people are in the target group for stakeholder pension schemes. The costs of contributing are voluntary and therefore avoidable.	(i) Availability of good value second pensions to up to 5 million people who currently do not have access to suitable schemes. (ii) Provision of more automatic and generous help to the poorest pensioners. (iii) Improved second-tier state pension provision for low earners. (iv) Improved portability of pensions through stakeholder pension schemes. (v) Improved security for pension scheme members; better information for members of money purchase schemes; and improved second-tier pension provision through measures that would increase the proportion of employees who join their employer's scheme.
Government	See **Chapter Twelve** *Financial implications*.	–

Monitoring and review

27 The impact of the proposed legislation will be closely monitored. The effectiveness of the legislation and whether more needs to be done to meet the objectives will be reviewed regularly.

Occupational and personal pension changes: ongoing costs and savings

28 There are a number of changes discussed in the Green Paper that may lead to ongoing costs or savings.

- Ensuring that all schemes have member-nominated trustees, and that large mature schemes accommodate a pensioner trustee, may lead to ongoing costs for some schemes in providing an acceptable nomination and selection procedure. Those schemes which already have at least one-third member-nominated trustees would only need to make minor changes, if any. There will be significant savings from the proposed scrapping of the statutory consultation procedure which the vast majority of schemes carry out every six years.
- Regulating payments to personal pensions by employers would lead to administrative costs in monitoring payments, reporting late payments to the members and providing an annual statement of payments. Most of these costs should be relatively small. However, where there is a high incidence of late payments by employers there could be significant costs for providers. Providers may seek to recover these costs through increased charges.
- Improving the compensation scheme will probably result in some increase in the overall cost of the compensation levy.
- Requiring money purchase schemes to provide an improved yearly benefit statement, would lead to additional administrative costs for employers running money purchase schemes in preparing and issuing statements and dealing with queries. The ongoing costs should be minimal as annual benefit statements are already issued.
- Reducing the regulatory burden for certain types of schemes would reduce the ongoing administrative costs for employers running those schemes.
- Simplifying contracting-out requirements would reduce the ongoing costs for employers running contracted-out schemes.

Appendix Two

Glossary of terms

Accrued rights

Also known as accrued benefits. Generally, the right to future benefits which a member of an **occupational pension scheme** has built up in respect of service up to a given point.

Active member

A member of a pension scheme who is building up rights on the basis of current contributions.

Additional Voluntary Contributions (AVCs)

Voluntary contributions over and above a member's normal contributions which a member may choose to pay to an occupational scheme in order to secure additional benefits.

Annuity

An arrangement by which a life insurance company pays someone a regular income, usually for life, in return for a lump-sum premium.

Appropriate Personal Pension (APP)

A personal pension scheme which an individual may join as a means of contracting out of the **State Earnings Related Pension Scheme (SERPS)**. To obtain an appropriate scheme certificate from the Secretary of State for Social Security, the personal pension scheme needs to satisfy certain conditions about the provision of **protected rights**.

Attendance Allowance

A non-contributory, tax-free, non means-tested benefit paid to meet the extra costs arising from the care needs of elderly and disabled people.

Basic state Retirement Pension/Basic state pension

Flat-rate state pension payable at state pension age to people who have met the minimum National Insurance contribution requirements.

Benefits Agency

An executive agency of the Department of Social Security with responsibility for the assessment, delivery and administration of all benefits except war pensions.

Child Benefit

A universal, tax-free benefit payable for each child in a family from birth to the age of 19 or to a date related to the end of secondary education, whichever is the earlier.

Contracting out

An arrangement under which members of a pension scheme which meets certain conditions, obtain rights in that scheme in place of their **SERPS** entitlement. **National Insurance contributions** for these employees are reduced or, in the case of an **APP**, partly repaid to the scheme.

Contracted-out rebate

The reduction of **National Insurance contributions** payable by employers and employees who have contracted out of **SERPS** into an occupational pension scheme. It is also the equivalent payment made by the Department of Social Security as a minimum contribution to a **personal pension**.

Council Tax Benefit

An income-related benefit designed to help meet Council Tax costs.

Defined benefit scheme

See under **salary-related scheme.**

Defined contribution scheme

See under **money purchase scheme.**

Disability Living Allowance

A non-contributory, tax-free, non means-tested benefit paid to meet the extra costs of care and mobility needs for people who become disabled before the age of 65.

Eligibility

The conditions which must be met for a person to be a member of a pension scheme or to receive a particular benefit. These may, for example, relate to age, service, status and type of employment.

Financial Services Authority (FSA)

Formerly known as the Securities and Investments Board, the FSA will become the single organisation responsible for banking supervision and regulation of the various investment businesses in the UK, including insurance companies, unit trust operators, building societies, stockbrokers and independent financial advisers.
At present, these responsibilities are carried out by a number of different organisations.

Funded/Funding

Arrangements for the savings and investment of contributions to accumulate assets which are used to meet future pension liabilities.

Graduated Pension Scheme

A state earnings-related scheme introduced in 1961 and replaced by **SERPS** in 1978.

Gross Domestic Product (GDP)

A measurement of the output of the domestic economy.

Group Personal Pension (GPP)

An arrangement made for the employees of a particular employer to participate in a personal pension scheme on a grouped basis. It is not a separate scheme but a collecting arrangement with each member having an individual contract with the pension provider.

Guaranteed Minimum Pension (GMP)

The minimum pension which a salary-related occupational scheme must pay a member in respect of contracted-out contributions paid between April 1978 and April 1997 as a condition of **contracting out**. (Replaced by the Reference Scheme Test for contributions paid after April 1997).

Higher Pensioner Premium

In **Income Support, Housing Benefit** and **Council Tax Benefit**, an additional amount of benefit payable to pensioners aged 80 or over.

Home Responsibilities Protection

Protection of entitlement to the **basic state Retirement Pension** for people who are unable to undertake regular employment because of caring responsibilities and who are receiving **Child Benefit** or **Invalid Care Allowance**.

Housing Benefit

An **income-related benefit** to provide help with the housing costs of private and public sector tenants.

Incapacity Benefit

A weekly benefit paid to people who meet the relevant requirements and who are unable to work because of illness or disability.

Income drawdown

Also known as income withdrawal. The facility to withdraw an income from a **personal pension** or a **money purchase** occupational pension scheme while the purchase of **annuity** is deferred.

Income-related benefit

Any benefit where entitlement is based on a person's financial resources as well as other qualifying criteria which vary according to the particular benefit claimed.

Income Support

An **income-related benefit** for people who are not in work (or who work for a limited number of hours a week) and whose income is less than a specified level, calculated on the basis of age, family membership and other prescribed circumstances.

Invalid Care Allowance

Non-contributory, non means-tested benefit for people who give up the opportunity of full-time work to provide care on a regular and substantial basis (at least 35 hours or more a week) to a severely disabled person.

Liabilities

The total amount of a pension scheme's current and future obligations towards its members.

Lower Earnings Limit (LEL)

The weekly level of earnings (roughly equivalent to the **basic state Retirement Pension**) below which there is not a liability to pay **National Insurance** contributions. See also **Upper Earnings Limit**.

Member-nominated trustee

A trustee of an occupational pension scheme nominated or elected by the members of that scheme in accordance with the statutory requirements set out in the Pensions Act 1995.

Minimum Funding Requirement (MFR)

A legal requirement that the value of the assets of a salary-related occupational pension scheme are not less than the amount of that scheme's **liabilities** (as described in section 56 of the Pensions Act 1995).

Money purchase scheme

(Also known as **defined contribution scheme**.)
An **occupational pension scheme** where contributions are invested to produce a capital sum on retirement. The capital sum (less any **tax-free lump sum**) is used to purchase an **annuity** to provide a pension.

National Insurance Contributions

Contributions payable by those in work and their employer into the National Insurance fund, which are used to pay contributory social security benefits to qualifying individuals. Self-employed people pay a lower rate but have more limited rights to benefits. Contributions are divided into four main classes which bring access to different benefit entitlements:

> *Class 1*
>
> Payable by employed earners on all earnings between the **Lower Earnings Limit** and **Upper Earnings Limit** and by employers on all earnings above the **Lower Earnings Limit**. Class 1 contributions give access to all **National Insurance** benefits both at a flat-rate and with earnings-related increases where relevant (subject to the individual meeting the specific conditions of entitlement for each benefit).

Class 2

Flat-rate contribution paid by self-employed earners. Benefits are payable at the basic rate only and there is no entitlement to certain benefits.

Class 4

Profit-related additional contributions payable by self-employed earners with profits above an annual threshold up to an upper threshold equivalent to the **Upper Earnings Limit** for Class 1 contributors. These contributions do not give entitlement to any additional benefits (they are intended to ensure that those who can, contribute an amount which more accurately reflects the levels paid by employed earners and their employers.)

New Deals

The New Deal approach offers claimants a flexible, personalised service to help them move from welfare to work. Claimants are given a personal adviser who will give them advice and help on jobsearch, training, benefits and other issues such as childcare and housing. The New Deal for Lone Parents, New Deal for 18–24-year-olds and New Deal for over 25s are now all national schemes. The New Deal for Disabled People is piloting innovative schemes to get disabled people into work and a personal adviser service. In addition, the Chancellor announced in the spring Budget that partners of the unemployed will also be given the help they need to take up work.

Non-state pension

Any pension provided by an employer, including a public sector employer, or by a personal pension provider.

Occupational pension scheme

A scheme organised by an employer or on behalf of a group of employers to provide pensions and/or other benefits for, or in respect of, one or more employees on leaving service or on death or retirement.

Occupational Pensions Regulatory Authority (Opra)

A statutory body, created by the Pensions Act 1995, responsible for ensuring that occupational pension schemes comply with the requirements of the relevant legislation. It has powers of investigation and can impose penalties ranging from prohibition from acting as a trustee, imposition of fines to criminal prosecution.

Pay-as-you-go

An arrangement under which current benefits are paid out of current contributions and no **funding** is made to meet future **liabilities**. Also referred to as an **unfunded** scheme.

Pension Compensation Board

A body set up under the Pensions Act 1995 to administer the Pension Compensation Scheme which provides compensation for members of **occupational pension schemes** where the sponsoring employer is insolvent and the assets of the scheme have been reduced through dishonesty.

Personal pension

An arrangement between an individual who is self-employed, in non-pensionable employment or who is not a member of an employer's scheme and a pension provider (such as an insurance company) which enables the individual to make provision for a pension on a money purchase basis.

Protected rights

The benefits under an **appropriate personal pension** or a contracted-out **money purchase scheme** which derive from the **contracted-out rebate** and which must be provided in a specified form as a condition of **contracting out**.

Public Sector Pension Scheme/Public Service Pension Scheme

An occupational pension scheme for employees of central or local government, a nationalised industry or other statutory body, for example the schemes for the civil service, local authorities, the police and fire services.

Regulatory Impact Assessment

An assessment of the impact on business, charities and voluntary organisations of regulatory proposals. It describes the objectives of the proposal and its likely effects, and sets out the cost and benefits. It is usually published for consultation and is open to comments, improvements and corrections by any interested party.

Salary-related scheme

Also referred to as **defined benefit scheme**. An occupational pension scheme where the benefits are calculated by reference to the employee's salary at or near the time of retirement or on leaving service and the length of pensionable service.

State Earnings Related Pension Scheme (SERPS)

Scheme introduced in 1978 which provides an additional state pension component, calculated by reference to the employee's earnings, on top of the **basic state pension**.

Tax-free lump sum

A lump sum which can be taken tax-free from an **occupational pension scheme** or a **personal pension** at retirement. For **personal pensions** and **money purchase schemes**, the amount that can be taken must not exceed 25 per cent of the value of the fund and cannot be taken from **protected rights**. For **salary-related schemes**, the lump sum must not exceed a specified proportion of final salary for each year of pensionable service.

Trust

A legal concept which enables one or more persons (the trustees) to hold property for the benefit of others (the beneficiaries) for the purposes specified in a trust deed. The trustees may also be beneficiaries of the trust.

Trustee

A person or a company appointed to carry out the purpose of a trust in accordance with the trust deed and rule, trust law and, where relevant, pensions law.

Transfer of Undertakings (Protection of Employment) Regulations 1981:

The legal framework which governs the continued employment rights of employees in business undertakings which are transferred from one employer to another as a going concern. The transferee takes over the employment contracts of all those employed in the undertaking immediately before the transfer and all rights and obligations arising from those contracts, except occupational pension rights.

Unfunded

See under **pay-as-you-go**.

Upper Earnings Limit

Level of earnings (equal to approximately seven times the **Lower Earnings Limit**) above which there is no liability for employee **National Insurance contributions** and above which **SERPS** does not accrue.

Waiver of premium

An insurance arrangement which, in return for an additional payment on top of the basic pension contributions, enables contributions to be waived during periods of ill-health.

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