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The *Pensions Bill*

Bill 12 of 2006-07

The *Pensions Bill 2006-07* was introduced on 28 November 2006 and published the following day. It is due to have its Second Reading in the Commons on 16 January. Amongst other things, it will raise the State Pension age for both men and women to 68 by 2046; re-link increases in the Basic State Pension to earnings; accelerate the conversion of the earnings-related State Second Pension into a flat rate pension, probably by 2030; make it much easier for people with caring responsibilities or disabilities to qualify for a full state pension from 2010; abolish contracting-out for defined contribution pension schemes, and establish a Delivery Authority to prepare the ground for the introduction of a new system of 'personal accounts'.

The Bill's provisions were foreshadowed in the White Paper, *Security in retirement: towards a new pension system*, published in May 2006. This, in turn, drew on recommendations made by the Pensions Commission in their November 2005 report, *A new pension settlement for the twenty-first century.*

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Summary of main points

The *Pensions Bill* published on 29 November 2006 implements a major part of the package of reforms described in the White Paper, *Security in retirement: towards a new pension system*, published in May 2006. A second Bill, establishing a system of 'personal accounts', will be presented at a later date to complete the reform.

The main provisions of the present Bill and the dates they are due to be implemented are summarised below:

- The **contribution conditions** for receipt of the Basic State Pension will be relaxed so that contributors will qualify for a full pension after 30 years. Under current rules, men must contribute for 44 years and women for 39 years. This will apply to people reaching State Pension age on or after 6 April 2010. At the same time the rules governing credited contributions for the state pension will be changed to make it easier for **carers** to qualify for a full pension.

- **Adult Dependency Increases** for new claims to State Pension will be abolished from 6 April 2010

- Increases in the **Basic State Pension (BSP**) will be linked to **earnings**, rather than prices, from 2012 "subject to affordability and the fiscal position … but in any event at the latest by the end of the next Parliament". A statutory requirement to increase the guarantee element of the **Pension Credit** in line with earnings will be introduced from 2008.

- The flat rate element of the **State Second Pension (S2P)** will become a fixed amount (£1.40 for each year of qualification in 2006/07 earnings terms) at the same time as the earnings link for the Basic State Pension is restored. Accruals to the earnings-related element will be restricted to 10% from 2010 and phased out altogether by a target date of 2030, so that S2P becomes fully flat rate.

- The **State Pension age (SPA)** for both men and women will be increased to 66 over two years starting in April 2024; 67 over two years starting in April 2034; and 68 over two years starting in April 2044. The Pension age for women is already due to rise from 60 to 65 over the period April 2010-April 2020.

- Defined contribution pension schemes will no longer be able to **contract out** of S2P from the date the earnings link for the BSP is restored

- Contracted out defined benefit pension schemes will be able to convert **Guaranteed Minimum Pensions (GMPs)** accrued between 1978 and 1997 to scheme benefits on the basis of actuarial equivalence from a date yet to be announced

- A **Personal Accounts Delivery Authority** (PADA) will be established to prepare the ground for the personal accounts (which the Government intends should be

introduced in 2012). The intention is that an Invitation to Negotiate for the provision of personal accounts should be issued in July 2008.

Explanatory Notes on the Bill are available at http://www.publications.parliament.uk/pa/cm200607/cmbills/012/en/index_012.htm

The DWP has published a number of Fact Sheets on aspects of the Bill, available at http://www.dwp.gov.uk/pensionsreform/factsheets.asp

Territorial Extent

Most of the Bill applies to Great Britain. Northern Ireland has its own body of pensions law but there is a long-standing policy of parity in this area. While the Northern Ireland Assembly is suspended, pensions provision is made by way of Order in Council. It is intended that a Northern Ireland Pensions Order, containing provisions corresponding to those of the Bill, will be made. However, the provisions establishing a Personal Accounts Delivery Authority (Part 3 of the Bill) apply to the whole of the UK. There are a few clauses (8, 23) which apply specifically to Northern Ireland.

Where matters extend to Scotland, it will not be necessary to invoke the Sewel Convention because pensions are a reserved issue.

CONTENTS

I Introduction 7

II State Pensions 12

A. Background to the current State Pension 12

B. National Insurance and qualifying for State Pensions 13

1. Background 13
2. Contribution rates 13
3. Qualifying for a Basic State Pension 13
4. Reduced rate pensions 15
5. Credits 15
6. Home Responsibilities Protection (HRP) 17
7. Voluntary contributions 18
8. The Bill 21
9. Issues 22

C. Adult Dependency Increases 25

1. Background 25
2. The Bill 27
3. Issues 27

D. Uprating 28

1. Background 28
2. Pension Credit uprating 32
3. The Bill 35
4. Issues 35

E. State Second Pension 36

1. Background 36
2. The Bill 48
3. Issues 50

F. State Pension age 55

1. Increase in State Pension age 55
2. The Bill 62
3. Issues 64

G. Costs and savings 70

III Occupational and Personal Pensions 73

A. Contracting out 73

1. Background 73
2. The Bill 87
3. Issues 88

B. Dispute resolution 90

1. Background 90
2. The Bill 90

C. Actuarial guidance 91

IV Personal Accounts 92

1. Background 92
2. Personal accounts - key issues 99

V The Personal Accounts Delivery Authority 110

2. The Bill 114
3. Issues 117

VI Bibliography and weblinks 120

A. Official Publications 120

B. Selected responses to the May 2006 White Paper 121

I Introduction

The *Pensions Bill* published on 29 November 2006 implements proposals contained in the White Paper, *Security in retirement: towards a new pensions system*, published on 25 May 2006. These proposals are based on the "new pension settlement for the twenty-first century" drawn up by the Pensions Commission chaired by Lord Turner of Ecchinswell.

The Government established the Pensions Commission in December 2002 in response to growing concern that people were not saving enough for their retirement and that measures taken to encourage private sector provision were not succeeding. Although its original brief was principally to consider whether a voluntarist approach to pension provision could secure adequate income in retirement or whether compulsion would be necessary, the Commission became the focus of a much wider debate about the whole future of pensions, both state and non-state.

The Commission's first report, *Pensions: Challenges and Choices*, published on 12 October 2004, contained a detailed description of the present position but did not make policy recommendations. It concluded – in a much quoted paragraph – that:

> Faced with the increasing proportion of the population aged over 65, society and individuals must choose between four options. Either:
>
> (i) pensioners will become poorer relative to the rest of society; or
>
> (ii) taxes/National Insurance contributions devoted to pensions must rise; or
>
> (iii) savings must rise; or
>
> (iv) average retirement ages must rise.
>
> But the first option (poorer pensioners) appears unattractive; and there are significant barriers to solving the problem through any one of the other three options alone. Some mix of higher taxes/National Insurance contributions, higher savings and later average retirement is required.[1]

The second report, *A new pension settlement for the twenty-first century*, published on 30 November 2005, contained a detailed blueprint for a major reform of the UK's pension system. Its key recommendations were:

- The establishment of a National Pensions Saving Scheme (NPSS) into which all employees without good existing provision would be automatically enrolled but with the right to opt out. Minimum default employee contribution rates would be 5% of gross pay above £5,000, of which 1% would effectively be paid by tax relief. Employers would be required to make matching contributions of 3%. Both

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[1] Pensions Commission, Pensions: Challenges and Choices: the First Report of the Pensions Commission, 12 October 2004, Executive Summary
http://www.pensionscommission.org.uk/publications/2004/annrep/fullreport.pdf

employers and employees would be able to make additional voluntary contributions, and the self-employed would be able to join on a voluntary basis. The design of the scheme would aim for low costs, e.g. 0.3% per year, thus boosting the value of pension saving by up to 30%.[2]

- Indexing the Basic State Pension to average earnings growth, "ideally starting in 2010 or 2011".
- Paying for this by increasing the State Pension age "broadly in proportion to life expectancy, for instance to 66 by 2030, 67 by 2040 and 68 by 2050".
- Accelerating the evolution of the earnings related State Second Pension (S2P) to a flat-rate by freezing the Upper Earnings Limit for S2P accruals in nominal terms.
- Abolishing contracting out for defined contribution pension schemes and phasing out contracting out for defined benefit pension schemes by about 2030.
- Limiting the spread of means testing by "freezing the maximum level of Pension Credit Savings Credit payments in real terms".
- Basing future accruals of Basic State Pension on an individual and universal (i.e. residency) basis and improving carer credits within S2P.
- "Ideally" introducing a universal Basic State Pension for pensioners aged over 75.
- Establishing a successor body to the Pensions Commission to keep the situation under review.

John Hutton, who had been appointed Secretary of State for Work and Pensions in October 2005, welcomed "the broad framework of the Pensions Commission proposals and options" and considered them "the right basis for the debate to come".[3] The Government's response would be informed by the "National Pensions Debate" launched by David Blunkett when he was Secretary of State,[4] and would have to meet the "five tests" John Hutton had set for a lasting pensions settlement:

> First, does it promote personal responsibility?
>
> Second, is it fair?
>
> Third, is it affordable?
>
> Fourth, is it simple?
>
> And fifth, is it sustainable? [5]

---

[2] Pensions Commission press notice, 30 November 2005
[3] Statement on the Pensions Commission Report, HC Deb 30 November 2005, cc 269-270
[4] HC Deb 9 June 2005, cc 59WS-60WS
[5] Speech to Institute of Public Policy Research, 24 November 2005,

When the Pensions White Paper was published on 25 May 2006 it adopted many of the Pensions Commission's proposals, but with modifications:

- the National Pensions Savings Scheme would take the form of "personal accounts";
- the earnings link for the Basic State Pension would be restored from 2012 at the earliest and "subject to affordability and the fiscal position … but in any event at the latest by the end of the next Parliament",
- the State Pension age would be increased but more quickly – to 66 phased in between 2024 and 2026; 67 between 2034 and 2036; and 68 between 2044 and 2046;
- the conversion of S2P to a flat-rate benefit would be accelerated
- contracting out would be abolished for defined contribution schemes although no proposals would be brought forward at this stage for abolishing contracting out for defined benefit schemes
- the maximum Pension Credit Savings Credit would be frozen in real terms from 2015.
- the White Paper rejected the idea of a residency-based "citizen's" pension preferring to retain the contributory principle. It did, however, propose major changes to the contribution conditions and credits which would make it easier for those with caring responsibilities and interrupted work records to qualify for a full basic pension.
- it also rejected the idea of a permanent Pensions Commission, preferring instead that the Government should periodically commission independent reviews.

In his statement on the White Paper John Hutton highlighted some of the Pensions Commission's findings:

> First, the Commission found that between 9 million and 12 million people are not saving enough for their retirement. Secondly, it estimated that, by 2050, there would be 50 per cent. more pensioners than today and that the ratio of people in work to those in retirement would halve over the same period. Thirdly, as a result of historical legacy, the current state pension system is complex and delivers unfair outcomes, especially for women and carers. Of those recently reaching State Pension age, 85 per cent. of men have a full entitlement to a Basic State Pension compared with only 30 per cent. of women. Finally, it found that, if we maintain current indexation, the Basic State Pension might be worth in today's earning terms only £35 by 2050 and that more than 70 per cent. of pensioner households could be eligible for pension credit—never the Government's

http://www.dwp.gov.uk/aboutus/2005/24-11-05.asp

> intention. The Commission urged the Government not to duck the long-term challenge of reform.[6]

He went on:

> I believe that the proposals in today's White Paper address the challenges that the Pensions Commission identified. We will therefore introduce a new system of personal accounts that will make it easier for more people to save. We will reform state pensions so that they are simpler and more generous. We will modernise the contributory principle and make the state pension fairer and more widely available. We will increase the State Pension age, keeping the proportion of life spent receiving the state pension stable for each generation and helping to secure the long-term financial stability and sustainability of the state pension system.[7]

A period of consultation followed the White Paper and the Government published a *Summary of responses* and its own response to these on 30 October 2006.[8] This made it clear that while legislation would be introduced at the start of the 2006/07 session to make changes to the state pension system, the Government was still working "with stakeholders to develop the detailed arrangements for personal accounts and it is likely that a second Bill will be needed to legislate for this."[9] A White Paper on personal accounts would be published in December 2006.[10] Nevertheless, the Government response announced that the first Pensions Bill would establish a Delivery Authority to prepare the ground for personal accounts.[11] John Hutton, in his foreword to the *Summary of responses*, emphasised that the proposals constituted a "comprehensive, integrated package of reform", so that all the key elements are required.

The *Summary of responses* concluded that there was "widespread welcome for the package of reforms that the White Paper proposed":

> Since publication, agreement on the broad direction of travel and the core principles of the package has been given by most parties. There are some differences of opinion on the detail of the policy, but there is nonetheless a broad consensus on the ultimate outcomes that must be realised: a simpler, sustainable and fairer pension system for the UK. One of the most encouraging aspects of the consultation process has been the propensity to accept trade-offs and compromises from all sides which will be needed to reach a consensus.[12]

Several responses regretted that the proposals did not do enough for current pensioners, but the Government argue that they have already made a number of improvements, for

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6 HC Deb 25 May 2006, cc 1648-1649
7 Ibid, c 1649
8 Department for Work and Pensions, Security in retirement: towards a new pensions system: summary of responses to the consultation, 30 October 2006, Cm 6960 http://www.dwp.gov.uk/pensionsreform/pdfs/pens-wp-response.pdf
9 Ibid, Chapter 6, para 1
10 Ibid, Chapter 2, para 3
11 Ibid, Chapter 2, para 36
12 Ibid, Chapter 1, para 3

example by introducing Pension Credit, winter fuel payments, and (from 2008) free bus travel. There remained, however, three specific areas of concern:

- whether the objectives of the state pension system would be better served by moving to a single-tier flat-rate State Pension at the level of the Pension Credit standard minimum guarantee, often referred to as a Citizens' Pension;
- the extent to which the new state pension system will make it 'pay to save' for people in personal accounts, or whether future interactions with income-related benefits would result in an opt-out rate higher than in the Government's central estimates; and
- whether the schedule outlined for future increases in the State Pension age was sustainable in the face of the uneven distribution of increases in life expectancy across different income groups.[13]

The Queen's Speech on 15 November 2006 announced that "a Bill will be introduced providing for long-term reform of pensions", and the *Pensions Bill 2006-07* was duly introduced on 28 November 2006. The Regulatory Impact Assessment for the Bill confirmed that the provisions of the Bill were largely as outlined in the White Paper, but highlighted four new measures included following consultation:

- new measures for reform of the State Second Pension to make it simpler to understand;
- reforms to enable a spouse (and in the future, a civil partner) to draw a pension based on their spouse's (or, in the future, civil partner's) insurance even if they choose not to retire; and
- confirmation of the uprating arrangements for adult dependency increases and other benefits as a consequence of uprating the Basic State Pension by earnings;
- establishing a delivery authority with a limited remit, to prepare the documentation necessary to enable commencement, in July 2008, of the commercial process for the infrastructure of personal accounts.[14]

General comments on the Bill include a concern that it will actually make pensions more complex and that the whole transition to the more generous state pension is far too slow. An article in *Professional Pensions* quotes industry experts as saying:

> The new Bill will just add another layer of complexity to what is already the most complex system in Europe… The government's plans for pensions sound good but camouflage some potentially controversial issues. Only people under the age of 20 today will start their state pension with the benefit of the full earnings link and on a realistic level of non means-tested benefit.[15]

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[13] Ibid, Chapter 1, para 12
[14] DWP, *Pensions Bill - Regulatory Impact Assessment*, 29 November 2006, pp4-5
[15] "Reforms will make things more complex", *Professional Pensions*, 23 November 2006

II State Pensions

A. Background to the current State Pension

There are a number of different types of state pension. These include the **Basic State Pension** (BSP) and additional State Pensions (**SERPS** and the **State Second Pension** (S2P)). These pensions are contributory benefits and entitlement is dependent on an individual having made the necessary National Insurance Contributions (NICs) during their working life. A BSP to a person on the basis of their own contributions is referred to as a **Category A** pension (full rate is £84.25 per week in 2006/07).

Married women who have not built up their own entitlement to a Basic State Pension can use their husband's contribution record instead (if he has reached State Pension age and claimed his State Pension). They can receive a **Category B** Basic State Pension of up to 60 per cent of their husband's Category A pension entitlement (the full rate is £50.50 in 2006/07). A married woman may be entitled to both Category A and Category B pensions; if their Category A pension is less that the full rate of Category B Pension they can receive a composite pension which can make up their entitlement up to the full Category B rate.

The Basic State Pension is increased for dependants, including a spouse and, in some cases, children for whom the pensioner is entitled to Child Benefit. The increase for adult dependants is payable only for new claims if the dependent's earnings are below a set limit - £57.45 pw where the dependent is living with the spouse who is getting the state pension.

For new claims since 6 April 2003, it has not been possible to get an increase for dependent children. Instead, provision for children is made through Child Tax Credit. People who were receiving an increase for children at 6 April 2003 continue to receive this for as long as they are entitled to Child Benefit for that child or children.

Employees earning more than the National Insurance Lower Earnings Limit pay into the additional state pension (unless they are "contracted-out" and contributing to an occupational or personal pension instead.) Between April 1978 and April 2002, this was built up under the State Earnings-Related Pension Scheme (SERPS). From April 2002, SERPS was replaced by the State Second Pension (S2P). This changed the way state earnings-related pensions were calculated. S2P was specifically targeted at those on low incomes, and those who have broken work records because of illness or caring responsibilities.

B. National Insurance and qualifying for State Pensions

1. Background

People in employment pay National Insurance Contributions (NICs) which give them entitlement to a range of contributory benefits. These include State Pensions.

2. Contribution rates

Class 1 NICs are paid by employees (and their employers). The current rates of contributions for a person not contracted out are shown in **Table 1.**

Table 1 Class 1 National Insurance Contributions in 2006/7 (not contracted out)

Weekly earnings £	Employee contribution %	Employer contribution %
Below 84	No NICs payable	No NICs payable
84 to 97	0	No NICs payable
97-645	11	12.8
Above 645	1	12.8

Employees who are contracted out from the State Second Pension receive a rebate of their contributions, which is calculated on their earnings above the Lower Earnings Limit (£84 per week). For employees the rebate is 1.6% of earnings in this band up to the Upper Earnings Limit (£645). For employers it is 3.5% up to the UEL for contracted-out salary related schemes; for contracted out money purchase schemes and appropriate personal pensions the employers' rebate depends on the age of the employee.

Class 2 contributions are flat-rate payments payable by all self-employed people over 16, unless they have applied for the small earnings exemption. Currently Class 2 contributions are £2.10 per week. (In addition self-employed people are liable for profit-related **Class 4** contributions.)

Class 3 contributions are voluntary and are paid by people aged 16 and over to enable them to qualify for BSP and bereavement benefits if their contribution record would otherwise not be sufficient; currently the rate is £7.55 per week.

3. Qualifying for a Basic State Pension

To qualify for a full Basic State Pension – currently £84.25 a week for a single person – people must have paid National Insurance Contributions (NICs) for about 90% of the years in their "working life". People with incomplete contribution records may still qualify for a reduced rate pension. They may also be able to pay voluntary contributions to improve their records, although there is normally a six year time limit on payment of contribution arrears.

There are two contribution conditions for the Basic State Pension:

> **Condition 1**
>
> You must either:
>
> - have [at least] one qualifying year since 6 April 1975 which is derived from the payment of Class 1, 2 or 3 National Insurance (NI) contributions or from Class 1 NI contributions treated as paid, …***or***
> - have paid 50 flat rate contributions at any time before 6 April 1975.
>
> **Condition 2**
>
> - To get the full rate Basic State Pension you must have qualifying years for about 90% of the years in your working life.
> - To get the minimum Basic State Pension payable (25%) you normally need 10 or 11 qualifying years...[16]

a. Qualifying years

A “qualifying year” is defined as follows:

> A qualifying year is a tax year in which you have either:
>
> - paid, or been credited with Class 1 contributions on earnings of at least 52 times the LEL for the payment of contributions in that year, or
>
> - paid 52 Class 2, or paid or have been credited with 52 Class 3 contributions.
>
> Any contributions paid or credited before 6 April 1975 are converted into a number of qualifying years by dividing the total number by 50 and rounding up to the next whole number. But the number of qualifying years made up in this way cannot be more than the number of actual years in your working life up to April 1975.
>
> Between 6 April 1975 and 5 April 1978, for a year to be classified as a qualifying year, you must have paid or been credited with Class 1 contributions on earnings of 50 times the LEL, or paid 50 Class 2, or paid or been credited with, 50 Class 3 contributions.[17]

The “LEL” is the Lower Earnings Limit for National Insurance Contributions. It is currently linked to the Basic State Pension – currently the LEL is £84.00 per week.

[16] DWP leaflet NP 46, April 2005 edition, p 20 http://www.thepensionservice.gov.uk/pdf/np46/np46apr05.pdf (retrieved 9 June 2006)

[17] Contributions Agency leaflet CA 07, April 2004, p 19

b. Working life

A person's "working life" is defined as follows:

> **Working life**
>
> Your working life is the period over which you have to meet the contribution conditions for Basic State Pension. It is normally:
>
> - 49 years for men
> - 44 years for women born on or before 5 October 1950
> - 45 years for women born on 6/10/50 or on any day through to and including 5/10/51
> - 46 years for women born on 6/10/51 or on any day through to and including 5/10/52
> - 47 years for women born on 6/10/52 or on any day through to and including 5/10/53
> - 48 years for women born on 6/10/53 or on any day through to and including 5/10/54
> - 49 years for women born on 6/10/54 or later.
>
> Your working life is counted from the start of the tax year in which you reach the age of 16 to the end of the tax year before the one in which you reach State Pension age.[18]

4. Reduced rate pensions

Someone who does not have enough qualifying years to get the full BSP can be awarded a reduced rate pension paid as a per centage of the full rate in relation to the number of qualifiying years as a proportion of working life. However, this is subject to a minimum of 25 per cent.

5. Credits

In certain circumstances, people can be credited with contributions to help them qualify for the Basic State Pension. Credits cannot help to satisfy the first contribution condition. A minimum number of contributions must have actually been paid for any pension to be payable. But credits can help to satisfy the second contribution condition.

The circumstances in which credits are given are set out in an HMRC leaflet as follows:

> You may be able to get credits instead of having to pay contributions if you
>
> - are unemployed or unable to work because of illness or disability for full weeks (a week for these purposes means Sunday to Saturday). You will normally have to attend an interview every two weeks at your nearest

[18] NP 46, April 2005 edition, pp 20-21, http://www.thepensionservice.gov.uk/pdf/np46/np46apr05.pdf (retrieved 9 June 2006)

Jobcentre, Jobcentre Plus or social security office (Social Security office in Northern Ireland), or send in sick notes (also known as medical certificates) to your nearest Jobcentre, Jobcentre Plus or social security office to get the credits. In Northern Ireland send in sick notes to Incapacity Benefits Branch, Castle Court, Royal Avenue, Belfast BT1 1SB. You may still be able to get a credit for being unemployed if you work part-time for less than 16 hours per week but you may also still be liable to pay contributions for the same period depending on your level of earnings

- are entitled to Maternity Allowance or Carer's Allowance or Unemployability Supplement.

- are entitled to Statutory Sick Pay, Statutory Maternity Pay or, from April 2003, Statutory Adoption Pay.

- are taking a course of approved training. For more details see leaflet CA 12 *Training for further employment and your National Insurance record.*[19]

- are receiving Working Tax Credit (WTC).

  If you are receiving WTC and your earnings are below the LEL for liability to National Insurance contributions (£79 a week in the tax year 2004-2005), you may be awarded National Insurance credits to help safeguard your entitlement to certain social security benefits such as the Basic State Pension. The Inland Revenue Enquiry Centre, the Tax Credits Helpline (0845 300 3900, Textphone 0845 300 3909) (in Northern Ireland ring 0845 603 2000, Textphone 0845 607 6078) or your local Jobcentre, Jobcentre Plus or social security office will be able to give you more detailed advice. You can also log on to our website at www.inlandrevenue.gov.uk/taxcredits

- are required to attend Jury Service and did not have earnings at, or exceeding the LEL from employed earners employment and are not self-employed.

- are a man aged between 60 and 64. These credits, known as autocredits, are available for the tax year containing your 60th birthday and the following four tax years, provided that in each tax year you:

  - are not liable to pay contributions, and
  - have not been abroad for more than 182 days.

  If you qualify, the credits are awarded automatically for each of these years if you need them, for most contributory benefit purposes.

- are receiving a compensatory payment such as a Payment in Lieu of Notice (PILON) or a Payment in Lieu of Remuneration (PILOR).

[19] essentially, full time vocational courses of no more than one year's duration

- were wrongly imprisoned and your sentence was quashed by the court of appeal.

Credits count as Class 1 contributions at the weekly LEL.

You cannot get credits for any period when you were a married woman or widow with reduced liability.[20] (Emphasis added)

6. Home Responsibilities Protection (HRP)

Home Responsibilities Protection is another way in which people with deficient contribution records can be helped to qualify for the Basic State Pension. In this case years in which certain benefits were paid to those with caring responsibilities are deducted from the number of qualifying years needed to get a full pension.

The Pension Service's *Guide to State Pensions*, explains:

> You can get HRP for any tax year from April 1978 if, throughout the year:
>
> - you were the person who was awarded Child Benefit for a child under 16; *or*
>
> - you have been regularly looking after someone for at least 35 hours a week who has been getting Attendance Allowance (AA), Constant Attendance Allowance (CAA) or the highest or middle rate of Disability Living Allowance (DLA) care component:
>
>   throughout the whole of tax years up to 05/04/94 *and*
>
>   for at least 48 weeks in each tax year from 06/04/94; *or*
>
> - you have been getting Income Support and were not required to be available for employment so that you could look after a ill or disabled person at home; *or*
>
> - you have been covered by a combination of these conditions.
>
> In addition, from 6 April 2003, HRP is available to registered foster carers who do not receive Child Benefit.
>
> **Married women and widows cannot get HRP** for any tax year in which they have reduced contribution liability. But you will have lost your right to reduced liability if, for any two whole consecutive tax years since 6 April 1978, you have not been liable to pay NI contributions or you have not been self-employed. This is known as the **2 year test.**

For a tax year to count for HRP, the qualifying conditions must have been met throughout the whole of the year. Years which count will be deducted from the total

[20] CA 07, April 2004, pp 9-11, http://www.inlandrevenue.gov.uk/leaflets/ca07.pdf (retrieved 25 June 2004)

number of qualifying years needed for a full pension but HRP cannot reduce the number of qualifying years below 20. In some circumstances HRP is awarded automatically, for others it has to be claimed.

7. Voluntary contributions

People who are not able to pay Class 1 or Class 2 contributions or to receive credits or HRP may decide to pay voluntary Class 3 contributions to protect their right to a full Basic State Pension. Some of the groups who might benefit from this are students in full-time higher education, people who go to live abroad and people who are out of the labour market by choice. Others who have, perhaps, been credited with contributions for some, but not all the weeks in a tax year, may wish to pay sufficient Class 3 contributions to make the year a qualifying year. However, any decision on whether or not to pay these contributions will be a highly personal one, closely dependent on individual circumstances. For example, many married women will be able to qualify for a pension on their husband's contributions: and this pension could be as much as, or even more than, they could get by paying Class 3 contributions.[21]

The general rule is that Class 3 contributions must be paid within six years of the tax year in which they were due, although there are some exceptions. In 2003/04 90,000 individuals of working age gained a qualifying year for a pension from Class 3 contributions alone. Additional people achieved a qualifying year from Class 3 contributions in combination with Class 1 or Class 2 so that the total using Class 3 contributions to gain a qualifying year was around 100,000.[22]

a. Women and the current state pension system

One of the key concerns of the Government has been to improve pension provision for women who, usually because of caring responsibilities, find it difficult to build up full state pension rights under the current contributory system. Although changes made since the mid-1970s will gradually improve matters, "there remains a generation of women aged over 45 who can expect to reach State Pension age with significantly lower amounts of Basic State Pension than men."[23]

Many women with incomplete contribution records rely on those of their husbands and draw a Category B pension. Taken with the single-rate pension of the husband together these are often referred to as the "married" or "couple" rate. The full basic single Category A pension rate is £84.25 per week. The full Category B rate paid on the basis of a husband's contributions is £50.50 pw. This gives "married" rate of £134.75 pw. Currently, to qualify for a Category B pension a married woman and her husband must

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[21] Ibid, pp67-85

[22] DWP *Contributions and Qualifying Years for State Pension 1978/79 to 2003/04* http://www.dwp.gov.uk/asd/asd1/dsu/contsandqualify/contsandqualify.asp

[23] Department for Work and Pensions, Security in retirement: towards a new pensions system, (the Pensions White Paper), 25 May 2006, Cm 6841, para 3.72 http://www.dwp.gov.uk/pensionsreform/pdfs/white_paper_complete.pdf White Paper

both have reached State Pension age; her husband must have satisfied the contribution conditions for a Category A pension; and the husband must have made a claim for his Category A pension.

The Pensions Commission proposed that women and carers should be helped by basing future accruals of Basic State Pension on a residence test and introducing a "citizen's pension" (based on residency) for all people aged 75 and over.

However, the White Paper rejected this approach:

> Our core objection to a residence test is one of principle. *A new deal for welfare: Empowering people to work* reaffirmed our view that our system of welfare should be based on the recognition that with rights come responsibilities.
>
> The Government believes it is right for people to receive state pensions in return for making economic or social contributions during their working lives. We do not think it is fair to recognise people for State Pension purposes purely on the basis of residence while others are contributing to society through working and caring.[24]

Instead, it proposed significant changes to the contribution conditions for state pensions which should enable many more women and carers to qualify for a full pension. The proposed changes, to take effect in April 2010, were:

- The **number of qualifying years** required to achieve a full Basic State Pension would be reduced from 44 (for men – and women when their Pension age has increased to 65 in 2020) - and 39 (for women now) to 30.

- **Home Responsibilities Protection** (HRP) would be converted from a system which reduced the number of qualifying years required to a system of positive credits for each week of relevant responsibilities. There would be credits for each week of receipt of Child Benefit for a child up to the age of 12. At present HRP covers those in receipt of Child Benefit for a child up to the age of 16 for Basic State Pension purposes, but only up to the age of 6 for S2P purposes. The new child care credits will be aligned, ceasing at age 12 for both BSP and S2P.

- It would be possible to **combine** periods with earnings (and, therefore, paid contributions) and periods with credits (e.g. for caring responsibilities) to make up a qualifying year for S2P purposes. At present, qualifying benefits (e.g. Child Benefit) have to be awarded for a full year for the year to count.

- A new specific **credit for carers** would be introduced. At present, people in receipt of Carers' Allowance are credited with a week's contributions for each week on the allowance. People who do not receive the allowance but nevertheless care for someone in receipt of Attendance Allowance or the care component of Disability Living Allowance for at least 35 hours a week qualify for HRP. Carers' Allowance is only awarded to people who care for one severely

[24] Ibid, Box 3c

disabled person for 35 hours or more a week. The new weekly credit would be awarded to those who care for the severely disabled for 20 hours or more a week. The Government estimate that 70,000 people a year could gain a BSP credit from this change while 110,000 more women and 50,000 more men would accrue entitlement to S2P.[25]

- The **"25 per cent *de minimis* rule"** and the requirement for **one year's paid contributions** will be removed.

The Government believes these reforms, taken together, will make a considerable difference to the proportion of women qualifying for a full pension in their own right:

> 3.109 Today around 30 per cent of women and 85 per cent of men reaching State Pension age are entitled to a full Basic State Pension. By 2010 only around 50 per cent of women reaching State Pension age are expected to be entitled to a full Basic State Pension compared with around 90 per cent of men. Introducing our reforms for those reaching State Pension age from 2010 will mean around 70 per cent of women reaching State Pension age in 2010 will have a full Basic State Pension entitlement. By 2025 over 90 per cent of women and men reaching State Pension age are expected to get full Basic State Pension entitlements compared with around 80 per cent if we do nothing.[26]

Currently, of 6.5 million women pensioners just under half (49%) have a full Basic State Pension and many of these are at least in part dependent on contributions made by their (late) husbands. The remaining 51%, around 3.3 million, have a pension below the full Basic State Pension; in 2.5 million cases this is below £50 per week.[27]

The prospects for women pensioners are already set to improve, as the introduction of Home Responsibilities Protection, the abolition of the married women's lower NI option and increased labour market participation fully impact on the pensioner age population. At present around 30% of newly retiring women pensioners have less than a full pension; but by 2025 this is set to reach just over 80%.

Under the White Paper proposals, the number of qualifying years required for a full Basic State Pension would be reduced to 30 for men and women. In addition the current system of Home Responsibilities Protection would be made into a system of credits for each week of relevant responsibilities for those with a child up to the age of 12. As a result the number of women retiring with a full Basic State Pension in 2010 would rise from just over 50% to over 70%; and by 2025 will be over 90%.[28]

While the proportion of women reaching State Pension age with entitlement to a full Basic State Pension is set to rise, the proportion of men retiring on a full Basic State Pension was projected to fall from around 90% to under 80%. The proposal to give full pensions to new retirees with 30 qualifying years from 2010 would mean that almost all

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[25] Ibid, para 3.93
[26] Ibid, para 3.109
[27] HC Deb 9 Jan 2006 : c 98W
[28] HC Deb 16 Feb 2006 c1556

men would retire on a full Basic State Pension and this would fall only slightly over the next few decades.[29]

b. Autocredits

At present, unemployed men aged 60-64 can be automatically credited with National Insurance contributions, even if they are not seeking work. This provision was introduced in April 1983 at a time of high unemployment when men in this age group were exempted from the requirement to seek work in order to qualify for unemployment benefits.

Autocredits were due to be extended to women aged over 60 as their Pension age was raised from 60 to 65 over the period 2010-2020.

The White Paper announced that they would, instead, be phased out over the period 2010-2020:

> 3.105 In developing our proposals for reform of the state pension system, we have reconsidered the rationale for these credits. Our conclusions are that:
>
> - they are out of step with other measures the Government is taking to encourage people to extend their working lives to their full capacity; and
> - under our proposals to widen access to the Basic State Pension they will become largely redundant.
>
> 3.106 We therefore propose that they should be phased out in line with the increase in women's State Pension age between 2010 and 2020.[30]

This change is not included in the Bill, but will be brought forward in regulations.[31]

8. The Bill

a. Single contribution condition

For people reaching State Pension age from 6 April 2010, **Clause 1** of the Bill introduces a single contribution condition for a Category A or Category B pension. The same condition applies to a spouse or civil partner of a claimant of a Category B pension. The number of years needed to qualify for a full Category A or B pension will be 30 for both men and women. A person with less than 30 qualifying years will be entitled to a reduced state pension in proportion to the number of qualifying years they have. The method of calculating the proportionate pension which will be payable will be specified in regulations (under **Schedule 1 paragraph 5 Subsection (2)**) and the *Explanatory Notes*

[29] Department for Work and Pensions, Security in retirement: towards a new pensions system, (the Pensions White Paper), 25 May 2006, Cm 6841, Figure 3.vi
[30] Department for Work and Pensions, Security in retirement: towards a new pensions system, (the Pensions White Paper), 25 May 2006, Cm 6841, paras 3.105-3.106
http://www.dwp.gov.uk/pensionsreform/pdfs/white_paper_complete.pdf Ibid
[31] DWP *Pensions Bill – Regulatory Impact Assessment* para 2.24

to the Bill state that this will be without the requirement for it to be 25% or more of the basic rate, as present.

b. Category B pension: removing the need for partners to claim

Clause 2 will, from 6 April 2010, remove the requirement that for a married woman (or a married man or civil partner) to be entitled to a Category B pension, her/his partner has to have made a claim for a Category A pension. They will still both have to be of State Pension age and one of them must satisfy the contribution conditions for a Category A pension. But in future it would be possible for the member of a couple to receive a Category B pension even if the other member has deferred claiming a Category A pension. Individuals who do not claim their pension after State Pension age may be able to get a higher State Pension, or (since April 2005) a one-off taxable lump sum payment when they finally claim.

c. Credits for parents and carers

Under **Clause 3** of the Bill, from 6 April 2010, parents and carers will be able to build up credited entitlement to a Category A State Pension and, for their spouse or civil partner, entitlement to a Category B pension. This will replace the existing system of Home Responsibilities Protection. For people reaching State Pension age on or after 6 April 2010, each complete year of existing HRP will be converted into a qualifying year for Basic State Pension. They will in effect be treated as if they have made voluntary Class 3 contributions.

Unlike HRP which for the Basic State Pension can be given in respect of children up to age 16, the new system of “credits” will apply only in respect of children for whom child benefit is paid under the age of 12.

These credited Class 3 contributions will be awarded to a person who:

- is awarded Child Benefit in respect of a child under 12 years; or
- is a foster parent for any part of that week; or
- is engaged in “caring” (this is to be defined in regulations, but the RIA outlines it as people who provide 20 hours or more care a week for one or more people receiving Attendance Allowance, Constant Attendance Allowance or the middle or highest rates of the care component of Disability Living Allowance).

9. Issues

The Bill’s changes to the contribution conditions will affect pension entitlement, particularly of women, after 6 April 2010. It will mean that those retiring before and after this date could potentially have very different pension entitlements.

At the moment, people who might otherwise have insufficient qualifying years for a full Basic State Pension can opt to pay voluntary Class 3 NICs. Under the new rules, if they reach Pension age after April 2010, they may find they would have qualified without having made these additional contributions.

Number of people who have accrued a qualifying year for State Pension, by method of accrual
United Kingdom 2003/4 (provisional)

Thousands/%

	Men & Women		Women		Men	
Total with a qualifying year from contributions or credits	**32,501**	**100%**	**15,300**	**100%**	**17,195**	**100%**
Class 1 only	21,889	67%	9,864	64%	12,023	70%
Class 2 only	1,898	6%	453	3%	1,446	8%
Class 3 only	90	0%	44	0%	46	0%
Combination of 1, 2 and/or 3	75	0%	27	0%	49	0%
Credits or Credits in combination	6,113	19%	2,559	17%	3,550	21%
Home Responsibilities Protection	2,435	7%	2,353	15%	82	0%

Contribution combinations have been defined based upon whether contributions or credits were used to accrue a qualifying year
Figures are based on a 1% sample and are shown to the nearest thousand.
Figures may not add due to rounding
Source: DWP *Contributions and Qualifying Years for State Pension 1978/79 to 2003/04*

Table 2 Ways in which individuals qualify for state pension 2003/4

Around two-thirds of today's contributors gain entitlement to a pension through contributions as an employee (Class 1). Around 2½ million women and 3½ million men (around 1 in 5) relied on credits to qualify for 2003/4. 15% of women with a qualifiying year were dependent on Home Responsibilities Protection but very few men relied on HRP for their qualification.

Following the publication of the 2006 White Paper, the HM Revenue and Customs has acknowledged this is a possibility and is advising potential Class 3 contributors as follows:[32]

> If you reach State Pension age before 6 April 2010 you will be unaffected by the proposed changes. You may want to pay voluntary Class 3 contributions to increase your entitlement to the Basic State Pension if you are not currently entitled to the full amount or will not be by the time you reach State Pension age.
>
> However if the proposals in the White Paper become law, **you may not need to pay voluntary contributions**, if you are due to reach State Pension age on or after 6 April 2010 and :-
>
> - have already paid enough contributions to qualify for a full Basic State Pension under the proposed new rules ;
> - anticipate working and paying enough contributions to qualify for a full Basic State Pension under the proposed new rules
>
> **You should therefore consider very carefully whether you should delay paying Class 3 contributions** until it is clear whether the rules will change. If you nevertheless decide that you want to pay, you might not be able to get a refund if it turns out at a future date that you need not have paid them. However, if you delay paying the contributions, you may have to pay them at a slightly higher rate.

[32] http://www.hmrc.gov.uk/nic/vc3-important.htm (10 Dec 2006)

Any decision to make voluntary contributions has to be made by individuals in the context of their own NICs records and bearing in mind entitlement to other benefits might be affected if contributions are not made.

Age Concern's Director, Gordon Lishman, welcomed the parts of the Bill which extend a full pension to more women, but regretted that it did not do so retrospectively:[33]

> We are thrilled that the Government has finally listened to our calls for a better deal for women. Reducing the number of years needed for a full state pension to 30 and promising a more flexible carer's credit will boost the pensions prospects of millions of women and carers. But these changes must be introduced retrospectively to help those already retired with incomplete records.[34]

Jenny Watson, Chair of the **Equal Opportunities Commission** recognised the improvements the Bill offers for women's entitlement to BSP. She described the Bill as:

> an important step towards ending the scandalous inequalities currently faced by women in retirement. The unpaid contribution to society made by millions of parents and carers will finally be recognised and rewarded on the same terms as paid employment. Many more women retiring from 2010 onwards can look forward to a full Basic State Pension, a fair reward for a life spent working and caring.[35]

Imelda Redmond, Chief Executive of **Carers UK**, also welcomed the move to 30 qualifying years and introduction of a new Carer's Credit, but suggested this should be widened to include a broader range of carers:

> Today's Bill recognises the vital role carers play in our society, and takes a bold step forward in offering them better pension rights and a more secure financial future. But Government must get these reforms right, and we would urge them to extend the coverage of the new Carer's Credit to include as many people as possible.
>
> Today's proposed reduction in the number of qualifying years needed for the full state pension and the introduction of a new Carer's Credit should mean that thousands more carers are eligible for a full Basic State Pension. The introduction of personal accounts with employer contributions should also help carers who have not previously been able to save for a private pension
>
> Under the reforms outlined in the Bill, for the first time a lifetime of caring will be equivalent to a lifetime of paid work. The new Carer's Credit should help 120,000 carers gain a credit towards their Basic State Pension by 2010 and 180,000 should accrue entitlements to the State Second Pension.

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[33] *Pension 'revolution' unveiled* The Guardian November 29, 2006 http://money.guardian.co.uk/pensions/story/0,,1959701,00.html (11 Dec 2006)

[34] Age Concern Response to the Pensions Bill 28 Nov 2006 http://www.ageconcern.org.uk/AgeConcern/DB60441F1D43495A8D7ADC11DE38F5A0.asp (11 Dec 2006)

[35] EOC welcomes Pensions Bill as an historic landmark in public policy 29 November 2006 http://www.eoc.org.uk/Default.aspx?page=19793 (11 Dec 2006)

> However, at present only people caring for 20 hours a week for someone claiming middle or higher rate Disability Living Allowance or Attendance Allowance will get the Credit, meaning that 15,000 carers will lose out. Carers UK has suggested that those caring for someone claiming lower rate DLA or Incapacity Benefit should also be included. Alternatively a professional such as a GP or social worker could certify that the person cares for more than 20 hours.[36]

The **ABI**'s Director General, Stephen Haddrill, viewed the pension reform measures as "a step in the right direction, in particular the measures to improve pensions for women and carers."[37]

The Government recognises that the introduction of the new arrangements could result in two people with similar working histories reaching State Pension age either side of 6 April 2010 ending up with different pension outcomes. It could have avoided this by phasing-in the new entitlements, but to do so would have meant that many of the women for whom the reform is most needed would miss out. Bringing the date forward, so that women born before April 1950 could have benefited, simply moves the cut-off date so that it affects a different group of people. The 2010 date has been chosen as a clear start date, based on what the Government believes is "fair, affordable and sustainable.[38]

C. Adult Dependency Increases

1. Background

a. Adult dependents

At present, a married man who receives a BSP is able to claim a dependency increase for his wife, provided she does not have earnings or an occupational or personal pension or more than £57.45 pw.[39] This is paid at the same rate as the Category B pension paid to married women who qualify for a pension on their husband's contributions (i.e. £50.50 full rate) but forms part of the husband's pension. Once the wife reaches Pension age herself, she would claim a category B pension and her husband's dependency increase would cease. At present, a married woman can only claim a dependency increase for her husband if she was getting an increase of Incapacity Benefit for him immediately before she qualified for her own pension. Over 99% of Adult Dependency Increase (ADI) recipients are currently men.[40]

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[36] *Carers UK reaction to Pensions Bill* 29 November 2006 http://www.carersuk.org/Newsandcampaigns/News/1164812263 (11 Dec 2006)

[37] ABI News Release 29 November 2006 Ref: 103/06 *Pensions Bill: State reforms good news for women and carers, but more work needed on Delivery Authority* http://www.abi.org.uk/Newsreleases/viewNewsRelease.asp?nrid=13839

[38] DWP *Pension Reform Fact Sheet* (downloaded 11 Dec 2006) http://www.dwp.gov.uk/pensionsreform/pdfs/fs_sp_fairer.pdf

[39] Generally this is the relevant amount; there are different rules where the dependent does not live with the pensioner

[40] DWP Tabulation Tool http://www.dwp.gov.uk/asd/tabtool.asp

From 6 April 2010, both married women and civil partners would have been able to claim dependency increases on the same basis as married men.[41]

The White Paper announced that these provisions would be abolished in April 2010 (i.e. before they ever become payable to married women or civil partners):

> B.22 In developing our proposals for reforming the state pension system, we have considered whether the current provisions for ADIs are relevant to, and compatible with, a system for the 21st century. Our conclusion is that the concept of 'dependency' on which the ADI provisions are based has little relevance in today's society in which partnerships of equals are the norm. There is a powerful argument that the expenditure would be better invested in providing improved state pensions, particularly for women.
>
> B.23 We therefore propose that ADIs will no longer be awarded from 6 April 2010. All existing entitlements will be protected up to 2020. This means that any ADI payable in respect of a dependent aged 55 or over will, subject to the current rules, remain in payment up to the point she reaches State Pension age and becomes eligible for a State Pension either in her own right or based on her spouse's contributions. Based on the current caseload, we estimate that around three-quarters of ADIs in payment at 2010 will be in this category. Those for whom ADIs would otherwise have been payable and who are unable to work will, of course, be eligible for the usual range of working-age benefits. In the minority of cases where there is an ADI still in payment in 2020, we will ensure that the individual and his or her spouse receive advice on other possible benefit entitlements. We recently announced in *A new deal for welfare: Empowering people to work* that we do not intend to carry forward ADIs into the Employment and Support Allowance.[42]

In May 2006 the average weekly pension (including additional pension) for a person with a Category A pension and no dependents was £94.77. For a Category A pensioner with adult dependants it was £144.51. There were 59,000 pensioners with an adult dependency addition in May 2006. The current annual cost of these additions is around £160 million. The majority of ADI recipients (59% in May 2006) are men aged 65 to 69.[43]

b. Child dependents

Most Child Dependency increases to non-means tested benefits were abolished as a consequence of the Tax Credits Act 2002. While new claimants receive Child Tax Credit, existing claimants continue to receive Child Dependency Increases

In May 2006 there were 5,300 pensioners receiving an increase for a dependent child. While the average weekly Category A pension for a person with no dependents was £94.77, the average for those with child dependency increases was £104.63.

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[41] Pensions Act 1995, schedule4, para2(2); Civil Partnership Act 2004
[42] Department for Work and Pensions, Security in retirement: towards a new pensions system, (the Pensions White Paper), 25 May 2006, Cm 6841, Annex B
http://www.dwp.gov.uk/pensionsreform/pdfs/white_paper_complete.pdf
[43] DWP Tabulation Tool http://www.dwp.gov.uk/asd/tabtool.asp

2. The Bill

Clause 4 of the Bill will abolish Adult Dependency Increases with effect from 6 April 2010. It puts in place arrangements to protect entitlements up to this date until 5 April 2020. These mean that existing recipients will continue to receive a dependency increase until 6 April 2020, unless their entitlement ceases earlier than this, or if a wife reaches State Pension age and is eligible for a Category B pension.

It also abolishes pension increases payable to pensioners with care of children; although it is worth noting that these had already been abolished for new claimants since April 2003 and replaced with Child Tax Credits.

The costs of Adult Dependency Increases were set to rise as the Pension age for women was equalised with that for men and when ADIs were to be extended to husbands and civil partners; so that by 2015 the gross annual cost would have been £0.6 billion and by 2020 £1.5 billion. After offsetting the increase in means tested benefits the overall saving as a result of the abolition of the Increases in the Billl is slightly lower - £0.5 billion in 2015 and £1.2 billion in 2020.[44] The DWP estimates that 660,000 people would otherwise have received increases in 2020.[45]

3. Issues

This part of the Bill has received little comment. Paul Lewis in Saga Magazine points out that the cut-off for new claims for dependency increase will result in some pensioners being worse off than others, as a result of them reaching Pension age the wrong side of 5 April 2010:

> One group of people will be worse off under the new proposals. At the moment a man who get Basic State Pension can claim £50.50 a week extra for a wife or partner who is under 60 and dependent on him. That means they must not earn or have their own private pension of more than £57.45 a week. From April 2010 no new claims will be accepted for this adult dependency increase. From April 2020 any payments still being made will be stopped. Anyone who reaches Pension age on April 5, 2010 or before will be subject to the existing rules. There will be a lot of people who will fall just the wrong side of this line and who will get a much smaller pension than someone in the same circumstances just a few days younger.[46]

The Government points out that the transitional arrangements will protect people already receiving an ADI, for up to 10 years and that the money saved "will provide better state pensions, particularly for women."[47]

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[44] HL Deb 6 July 2006 c 73 WA
[45] HC Deb 21 June 2006 c 1926 W
[46] SAGA Magazine *Guide to Pension Reform* August 2006 Paul Lewis http://www.saga.co.uk/magazine/lifechanges/planretirement/pdfs/pensionReform.pdf (5 Dec 2006)
[47] HL Deb 6 July 2006 WA73

D. Uprating

1. Background

The current statutory requirement is that the contributory National Insurance state pension must be increased each April at least in line with the increase in prices over the preceding review period (in practice, the year to the preceding September). The present Government has promised to increase the Basic Pension by a minimum of 2½% per annum even if prices have risen by less than this.

There is no statutory requirement to increase the means-tested Pension Credit in line with prices though the Secretary of State is required to review its level each year and to increase it as he thinks fit. The present Government has promised to increase the Pension Credit in line with earnings at least until the end of the current spending round in 2008.

In their Pensions White Paper, *Security in retirement: towards a new pensions system*, published on 25 May 2006, the Government announced its intention, "subject to affordability and the fiscal position", of linking the contributory Basic State Pension to increases in earnings from 2012 but, in any event, "at the latest by the end of the next Parliament" (i.e. 2015 at the latest). An announcement on the precise date will be made "at the beginning of the next Parliament". The White Paper also announced that the Guarantee Credit part of the Pension Credit would continue to be increased in line with earnings "over the long term".

a. Introduction of statutory duty, 1973

A statutory duty to increase state pensions annually in line with inflation was first introduced by section 39 of the *Social Security Act 1973*, although the first uprating under a statutory duty did not take effect until 7 April 1975. Before this, pensions, and other National Insurance benefits, had been increased at irregular intervals by a series of *National Insurance Acts.* These Acts did, however, keep pensions well abreast of price inflation and they usually covered earnings inflation as well.

b. Introduction of the earnings link, 1974

The Labour Government elected in February 1974 moved rapidly to increase pensions and to introduce a statutory earnings link. Before section 39 of the *Social Security Act 1973* could come into effect on its appointed day (6 April 1975), it was amended by section 5 of the *National Insurance Act 1974*. This provided for long term benefits to be increased in line with earnings or prices, whichever were more favourable. Short term benefits would still be increased in line with prices. The requirement to increase pensions in line with the higher of prices or earnings was eventually consolidated in section 125 of the *Social Security Act 1975.*

c. Breaking the earnings link, 1980

The Conservative Government, elected in 1979, was committed to controlling inflation and reducing taxation. Its election manifesto had promised to "look for economies in the

cost (about £1.2 billion) of running our tax and social security systems". During the election campaign, James Callaghan, the Prime Minister, had suggested that the Conservatives were thinking of breaking the link with earnings,[48] and in his first Budget, Sir Geoffrey Howe, the new Chancellor, announced that:

> the Government have decided that for the future the requirement for the statutory uprating of pensions should be based on price movements, and we shall be introducing legislation to that end.[49]

The following day, Patrick Jenkin, the new Secretary of State for Social Services, explained that the "ratchet effect" created by the obligation to increase pensions by the higher of prices or earnings was unsustainable in the long run:

> In the light of experience in the last three years and other factors, we have been driven to the conclusion that the statutory obligation to uprate long term benefits each year in line with either prices or earnings, whichever is the higher, is not sustainable in the long term. Much has been written about the so-called "ratchet effect". In years when earnings exceed prices, the real value of pensions increases. When prices exceed earnings, and when the living standards of the working population fall, the real value of the pension is maintained. It has been pointed out that the result over a period of years is that the proportion of the national income absorbed by pensions, and correspondingly, the proportion absorbed by the contributions necessary to pay those pensions, must inevitably rise, throwing an ever heavier and heavier burden on the working population.[50]

The legislation introduced was the *Social Security Act 1980*, section 1 of which amended section 125 of the *Social Security Act 1975* to link long-term benefit increases to prices, not earnings.

d. Current statutory provision

The legislative position on pension uprating has remained virtually unchanged since then, though the current legislative authority is section 150 of the *Social Security Administration Act 1992.* This requires the Secretary of State to review annually the Basic State Pension, the additional (earnings-related) pension, deferred retirement increments and the graduated pension and to increase them each April at least in line with price increases over the previous review period (in practice, the year to the preceding September). They can be increased by more than this if the Secretary of State so chooses. Pension Credit, on the other hand, does not have to be increased at all, though the Secretary of State can increase it as he thinks fit.

[48] Speech, 14 April 1979
49 HC Deb 12 June 1979, c 252
[50] HC Deb 13 June 1979, c 439

e. The operation of the prices link since 1980

VAT on fuel, 1994

Apart from the adjustments connected with over and under provision when the forecasting method was in use and the transitions to the historic method and the April uprating, the Conservative Government of 1979-1997 almost always increased the pension in line with prices only. The one exception was the April 1994 uprating when the single pension was increased by 50p more than inflation to compensate for the extension of VAT to fuel costs.

2.5% minimum increase, 2001

The Labour Government elected in May 1997 carried on with this strict adherence to the prices link until April 2001. Price inflation in the year to September 1999 was 1.1% so the April 2000 pension increase came out at 75p for a single pensioner. This notoriously small increase[51] persuaded the Chancellor, Gordon Brown, to announce a minimum increase in pensions.

In his Pre-Budget Statement on 8 November 2000, the Chancellor announced that he and the Secretary of State for Social Security had decided that:

> Over the next two years, pensioner incomes should rise faster than inflation – indeed, faster than earnings – so from April next year we propose that, for a single pensioner, there should be a cash increase of £5 a week; and for a married couple, a rise of £8 a week. I can tell the House that in the following year we can also guarantee the pension will rise above prices – a cash increase of £3 for single pensioners and £4.80 for married couples. Over two years, therefore, there will be a cash rise of £8 for single pensioners and £12.80 for couples – for pensions, £2.6 billion more: more than the link with earnings would give.[52]

In his Pre-Budget Statement on 27 November 2001, the Chancellor announced that he and the Secretary of State for Work and Pension had decided that "in future" the Basic State Pension would rise by the higher of 2.5% pa or inflation.[53]

This policy has been maintained since the May 2005 General Election.[54] There has, however, been no change to the statutory position.

f. Additional state pension increases

The policy of increasing the state pension by the higher of the RPI or 2.5% applies only to the basic pension, not to the additional state pension (commonly known as SERPS or S2P) which is still increased strictly in line with prices.

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[51] See, e.g., "Paltry 75p a week rise is an insult to all pensioners", *Sunday Express*, 23 April 2000, and "Pensions war hots up over 75p a week rise", *Sunday Mirror*, 9 April 2000

[52] HC Deb 8 November 2000, c 326

[53] HC Deb 27 November 2001, cc 836-837

[54] HC Deb 15 June 2005, c 437W

Thus, on the occasions when prices have risen at less than 2.5% since April 2000, the basic pension has gone up more than the additional pension.

g. Restoring the earnings link, 2012?

The Pensions White Paper, *Security in retirement: towards a new pension system*, published on 25 May 2006, announced that the Government intended, "subject to affordability and the fiscal position" to re-link the uprating of the Basic State Pension to average earnings in 2012. At the very latest the link would be restored "by the end of the next Parliament" (i.e. by 2015 at the very latest). This was partly to ensure that state pensions provided a firm foundation for private saving and partly to prevent the spread of means-testing which could have a serious disincentive effect to private pension saving. To fund the restoration of the link, the State Pension age would be increased – to 66 over the two years starting in April 2024, to 67 over the two years starting in April 2034 and to 68 over the two years starting in April 2044:

> 3.20 There are a number of reasons to think that an earnings link represents an appropriate response to long-term demographic change. We have outlined how our reforms since 1997 have led to pensioner incomes being at their highest-ever level. Having significantly reduced pensioner poverty, we are now able to create a long-term foundation for saving by restoring the earnings link. We can make clear for the long term the deal between the State and the individual, to allow people to plan with confidence for their retirement.
>
> 3.21 People's expectations for their incomes in retirement are largely based on their earnings and standard of living during working age. If the state system is to serve as a foundation for their retirement planning, it must retain its level relative to these expectations. This will help to address the problem of undersaving by enabling people to predict with confidence what they are likely to receive from the State when they retire, and therefore what they will need to save in addition to meet their expectations.
>
> 3.22 It is also important to ensure that targeted benefits are just that – directed at those in society who need them most. At present, Pension Credit achieves this. The Government has successively raised the Guarantee Credit by earnings and has already committed to do so to 2008 in order to continue to tackle pensioner poverty. We intend to continue this uprating strategy over the long term. But if Pension Credit alone continues to rise with earnings and the level of contributory benefits drifts away from the means-tested safety net, it could mean that more and more people fall subject to means-testing in retirement. This could affect people's incentives to work and save, and dilute the sense of personal responsibility for saving that we want to instil.
>
> 3.23 The Government believes that people must have the opportunity to build a Basic State Pension entitlement that can give them confidence in the value of making additional provision. This will also help to encourage people to save through automatic enrolment in the scheme of personal accounts. And we are clear that we cannot allow our progress against pensioner poverty to falter. Taken together, we believe that both the Guarantee Credit and the Basic State Pension must retain their value relative to the average earnings of society.

> 3.24 During the next Parliament, therefore, we will re-link the uprating of the Basic State Pension to average earnings. Our objective, subject to affordability and the fiscal position, is to do this in 2012 but in any event at the latest by the end of the next Parliament. We will make a statement on the precise date at the beginning of the next Parliament.
>
> 3.25 But this is a major undertaking. On its own, linking the Basic State Pension to rises in earnings from 2012 would lead to an increase in spending on pensioners of £46 billion or 1.4 per cent of GDP by 2050, in addition to the costs of increasing coverage to state pensions. We have made clear that the Government's economic policies since 1997 have had specific benefits for pensioners and future pensioners. To risk the stability of the economy for the sake of linking the Basic State Pension to earnings growth would be counter-productive. This element of the reform package is therefore inextricably linked to two others.
>
> 3.26 First, raising the State Pension age in line with increases in life expectancy will help to bring about a behavioural change so that people begin to work longer as they live longer. It will slow the growth in the number of pensioners, while ensuring that pensioners continue to be able to enjoy a roughly constant proportion of their adult lives in retirement. Maximising the impact of this increase, through the measures described in Chapter 4 to help people work for longer, will further help to stabilise the support ratio, ensuring that these reforms remain affordable.
>
> 3.27 Secondly, we intend to accelerate the withdrawal from direct provision of earnings-related pensions to provide a simple, flat-rate foundation that rewards working and caring, building on which will be the responsibility of individuals. Reforms to the State Second Pension will speed up the move to make it a flat-rate top-up to the Basic State Pension and will reduce expected expenditure on the State Second Pension in the longer term, further helping to fund linking the Basic State Pension to earnings. Reforms to the State Pension age and the State Second Pension are described later in this chapter.[55]

2. Pension Credit uprating

Pension Credit replaced the Minimum Income Guarantee (MIG) as the main means-tested benefit for pensioners in October 2003. The statutory requirement is for the Secretary of State to review the level of the pension credit each year and to increase it if he considers it "appropriate".[56] MIG itself had replaced Income Support for pensioners in April 1999. MIG was introduced at a rate of £75 a week for a single pensioner. At that time the single Basic State Pension was £66.75 a week, so – to put it simply - someone with a full basic pension would qualify for means tested support if they had less than £8.25 a week in other income. However, the Government adopted a policy of increasing MIG (and later the guarantee part of the Pension Credit) in line with average earnings.

[55] Department for Work and Pensions, *Security in retirement: towards a new pensions system*, May 2006, Cm 6841, http://www.dwp.gov.uk/pensionsreform/pdfs/chap3.pdf (retrieved 23 June 2006)

[56] Paragraph 16 of schedule 2 of the State Pension Credit Act 2002 inserted the relevant provision in section 150 of the Social Security Administration Act 1992, see section F above

The aim was to concentrate resources on the poorest pensioners. As earnings tend to rise faster than prices, the differential between the contributory pension (linked to prices) and the means tested Pension Credit has grown. At present it stands at £29.80 (£114.05 less £84.25). Many commentators feel that this expanding differential cannot be maintained in the long run. DWP estimates that under current uprating policies projected forward, around 70 per cent of pensioner households will be entitled to some Pension Credit by 2050.[57]

The earnings link for the guarantee part of the Pension Credit was confirmed until March 2008 after the May 2005 General Election:

> **Andrew Rosindell**: To ask the Secretary of State for Work and Pensions whether it is his policy to uprate pension credit in proportion to average earnings for the length of this Parliament. [7532]
>
> **Mr. Plaskitt:** The Government have given an undertaking to increase the guarantee credit in line with earnings up to March 2008.[58]

In the Pensions White Paper, *Security in retirement: towards a new pension system*, published on 25 May 2006, the Government announced that it would be increasing the guarantee credit part of Pension Credit in line with earnings "over the long term":

> 3.60 The Government has committed to uprating the Guarantee Credit in line with earnings until 2008. We can now announce an intention to continue this uprating strategy over the long term. This will ensure that the gains we have made against pensioner poverty are secure into the future. As now, the Guarantee Credit will provide a guaranteed minimum level of income in retirement for those who have been unable to provide adequately for their own retirement. It will also provide a higher income for people with severe disabilities and other specific groups.[59]

However, to curtail the spread of means testing, the White Paper announced that from 2008 the Savings Credit Threshold (currently equal to the Basic State Pension) would no longer be increased in line with prices, but with earnings, and that from 2015 the maximum Savings Credit would be frozen in real terms:

> 3.62 To ensure that, before implementing the earnings link of the Basic State Pension, means-tested provision continues to be focused on those with small savings, we will take steps from 2008 to target the Pension Credit on this group.
>
> 3.63 We think this is reasonable because the State Second Pension has, since 2002, provided generous provision for low-paid employees. Those who earn between the National Insurance contribution Lower Earnings Limit and £12,500 a year (and those credited in) accrue a pension at a flat rate as though they were earning £12,500 a year and at twice the old SERPS accrual rate. This means low-paid employees get a more than fair return on their contributions. This must, over time, influence the design of the Savings Credit.

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[57] Department for Work and Pensions, *Security in retirement: towards a new pensions system*, para 3.65
[58] HC Deb 19 July 2005, c 1643W
[59] Department for Work and Pensions, *Security in retirement: towards a new pensions system*, May 2006, Cm 6841, http://www.dwp.gov.uk/pensionsreform/pdfs/chap3.pdf (retrieved 23 June 2006)

> 3.64 The Savings Credit will continue to reward people who make provision for their retirement. However, as State Second Pension matures, more and more people will have built up State Second Pension entitlement. We agree with the Pensions Commission's assessment that the starting point for calculation of the Savings Credit should be raised as this happens. From 2008 we will uprate the lower threshold of the Savings Credit by earnings. From 2015 the maximum Savings Credit will be frozen in real terms.
>
> 3.65 The impact of this, alongside our reforms to the structure and coverage of the other aspects of the State Pension and the introduction of a low-cost scheme of personal accounts, will be a considerable reduction in the numbers of people whose entitlements will be means-tested in the future. Under current uprating policies projected forward, around 70 per cent of pensioner households will be entitled to some Pension Credit by 2050. Under our reforms, that figure will be reduced to around a third. This will further help to clarify people's savings decisions and retirement planning.[60]

The White Paper agreed with the Pensions Commission that the level of the Basic State Pension should be increased to form a firm basis on which people could plan their additional pension saving:

> People's expectations for their incomes in retirement are largely based on their earnings and standard of living during working age. If the state system is to serve as a foundation for their retirement planning, it must retain its level relative to these expectations. This will help to address the problem of undersaving by enabling people to predict with confidence what they are likely to receive from the State when they retire, and therefore what they will need to save in addition to meet their expectations.[61]

However, the Government is only willing to commit itself to restoring the earnings link by the end of the next Parliament at the latest, which could be some five years later than the Pensions Commission recommended:

> During the next Parliament, therefore, we will re-link the uprating of the Basic State Pension to average earnings. Our objective, subject to affordability and the fiscal position, is to do this in 2012 but in any event at the latest by the end of the next Parliament. We will make a statement on the precise date at the beginning of the next Parliament.[62]

As earnings tend to rise faster than prices, linking pensions to earnings should increase their value fairly rapidly. The White Paper says that "on its own, linking the Basic State Pension to rises in earnings from 2012 would lead to an increase in spending on pensioners of £46 billion or 1.4 per cent of GDP by 2050". Hence, the importance of

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[60] Ibid

[61] Department for Work and Pensions, Security in retirement: towards a new pensions system, (the Pensions White Paper), 25 May 2006, Cm 6841, para 3.21
http://www.dwp.gov.uk/pensionsreform/pdfs/white_paper_complete.pdf

[62] Ibid, para 3.24

measures to contain future expenditure on state pensions, such as the increase in the State Pension age.

3. The Bill

Clause 5 of the Bill requires the Basic State Pension to be uprated annually in line with earnings rather than prices; this will cover Category A, B, C and D pensions. The Bill effects this change by specifying that the Secretary of State must first exercise his power in "the designated tax year" (subsection 3). This year will be designated by regulation and the order for this is to be made before 1 April 2011. Additionally, the Secretary of State must ensure that the tax year following the designated year is a tax year that begins before the "relevant dissolution date". This is defined by reference to the maximum period for which a Parliament may exist – 5 years. The latest date on which the present Parliament can be dissolved is 10 May 2010. The order under this section would probably be made in the next Parliament and the effective date for the new system of uprating would be the last complete tax year of the next Parliament. The intention of this is to specify that the uprating link with earnings will be in place the year before the General Election after next (or 5 years after the next General Election).

Subsection (7) requires the standard minimum guarantee in Pension Credit to be uprated annually in line with earnings from 2008.

Clause 6 provides for the BSP and benefits linked to it (such as bereavement benefits) to be excluded from the legislation requiring uprating in line with prices and requires regulations altering the rate of Basic State Pension also to change linked benefits. It further provides for other benefits to continue to be uprated in line with prices.

Clause 7 (& 8 for Northern Ireland) removes the link between the Lower Earnings Limit and the Basic Pension. Currently the LEL is linked automatically to the BSP. Under these provisions this is removed and future changes to the LEL will be at the discretion of the Treasury. This comes into effect at the same time as the introduction of earnings uprating of the BSP.

4. Issues

While the re-linking of the BSP to earnings has been broadly welcomed, it has been pointed out that that not doing so until into the next Parliament means that today's pensioners will have to wait for a number of years to benefit from this move. Joe Harris, the **National Pensioners Convention** general secretary said in response to the Bill:[63]

> The government has completely ignored the needs of today's pensioners and the fact that over 2m of them still live in poverty, the vast majority of which are women. 3m older people will have died before ministers restore the link with earnings, yet it could be done today for as little as £300m.

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[63] http://www.npcuk.org/ (11 Jan 2007)

Others question the extent to which the new system can be sustained if the DWP's projections for the falling number of pensioners dependent on Pension Credit prove to be over-optimistic. Responding to the White Paper the **Pensions Policy Institute** stated:

> The proportion of pensioner 'benefit units' eligible today is uncertain because of data limitations. Official estimates are presented as a range: from 43% to 49% for 2007/867. How the proportion will change in future depends on how much income people have 'taken into account' for the calculation of their eligibility for PC in future. This depends on how much people save and to what extent older people work in future, so there is a wide funnel of doubt when looking as far ahead as 2050…..
>
> Therefore PPI estimates give a range of the possible extent of Pension Credit under the White Paper proposals of one-third to two-thirds in 2050, with a base case of no change from today's level of 45%-50%. This would mean between 4 million and 6 million households eligible for Pension Credit.
>
> The Department has published further explanation of its own projections of Pension Credit entitlement. It projects that:
>
> " around a third of pensioners will be eligible for Pension Credit by 2050 under the reform proposals in the White Paper. But only around one in 20 pensioners are projected to be eligible for the Guarantee Credit only.
>
> These estimates do not include the effect of personal accounts. So if personal accounts succeed in increasing private retirement saving the proportion on means-tested benefits would fall."[64]

E. State Second Pension

1. Background

National Insurance retirement pensions in the UK are composed of two main elements: a flat rate Basic State Pension (currently £84.25 a week for a single pensioner) and an earnings related additional pension. It is possible to "contract out" of the additional pension into an occupational or personal pension which meets certain conditions (see section III A below). The Government Actuary estimated that about 46% of employees jobs were contracted out in 2004/05.[65]

On 6 April 2002 the State Second Pension (S2P) replaced the State Earnings Related Pension Scheme (SERPS) as the state's additional pension provision. SERPS itself was introduced in April 1978 under the *Social Security Pensions Act 1975*, but significant cuts to SERPS were made both by the *Social Security Act 1986* and the *Pensions Act 1995.* All rights to SERPS already built up have been preserved, but from April 2002 additional pension rights have been accruing on the basis of S2P. S2P was introduced by the *Child Support, Pensions and Social Security Act 2000.* This amended the *Social Security Contributions and Benefits Act 1992* and the legislation covering S2P can be found in that Act.

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[64] DWP Factsheet, *Projections of Pension Credit Entitlement,* http://www.dwp.gov.uk/pensionsreform/forum/docs/fs-pc-projection.pdf (retrieved 11 January 2007)

[65] Government Actuary's Department, *Update of the Government Actuary's Quinquennial Review of the National Insurance Fund as at April 2000*, Table 2, 23 December 2004, http://www.gad.gov.uk/Publications/docs/Results%20summary1.pdf (retrieved 15 June 2006)

The chief differences between SERPS and S2P are that S2P produces a higher state additional pension for low and moderate earners and that it covers some carers and disabled people who were not covered by SERPS.

a. How is S2P calculated?

SERPS was built up by employed earners paying Class 1 National Insurance Contributions (NICs) and it accrued at a uniform rate on all earnings between the Lower Earnings Limit (LEL – currently £4,368 a year) and the Upper Earnings Limit (UEL – currently £33,540 a year) for NICs. This range of earnings is known as "surplus earnings". The original accrual rate was 25% but the *Social Security Act 1986* reduced this to 20% in stages for those reaching State Pension age between 2000/01 and 2009/2010 (in respect of accruals from 1988/89). The table below shows the accrual rates over this transitional period:[66]

Per centage rates of SERPS for those reaching State Pension age on or after 6 April 1999

Tax year in which State Pension age is reached	% of total surplus earnings from 1988/89
1999/2000	25
2000/2001	24 ½
2001/2002	24
2002/2003	23 ½
2003/2004	23
2004/2005	22 ½
2005/2006	22
2006/2007	21 ½
2007/2008	21
2008/2009	20 ½
2009/2010 or later	20

S2P has a more complicated structure based on three bands of earnings between the LEL and UEL. The bands are divided by a Low Earnings Threshold (LET) and an Upper Earnings Threshold (UET). The LET is the level of income that all who earn between the LEL and LET are treated as having for the purposes of calculating S2P, regardless of their actual earnings. The UET is defined as 3 x LET – 2 x LEL. The accrual structure is heavily weighted in favour of low and moderate earners.

The table below compares the accrual rates on different earnings bands for S2P and SERPS at 2006/07 rates for someone retiring after April 2009:

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[66] This table is taken from the Pension Service *Guide to State Pensions*, NP 46, April 2004, p 37

	Earnings bands	S2P accrual %	SERPS accrual %
Up to LEL	Up to £4,368	0	0
Band 1 (LEL to LET)	£4,368 - £12,500	40	20
Band 2 (LET to UET)	£12,501 - £28,800	10	20
Band 3 (UET to UEL)	£28,801 - £33,540	20	20
Above UEL	Above £33,540	0	0

For those retiring before 2009/10 the accrual rate for S2P will be higher, to reflect the phased reduction in the SERPS accrual rate. The S2P accrual rate is:

Band 1 2 x SERPS accrual rate
Band 2 ½ x SERPS accrual rate
Band 3 1 x SERPS accrual rate

So someone reaching State Pension age in 2006/07 would have their SERPS calculated using a 21.5% accrual rate and their S2P calculated using a 43% accrual rate on Band 1, 10.75% on Band 2 and 21.5% on Band 3.

The way in which S2P will be calculated on reaching retirement can be summarised as follows: for each tax year beginning 2002/03, the amount of the employee's earnings falling into each of the three bands will be established. The amount of earnings lying in each of the three bands will be separately revalued in line with the rise in national average earnings over the period up to the year before the employee reaches State Pension age. The three revalued amounts will then be multiplied by the appropriate per centage accrual rate, and added together. The totals for each tax year will be added together and divided by the number of tax years in the period beginning (inclusive) with 1978/79 or, if later, the year the employee reached the age of 16, and ending (exclusive) with the tax year in which the employee reaches State Pension age.[67]

S2P can accrue over a whole "working life" (i.e. from age 16 to State Pension age) but ceases to accrue when State Pension age is reached and there is no further liability for National Insurance contributions.

b. Low earners

S2P is designed to be redistributive and to give more to lower earners. The "underpin" – i.e. the fact that all contributors are deemed to earn at least the LET - means that low earners receive far more from S2P than they did from SERPS. The redistributive goal was clearly stated in the 1998 Green Paper, *A new contract for welfare: partnership in pensions*:

> 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.
>
> As a first stage, alongside our proposals for stakeholder pension schemes, we

[67] This is based on the account given in IDS *Pensions in Practice 2004/05* pp 22-23

> 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.[68]

The redistributive effect of S2P was illustrated by the answer to a Parliamentary Question in March 2001, which showed how much more additional pension low earners could expect to receive under S2P than under SERPS. As an example, a person earning £10,000 a year and working for 40 years would expect £50 a week S2P compared with £24 a week SERPS.[69]

c. Carers and the disabled

The major difference between SERPS and S2P is the introduction of deeming of earnings for specific groups of people, so that even if they have no earnings they are treated as if they have earned the low earnings threshold. SERPS, as it was originally introduced in 1978, was based on the "best 20 years" of an individual's earnings. The idea was that people (usually women) who took time out of the labour market because of caring responsibilities would still be able to build up a good level of SERPS during their non-caring years. People whose working life was shortened by disability would also have benefited. However, the *Social Security Act 1986* removed the "best 20 years" rule which also benefited carers and the disabled.

As well as those earning between the LEL and the LET, there are three groups of people who benefit from S2P's deeming provisions: parents caring for children under 6; people caring for the elderly or disabled and disabled people. When S2P was introduced, the government estimated that it would benefit 18 million people, of whom 8.5 million would benefit through deemed earnings.[70]

The current rules governing eligibility for deeming on grounds of caring responsibilities or disability require people to have received a qualifying benefit throughout a complete tax year. The Pension Service's *Guide to State Pensions* (NP46, April 2005) sets out the current rules:

> The State Second Pension rules will treat you, for additional State Pension purposes, as if you had earnings at the statutory Low Earnings Threshold (£12,100 for 2005/06) for each complete tax year you do not work at all, or earn less than the statutory annual Lower Earnings Limit (£4,264 for 2005/06) and:
>
> - you are looking after a child under age 6 and are the person who claimed and was awarded Child Benefit for that child, or
> - you are looking after an ill or disabled person and you qualify for Home Responsibilities Protection (HRP), or

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[68] DSS, *A new contract for welfare: partnership in pensions,* Cm 4179, December 1998, p39

[69] HC Deb 26 March 2001 c482W

[70] DWP Press release "McCartney sets out action to combat pensioner poverty" 22 April 2002

> - you are under State Pension age and are entitled to Carer's Allowance.
>
> …
>
> The State Second Pension rules will treat you as if you had earnings at the Low Earnings Threshold for each complete tax year that you were entitled to long-term Incapacity Benefit or got Severe Disablement Allowance, as long as, when you reach State Pension age, you have worked and paid, or are treated as having paid, Class 1 National Insurance contributions for a certain period of time (normally 1⁄10 of your working life since 1978). This is called the Labour Market Attachment Test.[71]

d. Contracting out rebates

As with SERPS, it is possible to contract out of S2P into either an occupational or personal pension scheme which fulfils certain criteria. When someone is contracted out into an occupational pension scheme, both the employer and the employee pay lower rates of National Insurance Contributions (NICs) to compensate for the foregone benefits. The reduction in NICs takes the form of a contracted out rebate on contributions otherwise due on earnings between the LEL and UEL. At present, the contracted out rebate for members of contracted out salary-related schemes (COSRS) is 5.1% (1.6% employee, 3.5% employer) and for members of contracted out money purchase schemes (COMPS) it is 2.6% (1.6% employee, 1% employer). In the case of COMPS, the National Insurance Contributions Office (NICO) of Her Majesty's Revenue and Customs (HMRC) "tops up" these rebates for older members as it is more costly for private schemes to provide pensions for those nearer Pension age. These age-related rebates mean that the total rebate for a COMPS can range from 2.6% for a 15 year old to 10.5% for a 63 year old.[72]

People who are contracted out into an appropriate personal pension scheme (APP) pay the normal contracted in rate of NICs. The NICO pays an age-related rebate or "minimum contribution" directly to the pension provider. These rebates vary not only with age but also with the band of earnings on which they are paid, so shadowing the S2P foregone more accurately than the COMPS and COSRS rebates. At present the rebates range from 4.2% for a 15 year old to 10.5% for a 63 year old, but these figures must be multiplied by 2 for earnings in Band 1 and by ½ for earnings in Band 2.[73]

The Government sets the level of rebates periodically on the advice of the Government Actuary. The present rates are based on the Government Actuary's review published in March 2001.[74] Details of the current rebates, including the age-related rebates for COMPS and APPs are contained in the following statutory instruments:

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[71] http://www.thepensionservice.gov.uk/pdf/np46/np46apr05.pdf (retrieved 30 November 2006)

[72] For more information, see Inland Revenue, *Termination of Contracted-out Employment Manual for: Money Purchase Pension Schemes and Money Purchase Parts of Mixed Benefits Schemes*, CA 14A, April 2002, http://www.inlandrevenue.gov.uk/pdfs/nico/ca14a.pdf (retrieved 26 November 2006)

[73] For more information, see Inland Revenue, *Appropriate Personal Pension Scheme Manual Procedural Guidance*, CA 16, http://www.inlandrevenue.gov.uk/pdfs/nico/ca16.pdf, November 2004, (retrieved 26 November 2006)

[74] *Occupational and Personal Pension Schemes: review of certain contracting out terms*, Cm 5076, March 2001, http://www.archive.official-documents.co.uk/document/cm50/5076/5076.pdf (retrieved 15 June 2006)

- *The Social Security (Minimum Contributions to Appropriate Personal Pension Schemes) Order 2001*, SI 2001/1354

- *The Social Security (Reduced Rates of Class 1 Contributions, and Rebates) (Money Purchase Contracted-out Schemes) Order 2001*, SI 2001/1355

- *The Social Security (Reduced Rates of Class 1 Contributions) (Salary Related Contracted-out Schemes) Order 2001*, SI 2001/1356

The rebates were adjusted to take some account of S2P,[75] but many commentators considered that the rates set for 2002/03 to 2006/07 were still not high enough to compensate for the loss of S2P. For example, Mercer Human Resource Consulting issued a press release in July 2004 which said:

> The stated long-term objective of the Government was to pass more responsibility for pension provision to the private sector. But now, the national insurance rebates given by the Government are often worth far less than the state benefits lost by contracting out. Figures suggest that the Government needs to pay up to £3.8 billion a year more in rebates to redress the balance. Otherwise, there is likely to be a surge of people contracting back into the state scheme.
>
> Dick Strattan, Worldwide Partner at Mercer, said: "In recent years, governments have chipped away at the rebates and changed the ground rules." He added: "Investment returns have dropped and people are now living longer, so the economics of contracting out have changed dramatically."[76]

Because there is a cap on age-related rebates (currently 10.5%), the Government itself has admitted that older people might do better to contract back in to S2P:

> **Pensions**
>
> **Mr. Webb:** To ask the Secretary of State for Work and Pensions what calculations his Department has made concerning at what age (a) a man and (b) a woman with (i) half average earnings and (ii) average earnings, with a stakeholder pension with charges of 1 per cent. of premiums which tracks movements in the stock market, should contract in to the state second pension if he makes assumptions about his life expectancy, stock market growth and other economic variables in line with those made by the Government Actuary's Department. [208161]
>
> **Malcolm Wicks** [holding answer 13 January 2005]: It is for individuals to decide the point at which it would be in their best interest to contract back in taking into account their attitude to risk and their personal circumstances. The Department is however committed to ensuring that people are properly informed of the issues involved so that they can make a decision that best suits their needs. This includes the fact that when people reach the age at which the age-related rebate

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75 But see section (e) on top-ups as well.

76 "Responsibility for UK pension provision pushed back to the state", Mercer Human Resource Consulting, 5 July 2004, http://www.mercerhr.com/pressrelease/details.jhtml/dynamic/idContent/1145405 (retrieved 16 February 2005)

> is capped, currently age 53, most of them would be better off contracting back in.[77]

Some insurance companies, including Norwich Union, have advised policyholders (of whatever age) to contract back in and others, such as HSBC, have automatically contracted their customers back in.[78] This has contributed to a "rush" to contract back in, which, according to research by Watson Wyatt, saw 522,000 people contracted back into the S2P during 2002/2003.[79]

The Government Actuary's report on his quinquennial review of the rates of contribution reductions and rebates for the period of 6 April 2007 to 5 April 2012 was published on 1 March 2006, together with the Secretary of State's response.[80] The Government Actuary recommended that, from 6 April 2007, the contracted out rebate for COSRS should be increased from 5.1% to 5.8% and that for COMPS should be increased from 2.6% to 3%. He also recommended increases to the age-related element of the rebate for both COMPS and APPs. However, the Government did not fully accept these recommendations. Instead, it has legislated for a COSR rebate of 5.3% (1.6% employee, 3.7% employer). The flat-rate COMP rebate will be 3% as the Government Actuary recommended (1.6% employee, 1.4% employer), but the cap on age-related rebates for both COMPs and APPs will be reduced from 10.5% to 7.4%.

The Government's reasons for announcing lower rebates for 6 April 2007 than those recommended by the Government Actuary were "the present fiscal circumstances" and the possibility of changes following the recommendations in the Pensions Commission's report published in November 2005.[81] Such changes might mean that "a further review of the reduced rates and rebates of National Insurance Contributions may be conducted earlier than would otherwise be necessary".[82]

Details of the rebates from April 2007, including the age-related rebates for COMPS and APPs are contained in the following statutory instrument:

- *The Social Security (Reduced Rates of Class 1 Contributions, Rebates and Minimum Contributions) Order 2006*, SI 2006/1009

Commentators believe that the new rebates will make contracting out even less attractive. The National Association of Pension Funds believes that a fair level of rebate for COSRs would be around 8%, while the Association of British Insurers argues that individuals aged 43 and over would now do better to contract back into S2P.[83]

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77 HC Deb 17 January 2005, c 777W

78 "Providers cry foul over second pension", *Sunday Telegraph*, 21 November 2004

79 BBC News, 23 December 2004, "Savers 'diving' for state pension cover", http://news.bbc.co.uk/1/hi/business/4120575.stm (retrieved 15 June 2006)

80 *Occupational and Personal Pension Schemes: Review of Certain Contracting-out Terms: Reports by the Government Actuary and the Secretary of State for Work and Pension*s, March 2006, Cm 6758, http://www.dwp.gov.uk/resourcecentre/OccupationalPensionsCm6758.pdf (retrieved 15 June 2006)

81 Ibid, pp25 and 26

82 Ibid, p 25

83 "Rebate review takes shine off contracting out", *Financial Times*, 11 March 2006

e. Contracting out top-ups

If people are to contract out of the additional state pension to save in a private pension, then they need to feel reassured that they will not be worse off by doing so. The Government recognised that it was unrealistic to expect private schemes to provide accrual rates of 40% in return for the rebates and eventually decided to provide S2P "top ups" for low and moderate earners in contracted out schemes.[84]

The top up provisions, now contained in Schedule 4A of the *Social Security Contributions and Benefits Act 1992*, were introduced at Committee stage of the *Child Support, Pensions and Social Security Bill*. DSS notes on the amendments explained how the system would work:

> A comparison is made between:
>
> - amount A — an individual's State Second Pension entitlement (as if they had been contracted-in) and
> - amount B — the pension they are deemed to receive from their National Insurance rebate. (The actual pension they receive from their contracted-out scheme will depend on the type of scheme and a number of factors, such as market returns, final salary levels etc.)
>
> If amount A is greater than amount B, a top-up (amount C) of State Second Pension will be paid for that year when the person reaches State Pension age.
>
> There are two methods of calculating amount B (the amount a person is deemed as receiving in respect of their National Insurance rebate). Those contracting-out into an occupational scheme will be deemed as receiving a pension based on an accrual rate of 20%, which is the basis for calculating the current rebate under SERPS. This means that for low and moderate earners amount B will be less than amount A, and the difference (amount C) will be paid as a State Second Pension top-up. Those contracting-out into a personal pension scheme (including stakeholder pension schemes) will be deemed to be receiving a pension equivalent to State Second Pension where their earnings are above the Low Earnings Threshold, since their rebate will be based on the 3 part accrual rates in State Second Pension. Where their earnings are below the Low Earnings Threshold amount B will be less than amount A, and the difference (amount C) will be paid as a State Second Pension top-up.[85]

In practice, it is exceptionally difficult to work out one's own entitlement and one must rely on the Inland Revenue's NIRS2 computer system as Jeff Rooker, the Minister taking the Bill through Committee, admitted:

> Part III of new schedule I sets out how the top-up provisions will work, and refers to three separate amounts: A, B and C. As I said, if the theory is simple, it is a question of putting it into practical legislation. Amount A is the amount of earnings

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[84] The Explanatory Notes on the *Child Support, Pensions and Social Security Act 2000* set out the background to this decision, http://www.legislation.hmso.gov.uk/acts/en2000/2000en19.htm (retrieved 15 June 2006)

[85] DSS February 2000

> related state second pension an individual would receive if they had not contracted out. Amount B is the amount of the pension represented by the contracted out rebate. The difference between the two is amount C, which is the state second pension top up for the year. That is added to the other amounts for each year of the working life, whether contracted in or out, and divided first by the number of years between 1978 - the start of SERPS - and the year before the State Pension age and then by 52 to find the weekly amount.
>
> That is an integral part of a computerised state second pension calculation and does not require employers to provide any additional information in order to calculate the amount due. The whole calculation is made by a computer, automatically, at the press of a button. [Laughter] I said that with a straight face. It would not be possible to do these calculations manually because of the numbers involved. It is dependent on IT - or on the legacy of the previous Government buying NIRS2. [HON. MEMBERS: "Oh."] I apologise for that, it was below the belt. [86]

f. Move to flat rate S2P

The Government has always intended that, in the long run, S2P will cease to be earnings related and become a flat rate scheme based on earnings at the Low Earnings Threshold. This was proposed in the 1998 Green Paper *A new contract for welfare: Partnership in Pensions:*

> 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).
>
> 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.
>
> 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.[87]

The *Child Support, Pensions and Social Security Act 2000* inserted a new schedule 4A into the *Social Security Contributions and Benefits Act 1992*, paragraph 2(5) of which allows the Secretary of State to bring in Regulations implementing this second, flat-rate, stage of S2P. The Explanatory Notes on the Act explain that the Regulations will not be made until stakeholder pensions have established themselves:

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[86] SC Deb (F), 7 March 2000, 24th sitting

[87] DSS *A new contract for welfare: partnership in pensions* December 1998 p39-40

> Sub-paragraph (5) will enable regulations to be made to bring in Stage 2 of the State Second Pension for people with a significant part of their working life ahead of them. All those coming within the scope of Stage 2 will earn entitlement to State Second Pension as if they had an earnings factor of £9,500, regardless of their actual earnings. This means that low earners, carers and long-term disabled people with broken work records will continue to be deemed to have an earnings factor of £9,500. However, those earning more than £9,500 will only earn entitlement to State Second Pension on the surplus in their earnings factor falling within Band 1, that is the amount between the prevailing annual Lower Earnings Limit (the Qualifying Earnings Factor) and the Low Earnings Threshold (the deemed earnings factor under new section 44A, which is £9,500 or the prevailing level at the time Stage 2 is introduced). This will only apply to entitlement accrued after the "second appointed year", which will be the year in which Stage 2 is introduced. Any entitlement accrued under Stage 1 will be preserved. It is intended that Stage 2 will not be brought in until stakeholder pension schemes have established themselves.[88]

If the transition to stage 2 had followed the timetable suggested in the Green Paper, S2P would have started to go flat rate in April 2006, five years after the introduction of stakeholder pensions in April 2001. However, stakeholder pensions have not been as successful as the Government hoped in attracting the target market of moderate earners.[89] The Government appointed Pensions Commission's First Report, published in October 2004, concluded:

> Finally, one of the Government's policies to respond to gaps in private provision, Stakeholder Pensions, has had only limited effect. The vast majority of small company Stakeholder schemes are empty shells with no contributing members. Sixty-five per cent of companies with 5-12 employees have nominated a Stakeholder supplier, but only 4% are making contributions [Figure 3.39]. And the "new premiums" which have gone into Stakeholder Pensions include a large element which previously were going into other types of pension scheme. There is little evidence of a net increase in ongoing pension contributions flowing into personal and GPPs [Group Personal Pensions] as a result of the introduction of Stakeholder pensions.[90]

g. Pensions Commission Report, November 2005

The Pensions Commission was clear that the state pension had to be increased substantially to reduce the spread of means-testing and provide a foundation for private saving. It identified two ways of achieving this. The first involved replacing the basic and additional pensions with a single "enhanced state pension". The second – which it favoured – involved building on the current system by increasing the basic element and accelerating the move to a flat rate additional element:

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[88] Pensions Bill: Explanatory Notes, Bill 12-EN 06-07, para 379
http://www.publications.parliament.uk/pa/cm200607/cmbills/012/en/index_012.htm

[89] See, eg, "'Tax dodge' stakeholders hide workers' low contributions", TUC press release, 13 August 2004, http://www.tuc.org.uk/pensions/tuc-8433-f0.cfm and "Stakeholders 'no help to workers on low incomes'", *Times*, 14 October 2004

[90] Pensions Commission, *Pensions: Challenges and Choices:* the First Report of the Pensions Commission, 12 October 2004, p 92
http://www.pensionscommission.org.uk/publications/2004/annrep/fullreport.pdf

> Our preferred way forward would therefore build on the present two-tier system but would:
>
> - Accelerate the evolution of the S2P to a flat-rate system by freezing in nominal cash terms the Upper Earnings Limit for S2P accruals. This would enable us to concentrate the use of constrained tax resources on the provision of as generous and non-means-tested, flat-rate provision as possible.
>
> - Over the long-term, link the value of the BSP to earnings and freeze in real terms the maximum amount of Savings Credit payable. This would stop the spread of means-testing which would occur if present indexation arrangements were continued indefinitely. …
>
> - Make future accruals of BSP rights individual and universal. (By individual we mean each person accrues entitlement in their own right rather than through their spouse. By universal we mean based on residency rather than contribution records or eligibility for credits.) This will ensure that all people, including those with interrupted paid work records and caring responsibilities can be certain of a significant floor of non-means-tested state provision. In addition improve the value of carer credits within S2P.[91]

h. Pensions White Paper, May 2006

The Pensions White Paper accepted the Pensions Commission's suggestion that the transition to a flat rate S2P should be accelerated as a way of boosting and clarifying the "foundation" of state pension on which people can build with their own private provision:

> 3.46 But while the Government will this year spend £19 billion on the State Second Pension, or its contracted-out equivalents through the rebates, this aspect of the system is poorly understood. Few people are aware of it at all, and even fewer of how their entitlement to it builds. Many people are building entitlement to the State Second Pension without even being aware that they are doing so.
>
> 3.47 The beginning of this chapter made clear that, in the face of an ageing population and the need for the state system to provide a foundation for people's savings, the State should move away from the direct provision of pensions related to individuals' earnings and concentrate on flat-rate provision in the future. The introduction of the new personal accounts scheme will mean that for the first time everyone will have access to a genuinely low-cost private savings vehicle. We do not want the State Second Pension to duplicate this, which is why we are able to reinforce and speed up its change in focus to a flat-rate top-up benefit for years spent working, caring or parenting.
>
> 3.48 Accruals will start to become flat rate more quickly at the same time as we start to uprate the Basic State Pension by earnings [2012, or by 2015 at the

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[91] Pensions Commission, A New Pension Settlement for the Twenty-First Century: The Second Report of the Pensions Commission, 30 November 2005, pp 9-10
http://www.pensionscommission.org.uk/publications/2005/annrep/main-report.pdf

> latest]. We estimate that the State Second Pension will become completely flat rate in around 2030, or shortly afterwards. (…)
>
> 3.50 We therefore plan to accelerate the way in which accruals in the State Second Pension are becoming flat rate. This benefit will be protected against rises in average earnings during accrual, and then against inflation once in payment. Combined with a Basic State Pension linked to earnings, this will produce a total State Pension that is uprated partly by earnings and partly by prices in payment, as recommended by the Pensions Commission. Under the new benefit, each year of work, parenting or caring will effectively top up the State Pension by at least £1.20 a week at retirement in average earnings terms.[92]

The White Paper also announced an extension to the number of carers who would be covered by S2P. People receiving Child Benefit for children up to the age of 12 (as opposed to the current 6) would be covered, as would people caring for the disabled for more than 20 hours a week (as opposed to 35 hours or more at present). In addition, Home Responsibilities Protection (HRP) would no longer be awarded only on the basis of a complete tax year's eligibility but would become a weekly credit. Aligning credits for care of children up to the age of 12 should mean around an additional 780,000 women and 30,000 men would be accruing State Second Pension entitlements. The new credit for those caring for 20 hours or more should mean around 110,000 more women and 50,000 more men would be accruing entitlements to State Second Pension.[93]

i. Summary of responses, October 2006

The Government's response to the consultation on the White Paper announced that it had been impressed by arguments about the need to progress to a simpler, higher state pension more rapidly. It would therefore explore the possibility of replacing the accruals based flat rate element of S2P with a fixed amount (£1.40) for every year of membership of S2P:

> 52. We are exploring whether it would be possible to replace the accruals-based flat-rate element of the State Second Pension with a flat rate and fixed amount immediately at the same time as we link the Basic State Pension to rises in average earnings. This would mean that for most people the system would effectively operate as a single state pension, which for all pensioners would be more valuable than the current scheme rolled forward.
>
> 53. Under the system going forward, a growing number of people – over 90 per cent by 2050 – will receive the full basic element of State Pension linked to earnings. Under this further simplification measure, most people would then accrue a weekly top up when they retire for all the time that they have contributed to society through working or caring. For example, the top-up could be set initially at £1.40 a week for every qualifying year, and would then be re-valued each year by earnings in accrual.

[92] Department for Work and Pensions, Security in retirement: towards a new pensions system, (the Pensions White Paper), 25 May 2006, Cm 6841, paras 3.46-50
http://www.dwp.gov.uk/pensionsreform/pdfs/white_paper_complete.pdf

[93] Ibid, paras 3.80-3.95

> 54. Once in payment this element of the pension would continue to be uprated by prices, meaning that the total pension in payment will rise by a level between prices and earnings.
>
> 55. Compared with a single-tier pension, this approach would allow us to get more money to more people in the early years of retirement when their spending needs tend to be greater – indeed, we know from the type of annuities that pensioners buy that this is the way pensioners themselves tend to prefer to organise their finances.
>
> 56. This policy, which rewards social contributions, also rewards people financially as the vast majority will be better off under our reformed system than they would have been under the old system.
>
> 57. By 2050, 80 per cent of people reaching retirement will have a state pension of at least £114 a week – the level of the Citizens' Pension recommended by some. The median value of State Pension for pensioners reaching State Pension age in 2050 will be £135, and any one with a good working or caring life will be entitled to around this amount.
>
> 58. We are also flat-rating the State Second Pension so people now have a much clearer idea of what they can expect in retirement – a single, simpler and more generous state pension. Under this proposal, we would continue to gradually withdraw the residual earnings-related element of the State Second Pension as described in the White Paper, while further simplifying the system in the meantime by ending the complex transitional measures built into the system in the transition from the State Earnings-Related Pension Scheme to the State Second Pension.
>
> 59. A simpler state pension package, made up of a basic element and an additional element, would give a clear foundation for saving, which will be made easier to do in our new system of personal accounts. We are continuing to explore this option in advance of the Pensions Bill.[94]

2. The Bill

Clause 9 of the Bill makes the changes to "deeming" so that a wider range of carers and disabled people will be treated as earning at the LET. The *Explanatory Notes* on the Bill summarise the changes as follows:

> 54. The proposed changes would increase the number of people who are deemed to be earning at the low earnings threshold, and so accruing state second pension as if they had Band 1 earnings until the proposed new simplified state second pension is introduced.
>
> 55. The changes allow persons to be deemed to be earning at the low earnings threshold for a tax year starting with that commencing 6 April 2010, if they satisfy any of 3 conditions:

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[94] Department for Work and Pensions, Security in retirement: towards a new pensions system: summary of responses to the consultation, 30 October 2006, Cm 6960, Chapter 4
http://www.dwp.gov.uk/pensionsreform/pdfs/pens-wp-response.pdf

- the first is that the person has earnings equal to or greater than the qualifying earnings factor for the year but less than the low earning threshold;
- the second is that the person has earnings less than the qualifying earnings factor but is entitled to enough new earnings factor credits to bring his earnings factor up to the qualifying earnings factor;
- the third is that a person has no earnings but is entitled to 52 of the new credits for the year.

56. The new earnings credits, of 1/52 of the qualifying earnings factor for the year are available in respect of each week in which a person was:

- awarded child benefit for a child under 12;
- a foster parent;
- caring for someone with a qualifying disability benefit for at least 20 hours a week; or
- entitled to carer's allowance;
- entitled to severe disablement allowance or incapacity benefit. The labour market attachment test would no longer apply to disabled people from 6 April 2010.

57. People earning at or above the low earnings threshold will continue to accrue state second pension according to the band of earnings they are in until the new simplified state second pension is introduced.[95]

Clauses 10 - 12 convert S2P into a flat-rate benefit. Clause 10 removes the Band 3 (20%) accrual rate from the 2010/11 tax year so that S2P will only accrue at 10% on any earnings above the LET and below the UEL.

Clause 11 and Schedule 2 provide for S2P to accrue at a weekly rate of £1.40 (£72.80 a year) on earnings or deemed earnings below the LET from the "flat rate introduction year". This is expected to be the year in which the Basic State Pension is re-linked to earnings (possibly 2012). The way in which S2P works at present, with the LEL linked to prices and the LET linked to earnings means that Band 1 is getting progressively wider so that 40% accrues on an ever larger range of earnings. At present the weekly accrual is about £1.20, but by 2050 it might be £1.55. The fixed figure of £1.40 is designed to be cost neutral. It will be uprated annually in line with earnings.

Clause 12 effectively freezes the upper limit of earnings on which S2P accrues at an "Upper Accrual Point" (UAP) equal to the UEL at the "flat rate introduction year" (probably 2012). As the LET will increase in line with earnings and this UAP will remain

[95] Pensions Bill: Explanatory Notes, Bill 12-EN 06-07

frozen, the band of earnings on which S2P is earnings-related and accrues at 10% will get smaller and smaller until the LET reaches the UAP when it will disappear altogether and S2P will become wholly flat rate. The target date for this to occur is 2030.

This part of the Bill also withdraws "the highly complex transitional State Earnings Related Pension Scheme transitional arrangements" to coincide with the introduction of the new scheme.[96] Very briefly, these transitional arrangements relate to the protection offered to members of SERPS when the working life over which it was calculated was increased from 20 years to 44 for women and 49 for men under the *Social Security Act 1986*. The "working life" began on 5 April 1978 or at age 16, whichever was later. People reaching State Pension age before 6 April 1999 would therefore still have their additional pension calculated over 20 years as originally planned (i.e. the 20 years from 1978/79 to 1998/99) and would not suffer loss. People reaching Pension age from 1999/2000 onwards would have a "working life" of an extra year for each year until 2022/23 (women) or 2027/28 (men). Technically, surplus earnings are divided by a "floating numerator" (the number of years in the working life) which is gradually increasing to 49 by 2027. The Bill fixes it at 44. This will mean a maximum loss of about £1 a week (for people retiring in 2012).[97]

These clauses also deal with the impact of changes to S2P on the Reference Scheme Test, where contracted out defined benefit schemes are expected to provide similar benefits to S2P and the "top ups" which S2P provides for contracted out people, to account for the fact that contracted out rebates do not fully reflect the costs of providing that benefit (but are still based on the old SERPS accrual pattern).

3. Issues

On the whole, most commentators welcome the acceleration of the development of S2P into a flat rate pension. It is seen as a significant simplification. However, the **TUC** sounds a note of caution:

> We believe the Government should be cautious about moving to flat rate S2P too quickly. We think that basing the proposed reform on an assumption that the NPSS will provide the majority of workers with additional pensions may be premature. We suggest that before any final decision is taken on reforming the S2P into a flat-rate weekly top-up, the NPSS should be up and running, and have been subject to an independent review of levels of opt-outs and contribution rates. Only when the success of the NPSS has been measured should the Government consider moving to flat rate S2P.[98]

Others recognise that it may be risky to leave the whole of any earnings-related element in the pension to personal accounts. For example, the **Actuarial Profession** consider:

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www.publications.parliament.uk/pa/cm200607/cmbills/012/en/index_012.htm

96 Department for Work and Pensions, Pensions Bill – Regulatory Impact Assessment, November 2006, para 3.21, http://www.dwp.gov.uk/pensionsreform/pdfs/RIAv6.pdf

97 Source: DWP

98 http://www.tuc.org.uk/pensions/tuc-12430-f1.cfm#tuc-12430-1

> It is a gamble to rely so heavily on a system that is only successful following a consistent level of long term saving that receives reliable real investment returns.[99]

They fear that the combined rate of the two flat rate pensions (£135 a week in 2053 after 43 years working or caring)[100] is still not high. The lower paid might have been better off with the existing S2P if means-testing is not significantly reduced and personal accounts fail to deliver:

> For these people, the effect of the personal accounts is to replace a benefit provided out of general taxation with one that they have had to pay for themselves so the progressive tax characteristics of current benefit provision are reduced. For this exchange to be reasonable, those people affected must have confidence that they are likely to get real value from their savings. If there is a high probability that people will become eligible for means tested benefits in retirement, then the new system will suffer the same criticism as the current arrangements, and nothing will have been achieved by the reforms being proposed.[101]

In response to a request from the Work and Pensions Committee, which expressed concerns that gaps would remain in state second pension entitlement would continue, particularly for the self-employed, the Government said that:

> Under the White Paper proposals, the Government projects that, by 2050, about half of individuals reaching State Pension age will have a total State Pension entitlement of at least £135 per week in today's earnings terms and around two-thirds will have an entitlement of at least £125 per week. Corresponding estimates for 2030 – which will not reflect the full impact of the reforms – are a third of those reaching State Pension age in 2030 are likely to have entitlement of at least £135 per week and half are likely to have at least £125 per week.[102]

Doubts about personal accounts also lie behind the **National Pensioners Convention**'s view that the state should provide second tier pensions:

> The advantages of a state run second pension are that it offers defined and predictable benefits, low administrative costs, portability between jobs and is not dependent on the performance of investment and annuity markets.[103]

The **Equal Opportunities Commission** argue that S2P should – like the future Basic State Pension – be linked to earnings rather than prices:

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[99] http://www.actuaries.org.uk/files/pdf/social_policy/security_retirement_resp.pdf

[100] DWP, *Security in retirement: towards a new pension system: summary of responses to consultation*, October 2006, chapter 1, para 16

[101] http://www.actuaries.org.uk/files/pdf/social_policy/security_retirement_resp.pdf

[102] Department for Work and Pensions, Report on Pension Reform: Government response to the Fourth Report of the Work and Pensions Select Committee, Session 2005-06 [HC 1068-1], Cm 6956, 30 October 2006, para 60
http://www.dwp.gov.uk/pensionsreform/pdfs/pens-wp-select-cttee-response.pdf

[103] http://www.npcuk.org/briefings/NPC%20White%20Paper.pdfhttp://www.npcuk.org/briefings/NPC%20White%20Paper.pdf

> The white paper proposes that the second state pension should be linked to earnings in accrual not in payment. This means that it will decline in value over the years as people claim it during their retirement. As this occurs pensioners who had not needed to claim pension credit will find that they are likely to slip below the poverty threshold and need to rely on means tested benefits after all.[104]

One long-running source of complaint about S2P – its exclusion of the self-employed – is not addressed by these reforms. The Pensions Commission proposed that the self-employed should be offered the option of joining S2P. It pointed out that low earning self-employed people were at a particular disadvantage because they did not benefit from "deeming":

> Low income self-employed are now particularly disadvantaged, relative to low income employees, since they do not gain the benefits of the redistribution to lower earners introduced by reforms to the S2P in 2002. Any employee earning between the Lower Earning Limit (LEL) and the LET now accrues S2P rights as if they were earning at the LET. For an employee earning just above the LEL all of their S2P accrual is now effectively paid for by a redistribution from other contributors rather than out of their own contributions. The self employed person earning just above the LEL receives none of this benefit.[105]

However, the Government felt that, on balance, the difficulties of extending S2P to the self-employed did not justify any possible benefits:

> 3.55 We share the Pensions Commission's own concerns that
>
> > "… the complexity of age-specific contribution rates and the higher level required later in life, might make voluntary membership of State Second Pension unattractive for many self-employed."
>
> 3.56 The Government is unable to reconcile these issues and is reluctant to commit taxpayers' money to setting up a speculative scheme where enrolment may be low. Nor does the Government wish to introduce a scheme exclusively for self-employed people with only low profits. Profits from self-employment can fluctuate year on year, which would result in people being included and then excluded. Such a scheme would have arbitrary cut-off points and would have to have numerous exclusions and exceptions (for instance, someone in part-time self-employment who had other earnings or a large occupational pension).
>
> 3.57 A further factor when considering scheme development is that the average duration of self-employment is around eight years. For many earners, who move from employment to self-employment and back again, it is unlikely that a period out of the State Second Pension would have a significant impact on their retirement income.
>
> 3.58 The introduction of personal accounts, described in Chapter 1, will bring in new arrangements to enable the self-employed to build a second pension. On

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[104] http://www.eoc.org.uk/PDF/pensions_debate_June_briefing.pdf

[105] Pensions Commission Second Report, chapter 6, p 280
http://www.pensionscommission.org.uk/publications/2005/annrep/chapters/chapter6.pdf

> balance, the Government believes that the State Second Pension should not be extended to the self-employed.[106]

Despite an acceptance that flat rate S2P might be simpler, many still consider that it will remain impossibly complicated. The **Association of Consulting Actuaries** comments:

> It will continue the mind-boggling complexity associated with the State Second Pension (which we understand no members of the public understood when the Pensions Commission examined pension understanding in focus groups) and will inevitably encourage more people in the low earner / older worker categories to opt-out, thereby placing greater burdens on future generations of taxpayers (reducing their ability to save).[107]

Malcolm McLean, Chief Executive of **The Pensions Advisory Service**, has put the "calculation of S2P" at the top of his list of the "top 10 complex areas in pensions".[108]

The **Pensions Policy Institute**, in a briefing entitled *State pension simplification?* suggests that the simplification might prove more presentational than real:

> **What are the advantages?**
>
> The technical change to the S2P calculation will make it easier to see how much pension is being accumulated each year as the amount is fixed, and allow S2P to be presented as a weekly 'top up' to BSP. The Government are interested in combining BSP and S2P together in a single pension. (…)
>
> **Towards a single state pension?**
>
> Although the proposed change will simplify S2P, there will still be some significant differences between S2P and BSP:
>
> - S2P may not become flat-rate for all individuals until 2031.
> - Some people may qualify for BSP but not S2P, for example the self-employed.
> - S2P will still be uprated in line with prices when it is payment, while BSP is uprated in line with earnings.
> - Some of S2P will be delivered by private pensions, through contracting-out.
>
> As a result of these differences, there will still be uncertainty as to the amount of S2P that individuals will receive. Amounts of S2P in payment to individuals will still vary according to lifetime characteristics, and by age. For example, because S2P is uprated by prices when it is payment, a woman with exactly the same

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[106] Department for Work and Pensions, Security in retirement: towards a new pensions system, (the Pensions White Paper), 25 May 2006, Cm 6841, Chapter 3
http://www.dwp.gov.uk/pensionsreform/pdfs/white_paper_complete.pdf
[107] Association of Consulting Actuaries response, http://www.aca.org.uk/Public_content/ACA_WhitePaper_final_response_140906.doc
[108] "Keep it simple", *Professional Pensions*, 16 November 2006

> contribution record as her younger sister will receive less S2P each year than her sister does.
>
> **Conclusion**
> This technical change to the way that S2P is calculated will allow for a simpler presentation of essentially the same benefits. Any gains or losses are likely to be marginal. Although the proposal appears to move closer to a single state pension, many of the differences that currently exist between BSP and S2P will remain.[109]

Joanne Segars, Chief Executive of the **National Association of Pension Funds**, commented:

> There will still be too much complexity and too much means testing. The state second pension reforms are likely to increase costs for employers offering defined benefit schemes.[110]

The Conservative Party has drawn attention to those who will lose out from the reform. An article in the *Daily Telegraph* reports:

> Millions of middle income earners face losing hundreds of pounds a year under Labour plans to overhaul the pensions system.
>
> Payments from the State Second Pension would be almost halved for many top-rate taxpayers under the proposed reforms published today.
>
> The Conservatives said last night that the changes would affect anyone earning more than £18,000 a year.
>
> Workers would carry on paying the same level of National Insurance contributions despite the fact that the amount they would receive from the State Second Pension would be significantly reduced.
>
> …
> The Tories estimate that by 2033 someone earning more than £35,000 a year would be paying £2,119 in National Insurance contributions for a pension benefit they will no longer receive. Someone on £18,000 would be paying £468 a year in National Insurance for a benefit they had lost.
>
> A Department for Work and Pensions spokesman said this loss would be partly compensated by an increase in the Basic State Pension.[111]

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[109] Pensions Policy Institute, Briefing Note Number 35, *State pension simplification?,* November 2006 http://www.pensionspolicyinstitute.org.uk/uploadeddocuments/Briefing%20Notes/PPI_Briefing_Note_35.pdf

[110] "Reforms will make things more complex", *Professional Pensions,* 23 November 2006

[111] "'Millions of middle-earners will lose' in pensions reform", *Daily Telegraph*, 29 November 2006

F. State Pension age

1. Increase in State Pension age

a. Background

State Pension age in the United Kingdom has varied in the past. The first support for pensioners, introduced from 1909, was only available for both men and women at 70. Legislation in 1925 introduced contributory pensions funded by contributions from employers, employees and the state, reducing the Pension age to 65 for both men and women. In 1940, the State Pension age for women was reduced to 60 by the Old Age and Widow's Pension Act; the Pension age for men remained unchanged at 65. The Beveridge Report (1942) accepted the existing 60/65 Pension age, as enshrined in the National Insurance Act 1946. This is the foundation of today's state pension.

Clause 13 of the Pensions Bill - the increase in State Pension age - has attracted widespread public and media attention. The Government's argument is that life expectancy has improved considerably since State retirement pensions were first introduced, and these improvements are projected to continue. Inevitably, there is growing concern about the pressure exerted on state pension funding by increased longevity. The State Pension age for women is already due to increase from 60 to 65 over the period 2010 to 2020,[112] and the Pensions Commission recommended that the State Pension age for both men and women should be further increased to 66 by 2030, 67 by 2040 and 68 by 2050 as a way of financing the increase in the level of the basic pension.[113] The Government accepted this recommendation and the Pensions White Paper proposes to increase the equalised State Pension age from 65 to 66 between 2024 and 2026; from 66 to 67 between 2034 and 2036; and from 67 to 68 between 2044 and 2046. The White Paper states:

> We are living longer – something that we should celebrate, but which also raises challenges for individuals and for society in how we support an ageing population. As a key part of our response to these challenges, we must enable and encourage people to work longer. Higher employment will sustain national wealth, while longer working provides a greater opportunity for people to build provision for their retirement through private saving.
>
> 4.2 Working for longer not only provides a direct means by which people can supplement their income in greater life, but also a way of building up greater state and private pension entitlement for the future – thus helping them to maintain their standard of living in retirement.
>
> 4.3 Longer employment is the logical response to an ageing population: the more people who are in work and contributing to the growth of the economy, the more funds there will be available to support those people who are in retirement.

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[112] Pensions Act 1995

[113] Pensions Commission (2005) A new pension settlement for the twenty-first century: The second report of the Pensions Commission http://www.pensionscommission.org.uk/publications/2005/annrep/annrep-index.asp

> 3.34 We therefore support the Pensions Commission's recommendation that the State Pension age should rise to 68 by the middle of the century. We propose to introduce legislation to raise the State Pension age in stages:
>
> - the first increase, from 65 to 66, to be phased in over two years, starting in April 2024;
> - the second increase, from 66 to 67, again phased in over two years, from April 2034; and
> - the third increase, from 67 to 68, also to be phased in over two years, from April 2044.
>
> 3.35 By 2050, these reforms to State Pension age alone will reduce the costs of our proposed reforms to the state pension system by around £30 billion. By doing this we will continue to tackle pensioner poverty, be able to sustain the generosity per pensioner of the State Pension, and sustain the balance between work and retirement. [114]

A recent written parliamentary question asks the Secretary of State for Work and Pensions the reasons for proposing a staggered rise in State Pension age.[115] The Department states:

> The timetable as proposed is designed to broadly keep pace with the projected rises in average life expectancy and so maintain at a roughly constant level the same proportion of adult life spent in receipt of the state pension following the proposed increase in State Pension age as set out in the Pensions White Paper Security in Retirement: Towards a New Pensions System. Our intention is that each increase will be implemented gradually over a two-year period. The first increase from 65 to 66 will be phased in between April 2024 and April 2026; the increases from 66 to 67 and from 67 to 68 will be implemented in the same way, starting from April 2034 and April 2044 respectively. Increasing State Pension age with no transitional period would mean that two people born a day apart could have a year between their respective State Pension ages, while a more extended transition period would increase complexity. We consider that our proposal, which follows a similar model as will apply to the increases in State Pension age for women between 2010 and 2020 under the Pensions Act 1995, strikes a reasonable balance between fairness and simplicity.

The Pensions Bill 2006/07 implements proposals to increase State Pension age in the context of population ageing, as contained in the White Paper. In a speech setting out the case for raising the State Pension age, John Hutton, Secretary of State for Work and Pensions, said:

> Possibly the most significant part of next week's Bill is to legislate for gradually raising the State Pension age to 68 by 2046. It is a big step to ask one parliament to set a course for forty years. But it is the right thing to do as we need to lock in stability in pension's policy to allow future generations to plan ahead with

[114] Department for Work and Pensions, Security in retirement: towards a new pensions system, (the Pensions White Paper), 25 May 2006, Cm 6841, http://www.dwp.gov.uk/pensionsreform/pdfs/white_paper_complete.pdf

[115] HC Deb 16 October 2006 c971-2w

> confidence. We need to be straight with people on this crucial issue so they know where they stand and can plan accordingly.
>
> As unpopular as it may be to talk about working longer – the simple fact is that if we aren't prepared to increase the State Pension age, we will simply pass an ever greater and frankly unsustainable burden onto our children and grandchildren.
>
> Those who would oppose the increase in the State Pension age must do so in the full knowledge of the predicted consequences. That they are in effect arguing for more than a 4p rise in the Basic Rate of income tax to pay for a population spending more and more of their lives in retirement. [116]

The population of the UK has changed considerably since State pensions were introduced. There are now 9.6 million people aged 65 and over in the UK, a 75 per cent increase since 1951. Over the last 50 years there has been a substantial change in the age composition of older people. In 1951, those aged 65-74 represented 67 per cent, and those aged 85 and over made up just 4 per cent, of the 65 and over population. Today, the two age groups represent 52 per cent and 12 per cent respectively.

The latest Government Actuary projections show that the age structure of the UK population will continue to grow older.[117] The number of people of working age (currently defined as between ages 16 to 64 for men and 16 to 59 for women) is projected to rise by 3.1 per cent from 37.1 million in 2004 to 38.2 million in 2010. Allowing for the planned change in women's State Pension age from 60 to 65 between 2010 and 2020, the working age population will increase further to 40.5 million by 2020 and is then projected to stabilise.

Projected population by age (principal projection)
United Kingdom, 2004-2071

	2004	2011	2021	2031	2041	2051	2061	2071
thousands								
Under 16	11,646	11,231	11,399	11,483	11,246	11,270	11,307	11,217
Working age*	37,064	38,479	40,588	40,191	40,214	40,377	39,868	40,029
Pensionable age*	11,125	12,182	12,740	15,340	16,894	17,605	18,682	19,235
percentages								
Under 16	19.5	18.1	17.6	17.1	16.5	16.3	16.2	15.9
Working age*	61.9	62.2	62.7	60.0	58.8	58.3	57.1	56.8
Pensionable age*	18.6	19.7	19.7	22.9	24.7	25.4	26.7	27.3
Support ratio* (working age/pensionable age)	3.33	3.16	3.19	2.62	2.38	2.29	2.13	2.08
Mean age (years)	39.5	40.4	41.9	43.3	44.4	45.1	45.5	46.0

Source: GAD, Population projections database

Note: * Working age and pensionable age population based on state pension age for given year. Between 2010 and 2020, state pension age will change from 65 years for men and 60 years for women, to 65 years for both sexes.

[116] DWP, 23 November 2006 Press Release, 'We must plan to raise pension age now or pass on a big bill to our children' - Hutton http://www.dwp.gov.uk/mediacentre/pressreleases/2006/nov/pens005-231106.asp retrieved 7 December 2006

[117] GAD 2004-based national population principal projection

The number of people of state pensionable age is projected to increase steeply after 2020. By 2051 it will be 17.6 million, that is over 6 million higher than today, and by 2071, 27.3 per cent of the population will be of state pensionable age.

Population ageing means there will be greater numbers of non-working pensioners, so that the working population will have to support an increasing number of elderly dependents in the future. In 2004 for every person of state pensionable age there were 3.33 persons of working age. By 2010, this demographic support ratio will decline to 3.14. Allowing for the change in women's State Pension age, the ratio will then rise slightly to 3.23 by 2020 before declining quickly to 2.62 by 2031. In the longer-term, the projections suggest the support ratio will briefly stabilise at about 2.40 around 2040, before declining further.[118]

The population will gradually become older with the average (mean) age expected to rise from 39.5 years in 2004 to 43.3 years in 2031. In the longer-term, the projections suggest that the average age will continue to rise beyond 2031, reaching 45 years by 2050.

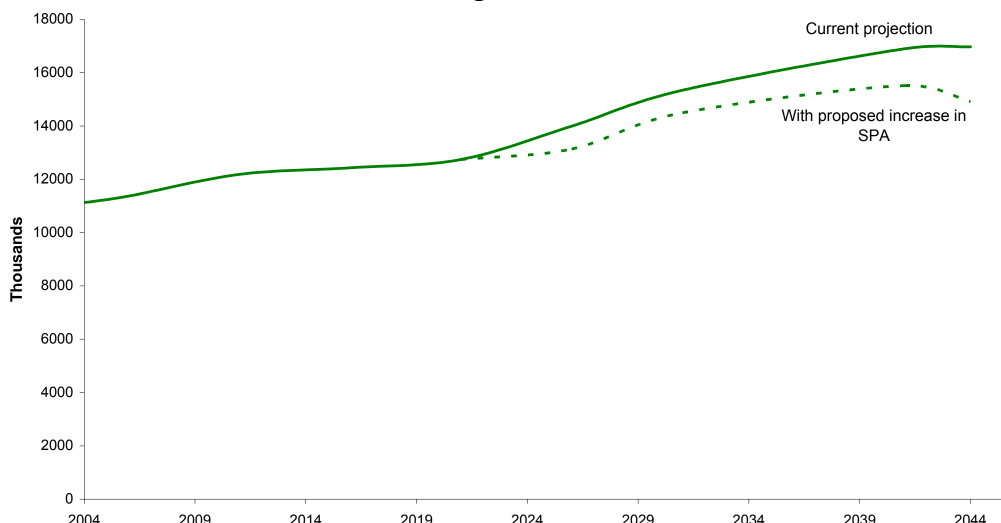
Increasing State Pension age will go someway towards tempering the rise in the number of pensioners. A rise in State Pension age means a higher proportion of people will continue to work for longer, therefore reducing the number of people of state pensionable age and increasing that of working age. The result is that the ratio of working age to pensionable age population will remain in decline, but not as sharply as if State Pension age remained unchanged (see table and charts).

Effect of proposed increase in State Pension age: Projected population by age (principal projection)
United Kingdom, 2004-2044

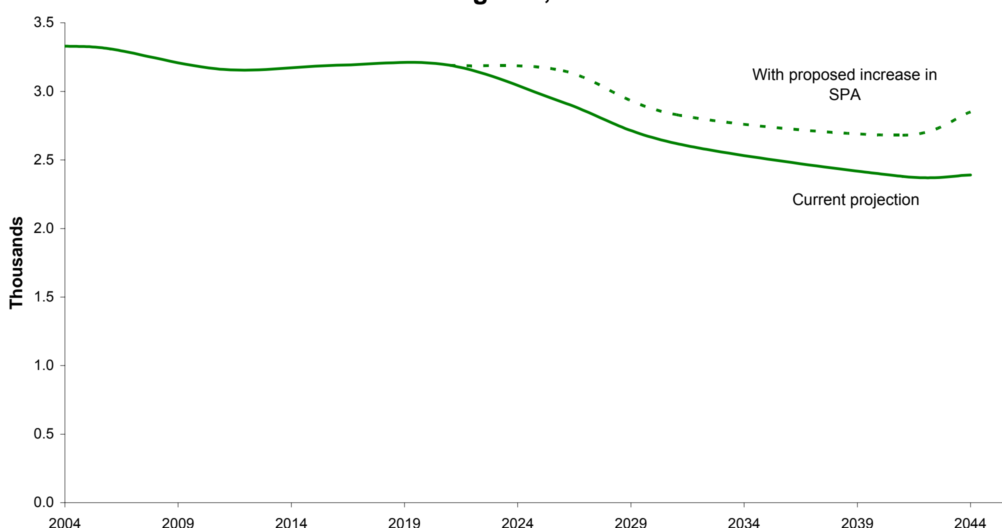
	2004	2011	2021	2026	2031	2036	2041	2044*
thousands								
Under 16	11,646	11,231	11,399	11,487	11,483	11,360	11,246	11,219
Working age*	37,064	38,479	40,588	41,381	41,040	41,568	41,594	42,526
Pensionable age*	11,125	12,182	12,740	13,134	14,491	14,838	15,513	14,911
percentages								
Under 16	19.5	18.1	17.6	17.4	17.1	16.8	16.5	16.3
Working age*	61.9	62.2	62.7	62.7	61.2	61.3	60.9	61.9
Pensionable age*	18.6	19.7	19.7	19.9	21.6	21.9	22.7	21.7
Support ratio* (working age/pensionable age)	3.33	3.16	3.19	3.15	2.83	2.80	2.68	2.85

Source: GAD, Population projections database (population by age by single year of age)
Note: * Working age and pensionable age population based on state pension age for given year. Between 2010 and 2020, state pension age will change from 65 years for men and 60 years for women, to 65 years for both sexes.
Table assumes that proposals to increase the pension age to 66 in 2024; 67 in 2034 and 68 in 2044 are implemented
*2044 figures are illustrative as they assume increase in pension age to 68 occurs in full in 2044 (the plans are for it to be phased over 2 years)

[118] This ratio has come under criticism as being too simplistic. Many factors other than age determine whether a person is 'dependent' or not. Older people are significant contributors as well as recipients, particularly outside the formal labour market. For example, a third of informal carers are elderly themselves (ESRC, 2006, Demographic aspects of population ageing) http://www.esrc.ac.uk/ESRCInfoCentre/Images/ESRC_population_ageing_doc_tcm6-15714.pdf

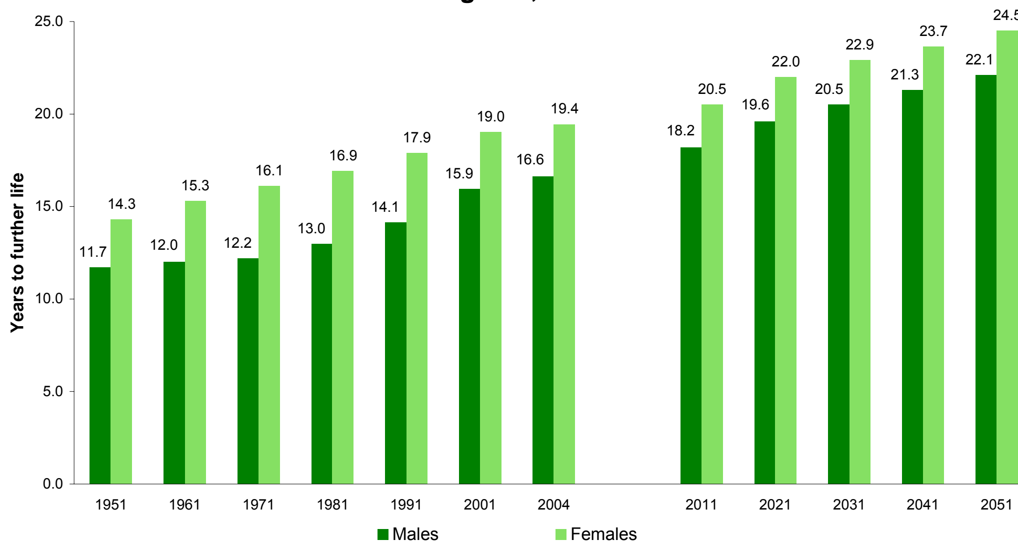


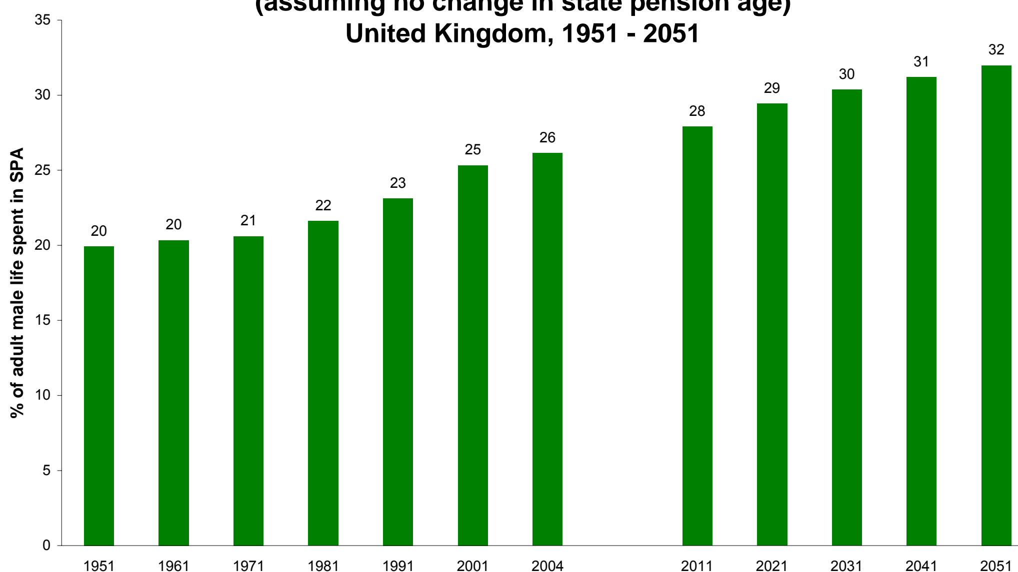
Population ageing is traditionally caused by sustained low levels of fertility. However, increased longevity is now the main driver of population ageing in the UK. Life expectancy, both at birth and at 65, has increased dramatically and will continue to do so. Average male life expectancy at 65 has increased from 12 years in 1951 to an estimated 17 years today, and is projected to rise to 21 years by 2031 and approximately 22 years by 2051. Female life expectancy is higher and also increasing, though at a slightly slower rate.[119]



[119] 1951-1971: English Life Table for England and Wales, ONS (1999) Mortality Statistics DH1 No.32
1981-2004: GAD, UK Interim Life Table
2011-2051: GAD, UK principal projection and House of Commons calculations

Because people are living longer, on average people are working proportionately less. Increasing life expectancy at older ages means that people are spending more years beyond state pension age. In 1951, male life expectancy at State Pension age is 12 years so that the average male could expect to live 20 per cent of his adult life in state pensionable age. Today male life expectancy at State Pension age is 17 years, so that 26 per cent of male adult life is spent in state pensionable age. By 2051, it will have increased to nearly a third of adult life if State Pension age remains unchanged.[120]





[120] Percentage of adult life spent in state pensionable age is given by life expectancy at 65/65 plus life expectancy at 65 minus 18. House of Commons Library calculations

In terms of male adult life spent in retirement, the proportion is even higher over time. This is because average retirement age for men has fallen and is currently below State Pension age whilst life expectancy has continued to improve. In 1950, the average male retired at age 67 and could expect to live for another 10.2 years, thus spending 17 per cent of his life in retirement. Today the average retirement age for men is 64.2, and life expectancy at that age is another 20.9 years, meaning that 31 per cent of life is spent in retirement. On current life expectancy projections and assuming retirement age remains at the current level, those who will retire in 2050 could look forward to spending on average 35 per cent of their adult life in retirement.[121]

The proposed increase in State Pension age will mean that men reaching State Pension age in the future will, on average, spend about the same number of years of their adult life in receipt of the State Pension as now. For women, there is a slight reduction by 2020 (when the increase in female State Pension age to 65 will be fully phased in). However, the number of years for women spent in post State Pension age remains greater than for men.

Increasing State Pension age would maintain the proportion of male life spent in retirement close to its current rate of 30 per cent. The White Paper states:

> 3.37 … the proportion of adult life spent in receipt of the State Pension will remain about the same. By 2055, assuming life expectancy continues to increase in line with projections, for both men and women the number of years after State Pension age will be broadly the same as that of those reaching 65 in 2020 – indeed for men, it would have grown slightly.[122]

Number of years and percentage of adult life spent post-State Pension age following transition to new State Pension ages

	2006 SPA at: 65	2020 SPA at: 65	2026 SPA at: 66	2036 SPA at: 67	2046 SPA at: 68	2055 SPA at: 68
Years						
Men	20.1	21.6	21.1	21.1	21.0	21.8
Women	28.3	24.5	24.0	23.8	23.6	24.4
Percentage						
Men	30.0	31.4	30.6	30.1	29.6	30.4
Women	40.3	34.3	33.3	32.7	32.1	32.8

Source: GAD 2004-based principal projection; median cohort figures for the UK

Note: Between 2010 and 2020, state pension age will change from 60 years to 65 years for women

[121] Department for Work and Pensions, Security in retirement: towards a new pensions system, (the Pensions White Paper), 25 May 2006, Cm 6841, http://www.dwp.gov.uk/pensionsreform/pdfs/white_paper_complete.pdf

[122] Ibid

2. The Bill

The Bill provides for State Pension age to increase by one year per decade between 2020 and 2050, with each change phased in over two consecutive years in each decade. The first increase, from 65 to 66, would be phased in between April 2024 and April 2026; the second, from 66 to 67, would be phased in between April 2034 and April 2036; and the third, from 67 to 68, between April 2044 and April 2046. These changes would therefore affect anyone born after 5 April 1959 - that is anyone below the age of 47 on 5 April 2006 (who would therefore reach the age of 65 on or after 6 April 2024). Details are included in **Schedule 3** of the Bill, see overleaf:

Period within which birthday falls	Day pensionable age attained
6th April 1959 to 5th May 1959	6th May 2024
6th May 1959 to 5th June 1959	6th July 2024
6th June 1959 to 5th July 1959	6th September 2024
6th July 1959 to 5th August 1959	6th November 2024
6th August 1959 to 5th September 1959	6th January 2025
6th September 1959 to 5th October 1959	6th March 2025
6th October 1959 to 5th November 1959	6th May 2025
6th November 1959 to 5th December 1959	6th July 2025
6th December 1959 to 5th January 1960	6th September 2025
6th January 1960 to 5th February 1960	6th November 2025
6th February 1960 to 5th March 1960	6th January 2026
6th March 1960 to 5th April 1960	6th March 2026

A person born after 5th April 1960 but before 6th April 1968 attains pensionable age when the person attains the age of 66.

Period within which birthday falls	Day pensionable age attained
6th April 1968 to 5th May 1968	6th May 2034
6th May 1968 to 5th June 1968	6th July 2034
6th June 1968 to 5th July 1968	6th September 2034
6th July 1968 to 5th August 1968	6th November 2034
6th August 1968 to 5th September 1968	6th January 2035
6th September 1968 to 5th October 1968	6th March 2035
6th October 1968 to 5th November 1968	6th May 2035
6th November 1968 to 5th December 1968	6th July 2035
6th December 1968 to 5th January 1969	6th September 2035
6th January 1969 to 5th February 1969	6th November 2035
6th February 1969 to 5th March 1969	6th January 2036
6th March 1969 to 5th April 1969	6th March 2036

A person born after 5th April 1969 but before 6th April 1977 attains pensionable age when the person attains the age of 67.

Period within which birthday falls	Day pensionable age attained
6th April 1977 to 5th May 1977	6th May 2044
6th May 1977 to 5th June 1977	6th July 2044
6th June 1977 to 5th July 1977	6th September 2044
6th July 1977 to 5th August 1977	6th November 2044
6th August 1977 to 5th September 1977	6th January 2045
6th September 1977 to 5th October 1977	6th March 2045
6th October 1977 to 5th November 1977	6th May 2045
6th November 1977 to 5th December 1977	6th July 2045
6th December 1977 to 5th January 1978	6th September 2045
6th January 1978 to 5th February 1978	6th November 2045
6th February 1978 to 5th March 1978	6th January 2046
6th March 1978 to 5th April 1978	6th March 2046

A person born after 5th April 1978 attains pensionable age when the person attains the age of 68.

A number of social security benefits either become payable or cease to be payable when State Pension age is reached. The Bill provides for these age thresholds to rise in line with rising State Pension age. The benefits to which this applies include Jobseeker's Allowance, Incapacity Benefit (and the new Employment and Support Allowance which is intended to replace Incapacity Benefit), Bereavement Benefits and State Pension Credit. In the case of Attendance Allowance and Disability Living Allowance, the age threshold is currently set at 65. By 2020, it will therefore have become aligned with pensionable age for both women and men. The Bill replaces the reference to age 65 with pensionable age with effect from 6 April 2024, so that the minimum age for entitlement to Attendance Allowance and the upper age at which a person may qualify for Disability Living Allowance will increase in line with rising State Pension age.

3. Issues

Projections in the future are inherently uncertain. For this reason, the Government Actuary produces variant population projections based on a range of assumptions on future improvements in life expectancy (as well as fertility and migration). Alternative scenarios around the principal projection show a continued ageing of the population, but at different extents. For example, the GAD's 'old' projection shows that by 2051, 30.1 per cent of the population will be of state pensionable age and by 2046-51 life expectancy at age 65 for men and women will be a further 25.1 years and 26.9 years, respectively. In contrast, the 'Young' projection shows that only 21.2 per cent of the population will be of state pensionable age by 2051 and by 2046-51 life expectancy at age 65 for men and women will be 19.1 years and 21.9 years, respectively.[123] This illustrates the uncertainty of future improvements in life expectancy, and as a result the uncertainty of the proportion of adult life spent in retirement. Therefore the feasibility of raising State Pension age will depend on accurate assumptions and projections in life expectancy. The **Association of Consulting Actuaries'** response to the White Paper states:[124]

> On the issue of the dates when the State Pension age (SPA) should be adjusted upwards, we support the change to age 66 to be made in 2024/2025. However, we do not believe that the specific dates of 2034 and 2044 should be included in the legislation for the dates when the SPA should increase to 67 and then 68. This will make it difficult to respond flexibly to any future changes in life expectancy, which are far from predictable. We feel this is a matter that should be left to a standing Pensions Commission type body to make recommendations on from time to time, in addition to other ongoing pension reform needs.

A recent written parliamentary question asked the Secretary of State for Work and Pensions whether it was the Government's intention that the timetable for increasing the State Pension age will be amended if changes were made to projected increases in life expectancy.[125] The Department stated:

[123] Assuming no change in the State Pension age
[124] ACA (15 September 2006) http://www.aca.org.uk/Public_content/ACA_WhitePaper_final_response_140906.doc
[125] HC Deb 9 October 2006 c27w

> Our proposals for increasing State Pension age are based on the current available evidence which, as we have said in the White Paper, we plan to review periodically. Whether the timetable for increasing State Pension age remains appropriate will be a decision for the Government of the day when considering the evidence available at that time.

There is also concern that raising State Pension age to 68 by 2046 would reduce the number of survivors to the new State Pension ages. Evidence from the GAD suggests otherwise. Moreover, the Bill's Regulatory Impact Assessment states:[126]

> 2.91 In 1950, those who reached State Pension age constituted just 50 per cent of their generation, today this proportion has risen to three-quarters. By 2050, it is expected that those who reach the new State Pension age of 68 will constitute 90 per cent of their generation.

Percentage of people projected to survive to State Pension age following changes in State Pension age

	Males	Females
Born in 1941 (1946 for women) reaching SPA in 2006	76	89
Born in 1955 reaching SPA of 65 in 2020	82	88
Born in 1960 reaching SPA of 66 in 2026	82	88
Born in 1969 reaching SPA of 67 in 2036	83	89
Born in 1978 reaching SPA of 68 in 2046	84	89
Born in 1987 reaching SPA of 68 in 2055	86	91

Source: Figures for people born in 1941 are based on GAD England & Wales life tables
Subsequent figures based on GAD UK life tables
Note: SPA for women is current 60

The Pensions Commission states that the viability of raising the State Pension age also depends on whether longer life expectancy is associated with good health in old age.

The Office for National Statistics (ONS) produces two measures of health expectancy: healthy life expectancy (HLE), defined as expected years of life in good or fairly good health; and disability-free life expectancy (DFLE), defined as expected years of life free from limiting long-standing illness or disability. In the UK in 2002, on average males and females could expect to live in good or fairly good health (HLE) for a further 12 years and 14 years at age 65, respectively. Males and females were also expected to live a further 9.1 years and 10.3 years free from limiting long-standing illness or disability at age 65.

Between 1981 and 2002 in Great Britain, male life expectancy at age 65 increased by 3.1 years (from 13.0 years to 16.1 years). Over the same period, HLE increased by 2.1 years and years spent in poor health increased by one year; DFLE increased by 1.5 years and the number of years spent with a disability increased by 1.6 years. For men at age 65, the proportion of life spent in either good health or with a disability decreased by just under 2 per centage points between 1981 and 2002. The changes over the last two

[126] Department for Work and Pensions, Pensions Bill – Regulatory Impact Assessment, November 2006, http://www.dwp.gov.uk/pensionsreform/pdfs/RIAv6.pdf

decades for women at age 65 have been markedly different. The increase in life expectancy at age 65 for women in Great Britain was smaller (2.2 years) than men between 1981 and 2002. Over the same period, HLE increased by 2.2 years and DFLE increased by 1.8 years. Therefore most of the gains in life expectancy were gains in good health or without a disability. As a result the proportion of life spent in good health or without a disability increased between 1981 and 2002 by about 3.5 per centage points for women at age 65.[127] [128]

Life expectancy and health expectancies at age 65: by sex, 1981 and 2002
Great Britain

	Males			Females		
	1981	2002	Absolute change (2002-1981)	1981	2002	Absolute change (2002-1981)
Life expectancy	13.0	16.1	3.1	16.9	19.1	2.2
Healthy life expectancy (years)	9.9	12.0	2.1	11.9	14.1	2.2
ill-health (years)	3.1	4.1	1.0	5.0	5.0	0.0
% of life healthy	76.2	74.5	-1.6	70.4	73.8	3.4
Disability-free life expectancy (years)	7.6	9.1	1.5	8.5	10.3	1.8
limited (years)	5.4	7.0	1.6	8.4	8.8	0.4
% of life without disability	58.5	56.5	-1.9	50.3	53.9	3.6

Source: ONS, Health Statistics Quarterly 29 (Spring 2006) Health expectancies in the UK, 2002

The ONS does not compile projections of health expectancy. Over the last 20 years, the healthy life expectancy of men and women aged 65 has risen by more than two years but it is uncertain whether the rate of increase seen in the last two decades will persist in the future.

Another factor which may limit the feasibility and equity of increasing State Pension age is inequalities in life expectancy and health between social groups. This means that some groups will (on average) not receive the State Pension for as long as others.

Men and women from higher social classes have a greater life expectancy of further life at age 65 than those from less skilled manual groups. For example, in England and Wales in 1997-2001, men in social class I had a life expectancy at 65 five years higher than social class V (18.3 years compared to 13.3 years). Among women, those in social class I had a life expectancy at 65 3.7 years higher than those in social class V (20.6 years compared to 16.9 years). Inequalities in life expectancy at age 65 appear to have widened over time. However, all groups have experienced an increase in life expectancy at age 65.[129] [130]

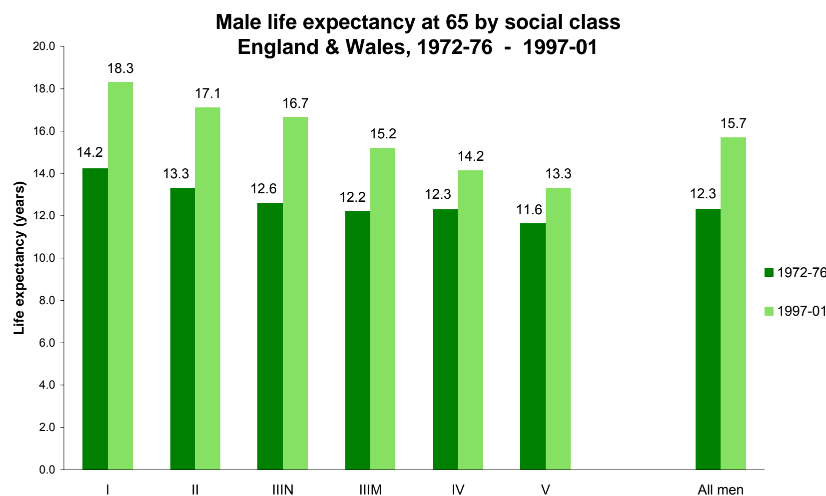
[127] ONS, Health Statistics Quarterly 29 (Spring 2006) Health expectancies in the UK, 2002 http://www.statistics.gov.uk/downloads/theme_health/HealthExpectancies2002.pdf

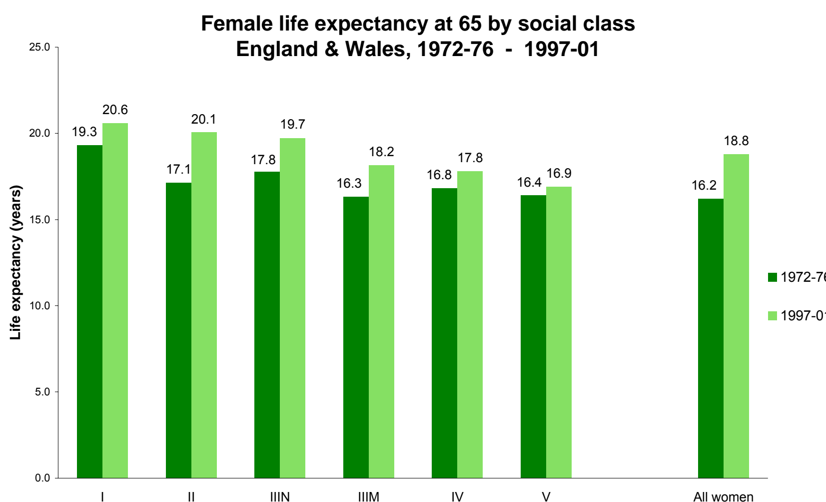
[128] The Pension Commission states that the ONS measures of health expectancy are based on self-reported measures of health, and data may be distorted because of rising expectations in health status. As people get healthier, it is likely that their measures of what constitutes health and sickness are changing, and as a result measures may underestimate health expectancy. Measures over time of precise physical and cognitive capabilities are required, but few are yet available. Those which are, however, all tend to suggest that ageing is on balance healthy.

[129] ONS, *Trends in ONS Longitudinal Study estimates of life expectancy by social class 1972-2001* http://www.statistics.gov.uk/STATBASE/Product.asp?vlnk=8460 retrieved 6 December 2006

Note that inequalities in life expectancy also persist geographically. Eight of the ten local authorities with the lowest male life expectancy are in Scotland. Glasgow City (69.9 years) is the only area in the UK where life expectancy at birth is less than 70 years. The local authority with the highest male life expectancy is Kensington and Chelsea (82.2 years), 12.3 years more than Glasgow City. Kensington and Chelsea also has the highest life expectancy for females (86.2 years), 9.5 years more than Glasgow City, the lowest at 76.7 years.[131]

Lower life expectancy tends to be associated with poorer health. The Pensions Commission notes that not only do lower socio-economic groups live for fewer years post-retirement, but a smaller per centage of these years is free of sickness or disability. Moreover, lower wealth groups are far more likely to leave the workforce early for health reasons. The Office for National Statistics does not compile projections of life expectancy by social class. A key issue therefore is how trends in life expectancy and health by socio-economic class develop in the future.





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[130] Social Class categories are I Professional, II Managerial and Technical/Intermediate, IIIN Skilled non-manual, IIIM Skilled manual, IV Partly skilled, V Unskilled

[131] ONS, 21 November 2006 News Release, *Life expectancy at age 65 continues to rise* http://www.statistics.gov.uk/pdfdir/liex1106.pdf

A number of organisations have expressed concern about raising State Pension age in the context of inequalities in longevity and health, including Age Concern, EEF and the National Pensioners Convention. In its response to the Bill, Age Concern states that the Government must ensure that the increase in State Pension age does not worsen the inequalities between rich and poor. The House of Commons Work and Pensions Committee said it feared that the "policy will have a disproportionate effect on those in lower socio-economic groups, manual workers and those with health difficulties.[132] The TUC, responding to proposals to increase the State Pension age in the White Paper states:[133]

> In evidence to the Pensions Commission the TUC showed that differences in life expectancy mean that an across-the-board increase in the Pension age would affect the poor the most. Moreover, an increase in State Pension age would have little impact on the retirement age of the better off, so it would be those on lower incomes who would be more likely to work longer to pay for better pensions.

The Pensions Commission had recommended that a permanent Pensions Advisory Commission be established to monitor trends in life expectancy and retirement ages. However, the Government has opted for ad hoc periodic reviews by independent experts instead. The White Paper states:

> 3.40 These reviews could, for example:
>
> - provide advice to the Government on whether the timetable for increasing State Pension age – as set out in legislation – remains appropriate;
> - gather evidence on future life expectancy and the consequences for public expenditure;
> - provide detailed analysis of disparities in life expectancy between different social classes and the relative effects on different social groups of increases to the State Pension age; and
> - monitor participation rates and levels of contributions to the personal savings scheme as well as the labour market for older workers (including average retirement ages).
>
> 3.41 While there is growing public acceptance of the evidence that life expectancy overall is increasing, there is nonetheless concern that the additional years will not necessarily be healthy years. To date, the evidence would suggest that increased life expectancy is also resulting in people staying healthier for longer. As the Pensions Commission has noted, this is an area where evidence is incomplete. Another task of these reviews could be to keep this evidence under review. [134]

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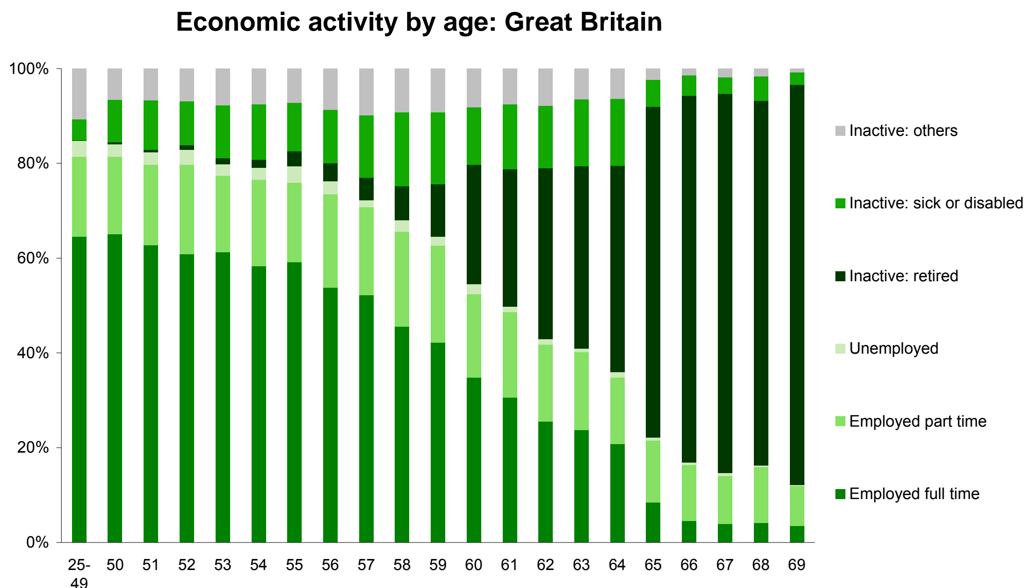
[132] House of Commons Work and Pensions Committee (July 2006) Pension reform, Fourth Report of Session 2005-06, HC 1068, vol. I para 366
http://www.publications.parliament.uk/pa/cm200506/cmselect/cmworpen/1068/1068i.pdf
http://www.publications.parliament.uk/pa/cm200506/cmselect/cmworpen/1068/1068ii.pdf

[133] TUC (September 2006) http://www.tuc.org.uk/pensions/tuc-12430-f0.pdf

[134] DWP *Security in retirement: towards a new pensions system*, (the Pensions White Paper), 25 May 2006, Cm 6841,
http://www.dwp.gov.uk/pensionsreform/pdfs/white_paper_complete.pdf

The average age of retirement has fallen over the last 50 years (although it has increased in recent years); the current average age of retirement for men is 64.2 and 61.8 for women[135] (compared to 67 and 64 in 1950). Encouraging people to work longer will be important in supporting the increase in State Pension age, and the Government will have to introduce policies to help extend working life. The economic activity rate of people aged 50 to the current State Pension age is lower than the overall working population (75 per cent), and considerably lower than for the 25-49 age group (over 80 per cent). Of those aged in their late 50s more are economically inactive due to ill-health than are out of work due to retirement or unemployment. Between the ages of 60 and 65, a large proportion of people retire. However, there is still a sizeable proportion who continue to work beyond State Pension age, the majority working part-time. Supporting this group and encouraging others to work longer will key to sustaining work up to State Pension age and beyond.

Economic activity by age: Great Britain



Source: Labour Force Survey, July – September 2006, Great Britain

However, the *Pensions 2002: Public attitudes to pensions and saving for retirement* survey suggests that younger people expect to retire earlier than their parents. The survey shows that 66 per cent of men expect to retire before 65 and women have not adjusted retirement age expectations in the light of the forthcoming equalisation of the SPA. This may in part reflect the fact that many people do not realise by how much life expectancy has increased.[136] A more recent survey on public attitudes to pension reform suggests that 57 per cent of respondents disagree with raising the State Pension age. More people are in favour of raising State Pension age when a specific timetable is mentioned, and a majority (67 per cent) opted to raise State Pension age to 67 in 2040,

135 ONS, 5 December 2006 News Release, Membership of defined benefit pension schemes continues to fall. http://www.statistics.gov.uk/pdfdir/pentr1206.pdf

136 DWP, Pensions 2002: Public attitudes to pensions and saving for retirement http://www.dwp.gov.uk/asd/asd5/rrep193.asp

with pension keeping up with earnings, rather than keeping State Pension age at 65, with the pension falling behind earnings.[137]

Age Concern's response to the Bill states:[138]

> If State Pension age must rise to fund a better state pension, there has to be a significant transformation in the workplace to enable older people to continue to work if they want or need to. Mandatory retirement ages must be scrapped and targeted programmes must put in place to support those who need training and those who cannot work.

G. Costs and savings

A Regulatory Impact Assessment accompanying the Bill outlines the DWP's view of the effects of reforms on pensioner benefit spending to 2050. These compare the cost of continuing current policies, with and without an earnings-linked standard minimum guarantee (Pension Credit).

On current policies, spending on Pensioner Benefits was set to go from £88 billion in 2010 to £165 billion by 2050[139] (a rise of 88%). With the reforms in the Bill spending on pensioner benefits would be £90 billion in 2010 and £246 billion by 2050. This is an additional £81 billion at today's prices. The DWP puts the additional cost by 2050 as equivalent to 2.2 per centage points of GDP, over what it would have been (5.1%) had current policies continued.

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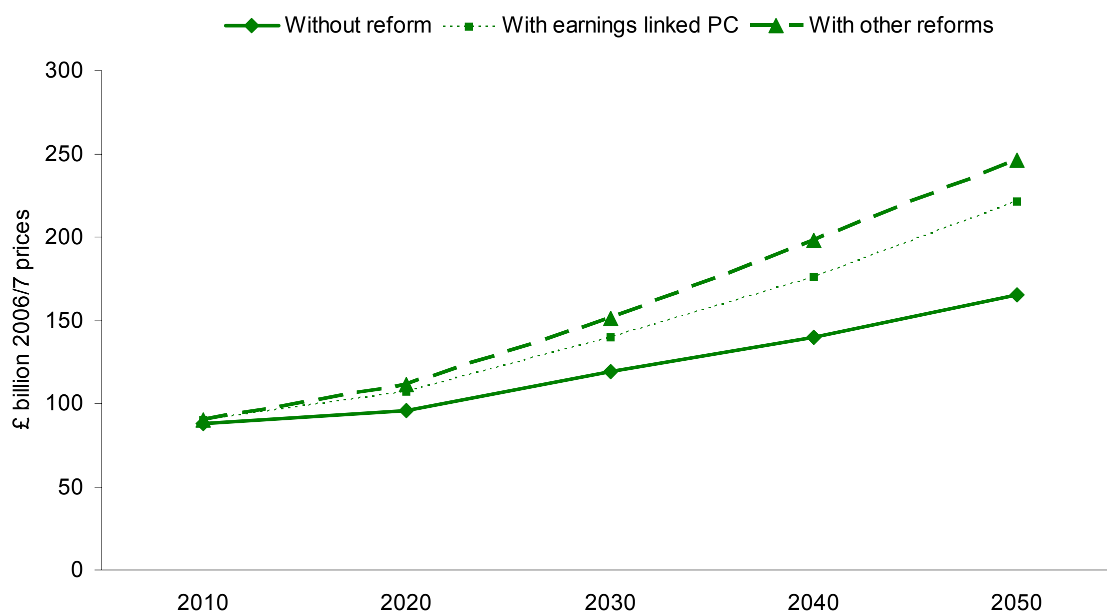
[137] DWP, 30 June 2006 Press Release, Pensions and public attitudes to pension reform http://www.dwp.gov.uk/mediacentre/pressreleases/2006/jun/pens-300606.asp

[138] Age Concern (29 November 2006) http://www.ageconcern.org.uk/AgeConcern/DB60441F1D43495A8D7ADC11DE38F5A0.asp retrieved on 11 December 2006

[139] 2006/7 prices .Source: DWP Regulatory Impact Assessment http://www.dwp.gov.uk/pensionsreform/pdfs/RIAv6.pdf)



Most of the estimated £81 billion (2006/07 prices) additional cost by 2050 arises through additional spending on the Basic State Pension (around 70%). It is however worth noting that the DWP puts spending on Pension Credit in 2050 after reforms at £4.5 billion (2006/07 prices), compared with £41.6 billion had there been no reforms and if the standard minimum guaranteed Pension Credit had been earnings-indexed.

The following reproduces DWP costings in 06/7 prices and as a percentage of GDP from the Regulatory Impact Assessment. Details of the methodology and assumptions involved in these estimates can be found in Annex A to the RIA.[140]

[140] http://www.dwp.gov.uk/pensionsreform/pdfs/RIAv6.pdf#page=84

Figure 1.2 : Total expenditure on pensioner benefits, 2006/7 prices, £ billions

	2010	2020	2030	2040	2050
[a] without reform:					
Basic State Pension	50.5	57.8	71.4	80.4	85
SERPS / S2P	12.1	17.4	25.6	36.2	55.5
Pension Credit	6.5	4	2.4	1.2	0.6
Other Pension Benefits	2.7	2.3	2.6	2.8	3.1
Total pensions spendindig	**72**	**82**	**102**	**121**	**144**
Housing and Council Tax Benefits	7.8	4.6	3.9	3.7	4.3
Attendance Allowance & Disability Living allowance	8.8	10.3	13	15.3	16.8
Total Pensioners Benefits	**8.8**	**96**	**119**	**140**	**165**
[b] with an earning-index standard minimum guarantee:					
Pension Credit	8.5	11.3	18.2	29	41.6
Total pensions spendindig	**74**	**89**	**118**	**148**	**185**
Housing and Council Tax Benefits	7.8	7.5	9.5	12.6	18.8
Total Pensioners Benefits	**90**	**107**	**140**	**176**	**221**
[c] with other reforms:					
Basic State Pension	50.6	66.9	95.9	128.6	154.7
SERPS / S2P	12.1	17.5	25.8	37.9	55.4
Pension Credit	8	7	6.2	5.3	4.5
Other Pension Benefits	2.7	2.3	2.5	2.8	3
Total pensions spendindig	**73**	**94**	**130**	**175**	**218**
Housing and Council Tax Benefits	7.8	7	7.6	8.7	12.1
Attendance Allowance & Disability Living Allowance	8.8	10.3	12.7	14.8	15.9
Total Pensioners Benefits	**90**	**111**	**151**	**198**	**246**

Figure 1.3 : Total expenditure on pensioner benefit, per cent of GDP

	2010	2020	2030	2040	2050
[a] without reform:					
Basic State Pension	3.5	3.2	3.2	3	2.6
SERPS / S2P	0.8	1	1.2	1.4	1.7
Pension Credit	0.4	0.2	0.1	0	0
Other Pension Benefits	0.2	0.1	0.1	0.1	0.1
Total pensions spendindig	**4.9**	**4.5**	**4.6**	**4.5**	**4.4**
Housing and Council Tax Benefits	0.5	0.3	0.2	0.1	0.1
Attendance Allowance & Disability Living allowance	0.6	0.6	0.6	0.6	0.5
Total Pensioners Benefits	**6.1**	**5.3**	**5.4**	**5.2**	**5.1**
[b] with an earning-index standard minimum guarantee:					
Pension Credit	0.6	0.6	0.8	1.1	1.3
Total pensions spendindig	**5.1**	**4.9**	**5.4**	**5.6**	**5.7**
Housing and Council Tax Benefits	0.5	0.4	0.4	0.5	0.6
Total Pensioners Benefits	**6.2**	**5.9**	**6.4**	**6.6**	**6.8**
[c] with other reforms:					
Basic State Pension	3.5	3.7	4.3	4.7	4.6
SERPS / S2P	0.8	1	1.2	1.4	1.7
Pension Credit	0.5	0.4	0.3	0.2	0.1
Other Pension Benefits	0.2	0.1	0.1	0.1	0.1
Total pensions spendindig	5	5.2	5.9	6.4	6.5
Housing and Council Tax Benefits	0.5	0.4	0.3	0.3	0.4
Attendance Allowance & Disability Living allowance	0.6	0.6	0.6	0.5	0.5
Total Pensioners Benefits	6.2	6.1	6.8	7.3	7.3

Notes: Figures refer to financial years, eg 2020 refers to 2020/21. Pension spending includes benefits specifically targeted at pensioners. Pensioner benefits include all benefits to which pensioners are entitled.

Such long-term forecasts are necessarily dependent on the assumptions made. The **Pensions Policy Institute** has urged the Government to publish a wider range of outcomes, based on different assumptions. This is particularly important given the critical nature of the assumptions about the number of pensioners on Pension Credit. The PPI has suggested that the Government's figures are based on an assumption that in this respect is at the lower end of any range.[141] James Purnell, Minister for Pensions, stated that the differences between the DWP and PPI stem from differences in the way each models outcomes from the State Second Pension and about the growth of private pensions.[142] The DWP has subsequently published a paper describing its projections for Pension Credit, with an assessment of their sensitivity to changes in key assumptions.[143]

III Occupational and Personal Pensions

A. Contracting out

1. Background

The UK is unusual in having a state pension system which allows employers and employees to opt out of the earnings-related second tier provision if alternative private provision, meeting specified requirements, is made. This process is known as contracting out. Section II D above describes the state second tier provision which contracted out private provision replaces and the rebates contracted out employers and employees receive to their National Insurance Contributions in return for giving up this state provision.

a. Graduated Retirement Scheme

Contracting out was introduced in April 1961 with the graduated pension scheme which yielded Graduated Retirement Benefits (GRB). Employers were able to contract out of this scheme, and pay lower National Insurance Contributions (NICs) if they provided Equivalent Pension Benefits (EPBs). The scheme was wound up in 1975, and most contracted-out employers bought prospective pensioners back into the state scheme, thereby removing any need to preserve EPBs. There was no provision for revaluing accrued rights over time, or for inflation-proofing benefits in payment.[144] As a result any remaining EPBs are extremely small and, since April 2002, it has been possible for schemes to commute these when they are the member's only rights under the scheme

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[141] PPI *An evaluation of the White Paper state pension reform proposals* 20 July 2006 http://www.pensionspolicyinstitute.org.uk/uploadeddocuments/Nuffield/PPI_Press_Release_White_Paper_Evaluation_20July06.pdf

[142] DWP Press Notice 7 Nov 2006 James Purnell *Is there a consensus for Pension Reform?*

[143] DWP *Projections of Pension Credit entitlement* http://www.dwp.gov.uk/pensionsreform/forum/docs/fs-pc-projection.pdf

[144] Although the State did start to inflation proof GRB in payment after 1978

and pay them to members as a lump sum before normal Pension age. Since April 2006 it has been possible to do this without first obtaining the member's consent.[145]

b. Pensions Act 1975: Contracting out into defined benefit schemes which provide Guaranteed Minimum Pensions (GMPs)

A much more significant form of contracting out was introduced from April 1978 under the *Pensions Act 1975* which introduced the State Earnings Related Pension (SERPS). Originally, employers were able to contract out of SERPS only if they provided defined benefit (DB) schemes and a Guaranteed Minimum Pension (GMP) which at least equalled the SERPS they would have earned had they not been contracted-out. Contracted out employers and employees paid lower NICs as they would be receiving a lower state pension. The amount of this reduction – the "contracted out rebate" – is set by the Government on the advice of the Government Actuary's Department and is designed to reflect the cost of providing the benefits foregone.

A Department of Health and Social Security (DHSS) leaflet, *New Pensions: a more secure future*, (NP34), issued in January 1978, shortly before the new scheme came into force, explained how it would work:

> The new state pension will operate in partnership with good occupational schemes … if your employer operates such a scheme he can apply to contract you out … of the state scheme's additional pension and you would then pay lower contributions to the state scheme … Your basic pension would then be provided by the state scheme and your additional pension by your employer's occupational scheme, with inflation-proofing after the pension is in payment provided by the state (…)
>
> **Guaranteed minimum pensions**
>
> A contracted-out occupational pension scheme must provide you with at least a guaranteed minimum pension, to match the additional pension you would have earned from the state scheme … Your occupational pension may, of course, be much higher than the guaranteed minimum pension, particularly if you are already a member of a scheme.

People who remained contracted in to the state scheme would receive a two-part state pension made up of the flat rate "basic" pension and the earnings related "additional" pension. Those who were contracted out were told what their additional pension would have been had they remained in the state scheme but a "contracted out deduction", equal to the GMP they should receive from their occupational scheme, was made before payment.

[145] The *Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2006*, SI 2006/778

c. *Social Security Act 1986: contracting out into defined contribution schemes which provide protected rights*

The *Social Security Act 1986* introduced many changes to SERPS and contracting out from April 1988. The SERPS changes (designed to reduce its emerging costs by reducing the rate of accrual and increasing the period over which it accrued from 1999-2000) were reflected (though not precisely replicated) in the GMP calculation. At the same time, contracting out into defined contribution (DC) occupational schemes and appropriate personal pensions (APPs) was permitted, and, indeed, encouraged. In these cases, a "minimum payment" ("minimum contribution" in the case of APPs) equal to the contracted-out rebate had to be made to the scheme.[146] The benefits secured by these minimum payments were called "protected rights" and had to meet certain conditions. There was no guarantee that they would produce a pension equal to the SERPS foregone, but nevertheless, a "notional" GMP was calculated by the DHSS for purposes of the contracted-out deduction from the state pension eventually payable.

A Department of Health and Social Security (DHSS) booklet, *New pensions choices: information for employees*, published in January 1988, summarised the protected rights which the minimum contributions had to provide:

> When you reach State Pension age, the full value of your protected rights built up in your Personal Pension will be used to provide a regular agreed amount in return for your savings, and paid until you die. This pension will be bought from an insurance company or friendly society. You will be able to delay arranging a pension up to age 75. (…)
>
> Your pension will be protected against inflation in the following ways:
>
> The part bought with your protected rights in place of SERPS must be increased each year by the rate of price increases, or by 3 per cent if prices rise at a higher rate.
>
> If prices do go up by more than 3 per cent a year, the DHSS will add extra to your State Retirement Pension (…)
>
> Personal Pension schemes chosen in place of SERPS will also have to provide financial benefits that protect your dependents.
>
> If you die after retirement, your widow or widower may receive half the pension bought for you with your protected rights.
>
> This will be paid if she or he has dependent children. Or is 45 or over. [147]

[146] These minima also included the special 2% incentive payments designed to encourage people to contract out into money purchase schemes which applied until 1993

[147] NP 41, from January 1988, p25. The same rules applied to the use of minimum payments to COMPS – see DHSS booklet NP 42 from January 1988, *New pensions choice: information for employers*, pp 9-10, 12

d. *Pensions Act 1995: Reference Scheme Test replaces GMPs*

The *Pensions Act 1995* broke the link between SERPS and contracted-out pension schemes with effect from April 1997. Contracted-out salary-related schemes (COSRS) do not have to provide GMPs in respect of benefits accrued after 1997, but they still have to provide them in respect of benefits accrued between 1978 and 1997. To contract out, COSRS must now provide benefits which are broadly equivalent to or better than a statutorily defined the Reference Scheme Test (RST).[148] The main features of the RST are that the DB scheme:

- provides for pensions to be paid at a normal Pension age of 65 and to continue for life
- has an accrual rate of 1/80th of average qualifying years in the last three tax years preceding the end of service for each year of pensionable service up to a maximum of 40 years
- defines qualifying earnings as 90 per cent of the employee's earnings between the Lower Earnings Limit and Upper Earnings Limits [for NICs]
- provides for widow(er)s' pensions if the member dies after age 65 at the rate of one half of the pension in payment
- provides widow(er)s' pensions if the member dies before age 65 at the rate of one half the pension rights already accrued by the member based on actual pensionable service.[149]

e. *Pickering Report, July 2002, proposes simplification of contracting out rules*

The pensions industry has long complained that the rules their schemes must comply with to satisfy the contracting out requirements are unnecessarily complex and a particular disincentive to the provision of DB schemes. The Pickering Report, *A simpler way to better pensions*, published in July 2002, made the case for a major simplification of the contracting out rules:

> Contracting out is by definition complicating. Some who have contributed to our review have suggested that contracting out may not be appropriate in the future especially if the State Second Pension becomes flat rate.
>
> 2.4 If the Government is committed to a public/private partnership based on contracting out, urgent simplification of the system is essential. This is particularly so as there is increased awareness of the risk associated with providing benefits in the private sector that would otherwise be provided by the State. The current contracted-out rebates do not include a risk margin – that is to say they have been calculated by the Government Actuary to replicate as closely as possible the value of benefits foregone in the state scheme, with no additional incentive to contract out.

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148 Section 12B *Pensions Schemes Act 1993*
149 Incomes Data Service (IDS), *Pensions in Practice 2003/04*, para 2.21

> 2.5 In this context, unnecessary administrative complexity and cost becomes all the more important, and may lead, by default, to the ending of contracting out in practice if not in theory. Indeed, the existing rules on contracting out make this element of pensions among the most complex to administer. We do not intend to spell out in detail all the complexities involved in contracting out. However, symptomatic is the need for employers and commercial providers to undertake double record keeping because of the different rules pertaining to pension derived from contracted-out National Insurance Contribution rebates, compared with pension derived from other sources.
>
> 2.6 If contracting out were to be abolished, that would not herald the end of the public/private partnership – that can flourish even in a world without contracting out. However, contracting out is one way of nourishing this partnership, and we set out in Appendix 1 a package of measures which we believe can help to simplify contracting out.[150]

f. Pensions Green Paper, December 2002, proposes simplifications

The Pensions Green Paper, *Simplicity, security and choice: working and saving for retirement*, published in December 2002, confirmed the Government's belief that "contracting out should remain" but accepted that "the arrangements for doing so should be simplified".[151] The Green Paper, and the accompanying Technical Paper,[152] contained a number of proposals for discussion, including:

- Survivors' benefits – the Pickering Report proposed that the requirement on contracted-out schemes to provide survivors' benefits should be removed. The Green Paper said the Government "would not introduce these changes unless [it] had good reason to believe that the coverage of and contributions to occupational pensions would be higher than would otherwise be the case".

- Reference scheme test – reducing the minimum accrual rate in the RST from 1/80ths to 1/100ths. (This was the "central proposal" of the Pickering Report.). Allowing schemes to contract out on the basis of career average, as opposed to final salary, earnings. Requiring all earnings to be included in pensionable salary.

- GMPs – permitting schemes to convert GMPs to simpler RST benefits of equivalent value

- Removing restrictions on the age at which benefits can be taken – Inland Revenue rules currently allow benefits from private pension schemes to be taken at any age from 50 (although the pension tax simplification provisions of the

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[150] *A simpler way to better pensions. An independent report by Alan Pickering.* The report was commissioned by Alistair Darling when he was Secretary of State for work and Pensions in September 2001.

[151] Department for Work and Pensions, *Simplicity, security and choice: working and saving for retirement,* Cm 5677, December 2002, para 4.39

[152] Department for Work and Pensions, *Simplicity, security and choice: technical paper*, December 2002

Finance Act 2004 require this to increase to 55 by April 2010). Contracted-out benefits, however, could not be taken until State Pension age (age 60 in DC arrangements)

- Removing restrictions on taking benefits as lump sums – Inland Revenue rules allow part of the pension to be taken as a lump sum: with a very limited exception on grounds of triviality, no part of the contracted-out rights could be taken as a lump sum.

- Trivial commutation – where total scheme benefits do not exceed £260 a year, contracted-out schemes could commute them into a lump sum. The Green Paper proposed raising this to £520 a year.

- Contracted-out mixed benefit schemes (COMBS) – abolishing the right of COMBS (which combine DC and DB schemes) to contract out

- Safeguarded rights – where a pension sharing order has been made on divorce, any element of the share derived from contracted-out rights is "safeguarded" and subject to certain requirements. The Green Paper took up Alan Pickering's proposal that these extra conditions should be removed

- EPBs – removing the requirement to obtain a member's consent before commuting EPBs

It also suggested making changes to section 67 of the *Pensions Act 1995* which prevents changes from being made to the rules of a scheme which would reduce a member's accrued rights without the member's consent (This applies to all occupational schemes, not just those that are contracted-out).

g. Pensions White Paper, June 2003, proposes simplifications

The 2003 Pension White Paper, *Action on occupational pensions,* announced that the Government would "introduce a package of measures to simplify the operation of contracting out" which would:

> ● relax some restrictions on contracted-out rights forming part of the tax-free lump sum permitted under Inland Revenue rules;
> ● relax some restrictions preventing contracted-out rights being paid at the same time as other benefits;
> ● increase the level at which small pensions derived from contracted-out rights can be commuted;
> ● remove the requirement to obtain member consent for the commutation of pension into a lump sum when their entitlement consists solely of Equivalent Pension Benefits arising from the graduated pension scheme which ceased to accrue in 1975; and
> ● extend commutation on grounds of serious ill-health to contracted-out rights in Appropriate Personal Pensions. This did not form part of our Green Paper

> proposals, but we have listened to the comments received during the consultation exercise and will now move forward with this proposal.[153]

It also announced that it would:

> amend the restriction in Section 67 of the Pensions Act 1995 which heavily restricts schemes' ability to change any member's accrued rights without the member's consent. Schemes will be able to make such rule changes if:
>
> ● there is a power in the scheme rules to make the change;
> ● the change does not involve converting defined benefit rights into defined contribution rights;
> ● the trustees approve the change;
> ● the total actuarial value of members' accrued rights at the point of any change is maintained;
> ● pensions already in payment are not reduced; and
> ● members are consulted before a change is made.[154]

The Government wished "to simplify the administration of GMPs which ceased to accrue in 1997, and the anti-franking legislation that protects benefits over and above the GMP from being eroded" and was "continuing to explore options in this area".

On 20 October 2003, Andrew Smith, then Secretary of State for Work and Pensions, announced that the Government would be introducing measures that would permit schemes to convert GMPs into scheme benefits on the basis of actuarial equivalence. He estimated that this and the other simplification measures already announced would save pension schemes up to £16 million a year:

> We intend to introduce measures that will permit contracted-out defined benefit schemes to convert GMPs into scheme benefits. Where a scheme converts its liabilities in this way, it will no longer be required to offer a scale of benefits incorporating the complex GMP rules for the period 1978 to 1997 and will be free to design a benefit structure that best reflects the needs of its members. If schemes take up this option they will have to convert on the basis of actuarial equivalence: the trustees will be required to offer scheme benefits of equal accrued value in exchange for the benefits given up, including the GMP.
>
> As a result of this and other measures announced previously, pension schemes will be able to achieve significant simplification in their administration. On top of the other proposals for simplifying contracting out in "Action on Occupational Pensions", we estimate that these measures should result in administrative savings for pension schemes of up to £16 million a year.
>
> Because of the process of actuarial conversion, any resulting changes will not affect the value of individual accrued rights. Members' interests will also be protected by other measures already outlined in our Green Paper "Working and Saving for Retirement" and "Action on Occupational Pensions".

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[153] DWP, *Simplicity, security and choice: working and saving for retirement: action on occupational pensions,* Cm 5835, June 2003, para 3.25
[154] *Ibid*, para 3.17

> For example, the new Pensions Regulator will be able to issue a code of practice aimed at protecting the interests of members of schemes wishing to take advantage of the GMP conversion measure. Also, the Pensions Advisory Service and the Pensions Ombudsman will be able to consider any complaints that members have as a result of any change.
>
> Nothing in these proposals forces schemes to change and we appreciate that many of them may not wish to do so. We are simply offering schemes the option to design their benefits more flexibly across the piece in this way, while protecting the value of members' accrued rights. This means we are striking the right balance between making it easier (and more cost effective) for employers to run schemes and safeguarding members' rights.[155]

h. Pensions Act 2004 implements some simplifications

In the event, the *Pensions Bill 2003/04*, as published on 12 February 2004, did not contain provisions permitting schemes to convert GMPs into scheme benefits on the basis of actuarial equivalence. Nor did it remove the requirement to obtain member consent for the commutation of Equivalent Pension Benefits, although this was later achieved by regulations.[156] Moreover, it did not amend section 67 of the 1995 Act to allow retrospective modifications to scheme rules. However, the Government introduced a New Clause during the Commons Standing Committee stage which replaced section 67 of the *Pensions Act 1995* with a new section 67 which allows pension schemes to modify members' accrued rights, provided they do so on the basis of actuarial equivalence.[157]

The Bill did pave the way for removing age and commutation limits which are more restrictive than those imposed by the Inland Revenue by regulations.[158] As a result, protected rights in DC schemes may now be taken at age 50 (rising to 55 in April 2010) and up to 25% of protected rights can be taken as a tax free lump sum.

Another Government amendment, made in Grand Committee in the Lords, removed altogether the indexation requirements imposed on DC schemes.[159] Protected rights no longer have to be used to purchase index linked annuities.

i. Pensions Commission Report, November 2005, proposes abolition of contracting out

The Pensions Commission, in its Second Report, A New Pensions Settlement for the Twenty-First Century, recommended the removal of contracting out for DC schemes. For DB schemes it recommended the continuation of the contracting out option for the foreseeable future but proposed that it should be abolished by at the latest around 2030:

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155 HC Deb 20 October 2003, c 26WS

156 The *Occupational and Personal Pension Schemes (Miscellaneous Amendments) Regulations 2006,* SI 2006/778

157 SC Deb (B), 27 April 2004, 21st sitting

158 in what became section 284 of the *Pensions Act 2004.* Changes were made predominantly by the *Taxation of Pension Schemes (Consequential Amendments of Occupational and Personal Pension Schemes Legislation) Order 2006*, SI 2006/744

159 HL Deb 13 October 2004, cc GC 90-91

(ii) Contracting-out rebate

Our preferred option for reform of the state system has implications for the contracted-out rebate. Since we recommend building on the existing two-tier BSP and S2P system, rebates will continue to be paid to employers and employees contracted-out of the S2P. But since we recommend freezing the Upper Earnings Limit for S2P accruals the importance of these rebates will decline over time. We believe this gradual disappearance of the contractedout/ contracted-in system is the most appropriate policy since:

- The contracted-out/contracting-in choice has added complexity to the UK pension system and is poorly understood. Its application to personal pensions helped generate the pension mis-selling problems of the 1990s. And it requires the government to set a “fair” level of rebate: this is likely to turn out in retrospect to be either too high, in which case government has spent money unnecessarily, or too low, in which case people would have been better to stay contracted-in. It is not a feature of the pension system which we would recommend now if it did not already exist.

- But we believe that its immediate abolition would accelerate still further the decline of employer DB pension provision.

- And the Pensions Commission does not believe it prudent to argue that abolition of contracted-out rebates can provide resources to offset the costs of an immediate increase in state pension generosity. Such a policy would reduce national savings by reducing the pre-funding of pensions at precisely the time when demographic change makes some increase in the national savings rate desirable.

We therefore recommend phase-out and simplification of the contracting-out rules rather than immediate abolition.

- For Defined Contribution (DC) occupational schemes (where contracting in already dominates) and for personal pension schemes (where many industry experts are already advising customers to contract-in), we recommend that the contracting-out option be removed, with all people not in DB schemes becoming members of the S2P.

- For DB schemes, we recommend the continuation of the contracting-out option for the foreseeable future. But we propose that this option be abolished by at the latest about 2030, the date around which, under our proposals, accruals to the S2P become entirely flat-rate.

Additional government cash flow generated from these changes should be used to increase government’s contribution to national saving: this requires either the pay down of debt, the diversion of the money into a national “buffer fund”, or its use to promote individual funded savings (e.g. by measures to ensure the success of the NPSS).[160]

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[160] Pensions Commission, A New Pension Settlement for the Twenty-First Century: The Second Report of the Pensions Commission, 30 November 2005, pp 26-7

j. Pensions White Paper, May 2006, proposes abolition of contracting out for DC schemes and option to convert GMPs for DB schemes

The White Paper agreed that contracting out should be abolished for DC schemes, but postponed any decision on the ultimate abolition of contracting out for DB schemes:

> 2.9 An increasing proportion of private pension schemes now operate on a DC basis. Under the current DC arrangements, with an actuarially neutral rebate, it has become increasingly difficult to judge (particularly for personal pensions) whether or not an individual would be better off in the State Second Pension scheme or contracted out. There is an inevitable tension in substituting DC for DB provision because it is not comparing like with like. Contracting out on a DC basis involves investment in equities and bonds and, as with all investments, there is no guaranteed outcome.
>
> 2.10 Current trends would suggest that an increasing number of people with DC pensions are contracting back into the State Second Pension. There is also evidence that a growing number of providers have contracted policy holders back into the state scheme, unless the policy holder opts not to do so. Between 2001/02 and 2003/04 around 700,000 people in DC schemes contracted back into the State Second Pension.
>
> 2.11 The evidence that complexity is a key factor in putting people off any sort of long-term savings decisions is compelling. (…)
>
> 2.18 …. We now propose to abolish contracting out into DC schemes, both occupational and personal/stakeholder. (…)
>
> 2.23 The Pensions Commission concluded that, for DB schemes, rather than abolishing contracting out, it should be phased out by 2030 when the State Second Pension becomes flat rate, making the flat-rate element of the State Second Pension 100 per cent contracted in. However, we do not intend, at this stage, to bring forward additional proposals to abolish DB contracting out in the longer term. Instead, the long-term future of contracting out for DB schemes will be subject to ongoing review as part of the evaluation of the overall reform package.[161]

The White Paper stated that contracted out rebates for DC schemes would end at the same time as the earnings link was restored for the Basic State Pension – i.e. 2012 (or by 2015 at the latest).[162]

It also announced that the Government intended to allow contracted out defined benefit schemes to convert Guaranteed Minimum Pensions to scheme benefits. This change was expected in the *Pensions Bill 2003-04* but did not appear then.

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http://www.pensionscommission.org.uk/publications/2005/annrep/main-report.pdf

[161] Department for Work and Pensions, Security in retirement: towards a new pensions system, (the Pensions White Paper), 25 May 2006, Cm 6841, Chapter 2
http://www.dwp.gov.uk/pensionsreform/pdfs/white_paper_complete.pdf

[162] Ibid, para 2.21

In response to the Work and Pensions Committee's report, the Government said it was "committed to reviewing the long-term future of Defined Benefit contracting out. It plans to do this around five years after the implementation of the reform package.[163]

k. Consultation paper on treatment of protected rights, September 2006

In September 2006, the DWP published a consultation document, *Abolition of defined contribution (DC) contracting out: treatment of protected rights accrued in the past and proposed operational arrangements*.[164] This sought views on:

- The treatment of protected rights accrued before the abolition of DC contracting out; and
- The operational arrangements to be put in place to cater for the abolition of DC contracting out.

The consultation document set out the remaining conditions attached to protected rights:

> 6. In contracted-out DC schemes, the amount of an individual's pension fund derived from the rebate, its investment return and any tax relief on the rebate are known as protected rights. Certain conditions are attached to protected rights. The main ones are:
>
> - investment of the rebate and protected rights is restricted to certain types of pension schemes;
> - an annuity securing protected rights must be provided on a unisex basis;
> - an annuity securing the protected rights of a scheme member who is married or in a civil partnership at the point of annuity purchase, must make provision for a survivor benefit;
> - protected rights may only be transferred to schemes that meet certain conditions; and
> - the protected rights fund must be paid to the member's surviving spouse or civil partner where the member died before giving effect to his or her protected rights.

It went on to show how protected rights caused problems for contracted-out schemes where members' funds were derived from more than just the contracted out rebates:

> 7. These restrictions, which only apply to protected rights, have been a source of complexity for schemes and members. Protected rights have to be tracked

[163] Department for Work and Pensions, Report on Pension Reform: Government response to the Fourth Report of the Work and Pensions Select Committee, Session 2005-06 [HC 1068-1], Cm 6956, 30 October 2006, para 36
http://www.dwp.gov.uk/pensionsreform/pdfs/pens-wp-select-cttee-response.pdf

[164] http://www.dwp.gov.uk/publications/dwp/2006/DC%20consultation%20document.pdf (retrieved 15 November 2006)

> separately from non-protected rights and are treated differently from non-protected rights at the point of annuitisation. A scheme can hold both protected rights and non-protected rights. These separate requirements result in additional administrative costs for schemes and members, more complex arrangements and less choice for the member.

The Government therefore proposed to remove the remaining conditions associated with protected rights which have already accrued. There was a problem, though, in relation to the requirement to provide a survivor's pension. A contracted out deduction would still be made from a survivor's state pension even if no survivor's pension was paid by the DC scheme:

> 11. The Government is therefore proposing to remove the remaining conditions that apply to protected rights so that all scheme members' entire money purchase pension funds can always be treated in the same way e.g. rules applying to purchase of annuities, transfers, payment after death of member etc. This approach presents a number of advantages for schemes and members because it would:
>
> - reduce the administrative burden for schemes as it would no longer be necessary for the protected rights to be tracked separately from the non-protected rights;
> - in some circumstances, reduce the costs borne by scheme members, for example, in some "with profits" arrangements;
> - maintain the value of the members' pension funds;
> - allow members a greater say in how their fund is invested;
> - potentially make the open market option more straightforward to exercise because members would have just one pot of money that could all be treated in the same way and subject to the same rules;
> - simplify the annuity purchase process for members, improve members' understanding and reduce members' costs;
> - allow members and their spouse or civil partner to make a decision about the provision of survivor benefits that is best suited to their circumstances - for example, members could opt for a higher starting pension rather than providing for a survivor benefit.
>
> 12. A particular question arises, however, in relation to the current requirement to provide a survivor benefit out of protected rights. This requirement reflects the fact that, under rules on State Additional Pension, a legal spouse or civil partner is entitled to a survivor benefit based on the deceased member's State pension rights.
>
> 13. Where persons were contracted-out pre-1997, they are still treated as having an entitlement to the State Additional Pension. A contracted out deduction (COD) is made from the State Additional Pension entitlement, to avoid double provision. When the scheme member dies, his or her surviving spouse or civil partner is entitled to some or all of the deceased member's State Additional Pension rights

> and, where the member was contracted-out pre-1997, a COD is also applied to the survivor benefit.
>
> 14. If the survivor benefit requirement were to be removed, the scheme member would be able to buy a single-life annuity (one that does not make provision for a survivor benefit) from his or her protected rights fund. The consequence of this is that the member would receive a higher starting pension but, after death his or her surviving spouse or civil partner would receive no inherited benefit from the protected rights pension and any inherited State Additional Pension would still be reduced by the COD. The COD would still be deducted regardless of whether or not a survivor's pension is paid by the scheme which paid a pension to the member (before his death) in respect of his or her protected rights. The interaction between contracting out and the State scheme is described in more detail in Annex A.
>
> 15. The value of the member's pension pot would, however, remain unchanged (it could even increase if the simplification led to lower scheme administration charges) and nothing would prevent the scheme member from opting to make provision for a survivor benefit. Also, a higher starting pension might be more appropriate to the couple's situation, for example where both of them had their own pension provision or where the spouse or civil partner was suffering from a life threatening illness. If the member dies before giving effect to his or her protected rights (i.e. by buying an annuity) then the protected rights fund would not have to be paid to his surviving spouse or civil partner.
>
> 16. The Government is seeking your views on its proposal to abolish the conditions that currently apply to protected rights, and in particular the requirement to make provision for a survivor benefit if the member is married or in a civil partnership at the point of securing the protected rights.[165]

The Government's *Summary of responses* to the White Paper consultation (Oct 2006), said that it would publish a summary of responses to this consultation on protected rights "later in the year" and that this would "outline in further detail the approach we plan to take on abolishing contracting out for defined contribution schemes".[166]

I. Numbers and costs

The *Regulatory Impact Assessment* on the May 2006 Pensions White Paper contained a table summarising the numbers contracted out in 2003/04 and the cost of the contracted out rebates they received:[167]

[165] http://www.dwp.gov.uk/publications/dwp/2006/DC%20consultation%20document.pdf

[166] Department for Work and Pensions, Security in retirement: towards a new pensions system: summary of responses to the consultation, 30 October 2006, Cm 6960, p 49
http://www.dwp.gov.uk/pensionsreform/pdfs/pens-wp-response.pdf

[167] DWP, *Security in retirement: towards a new pension system. Regulatory impact assessments and technical appendices*, May 2006, http://www.dwp.gov.uk/pensionsreform/pdfs/ria.pdf

Numbers contracted out and rebate costs in 2003/04

Type of scheme	Membership (million)	Rebate cost (£ billion)
Defined benefit, of which:	7.6	6.5
Private Sector	2.8	2.5
Public Sector	4.8	4.0
Occupational defined contribution	0.6	0.5
Personal Pensions	2.9	3.1
Total	11.1	10.1

Sources: Membership data is from Department for Work and Pensions, *Second Tier Pension Provision 1978/79 to 2003/04*; rebate data is DWP's estimate.
Note: Costs are for GB, on an accruals basis and in cash terms.

It pointed out that the attraction of contracting out into DC schemes was rapidly declining in any case so that its importance was already diminishing.

The DWP's *Employers' Pension Provision Survey 2005* suggested that only 3 per cent of occupational DC schemes are now fully contracted out:

> Results from the last three Employers' Pension Provision surveys are somewhat mixed, but do tend to indicate something of a movement away from contracting out among occupational pensions. Figures are not presented in entirely comparable ways for closed schemes, but are available relating to open schemes, and separately for defined benefit (DB) and defined contribution (DC) occupational pensions. The overall results indicate something of a decline in contracting-out among both DB and DC schemes. Between 2000 and 2005, the proportion of open DB schemes that are contracted out appeared to reduce from being the vast majority of schemes (92 per cent) down to around two-thirds (63 per cent). The figure reported in 2003 was even lower.
>
> There was a consistent declining trend of contracting out among DC schemes. This fell from 22 per cent of open schemes in 2000, to 13 per cent in 2003, to just three per cent in 2005. In the last set of figures there were also seven per cent of open DC schemes, in which part of the scheme was contracted out, and the other part was not. [168]

Table 3.4 Whether a scheme is contracted out of State Second Pension - open DB and DC schemes

Column percentages

Contracting out of S2P (SERPS)	Type and status of occupational scheme					
	Open DB schemes			Open DC schemes		
	2000	2003	2005	2000	2003	2005
Contracted out of S2P	92	53	63	22	13	3
Not contracted out	7	47	37	73	87	88
Part contracted out, part not	1	*	*	5	*	7
Unweighted base	463	362	306	208	285	298
Weighted base	216	34	27	159	47	18

Note: Refused and don't know responses have been dropped from the table, as this is the only way to present comparable figures from past reports
Weighting method in 2000 was re-based in a different way to 2003/2005.
Note: * indicates more than 0 but less than 0.5 per cent.

168 http://www.pfrc.bris.ac.uk/Reports/Employers_Pension_Provision_Report.pdf (retrieved 26 November 2006)

There has also been a marked decline in the number of people contracted out into Appropriate Personal Pension Schemes from 3.5 million in 2000/01 to 2.9 million in 2003/04.[169]

The abolition of contracting-out for DC schemes will lead to an immediate saving of £4 billion a year for the Exchequer. Over time this will be offset by the greater costs of S2P which will be paid out:[170]

State Second Pension and rebate savings due to the abolition of contracting out for defined contribution schemes

£ billion

	2012	2015	2020	2030	2040	2050
State Second Pension	0	0	0.1	1.3	3.8	5.4
Rebates	–4.0	–4.2	–4.3	–4.3	–4.3	–5.1

Source: DWP estimates.
Note: Data in 2006/07 prices. Coverage is GB.

The Exchequer will also save the cost of tax relief on Appropriate Personal Pension minimum contributions:[171]

Estimated cost of tax relief on appropriate personal pension (APP) rebates in future

	2012	2015	2020	2030	2040	2050
Cost of tax relief (£ million, earnings terms)	195	185	175	150	125	125
Cost of tax relief (£ million, 2006/07 prices)	225	230	240	250	255	310

Source: DWP modelling

2. The Bill

a. Guaranteed Minimum Pension conversion

Clause 14 amends the *Pension Schemes Act 1993* (a consolidation Act) to allow contracted out defined benefit schemes to convert GMPs into scheme benefits provided they meet certain conditions, including:

- actuarial equivalence of the value of members' conversion benefits with those possessed pre-conversion. Regulations will set out how actuarial equivalence is to be determined
- no reduction of pensions in payment
- conversion benefits not to include money-purchase benefits
- survivors' benefits to be provided
- agreement of scheme sponsor secured

[169] HC Deb 10 July 2006, cc 1609-1610W
[170] Department for Work and Pensions, Security in retirement: towards a new pensions system, Regulatory impact assessments and technical appendices, May 2006, figure 3.viii
http://www.dwp.gov.uk/pensionsreform/pdfs/ria.pdf
[171] Ibid, figure 3.x

- members, survivors and HMRC informed

In schemes which do not convert GMPs for all members, trustees will be able to do so on an individual basis to enable transfers out of the scheme, provided the individual consents. Transfers out of schemes which do convert will only be permitted where the receiving scheme continues survivor benefits.

The Pensions Regulator will enforce the law on GMP conversion.

People with converted GMPs will still suffer a contracted out deduction from their SERPS payment.

This provision will be brought into effect on a day to be appointed by order. It is not expected to be before 2009 because of the need to make relevant changes to HMRC's NIRS2 software.[172]

b. Abolition of contracting out for defined contribution schemes

Clause 15 and Schedule 4 provide for the cancellation of contracting out certificates for COMPS and APPs from an "abolition date", which is intended to be the same date as the earnings link for the Basic State Pension is restored (i.e. probably 2012). In other words, no-one will be able to contract out into a DC scheme from this date, and contracting out rebates will no longer be paid. However, as the Bill stands at present, protected rights earned up to the date of abolition are retained in full.

The clause and schedule are lengthy and complicated because of the need to preserve legislation which will not apply to schemes from the abolition date but will still be needed both for HMRC to deal with outstanding matters relating to contracted-out rebates, minimum contributions and minimum payments etc and to ensure the preservation of protected rights accrued before that date.

3. Issues

The abolition of contracting out will lead to a loss of revenue for the insurance industry, which they must, presumably, hope to replace through personal accounts. Writing in the *Daily Telegraph* shortly after the publication of the White Paper, Ian Dey said:

> There were some unexpected downsides for the industry such as the shock decision to end contracting out from the State Second pension for defined contribution schemes, which will cost the industry about £3bn a year in lost premiums.[173]

The Regulatory Impact Assessment on the Bill considers that income from personal accounts will make up for income lost from the contracted out rebate:

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[172] Source: DWP
[173] "Pensions: now for the wrangling" , *Daily Telegraph*, 28 May 2006

> 4.47 In terms of premium income to insurance companies, the rebate for DC schemes was £3.5 billion in 2003/04. The total UK insurance net premium income from individual pensions, other pensions and the rebate was £54 billion in 2004.6 The rebate therefore constitutes only around 6 per cent of total net premium income.
>
> 4.48 Together with the introduction of personal accounts, therefore, these proposals will have some impact on the financial services sector, with a reduction in income from the rebate but a forecast net increase in savings of £4-5 billion from personal accounts. The Government will consider carefully the implementation of these proposals, and the timescale over which they are implemented will provide the financial sector with time to prepare for the new opportunities and challenges.[174]

Pension providers have expressed concern about the low levels of contracting out rebates and accept that if they are not increased contracting out may as well be abolished. The Association of Consulting Actuaries argue that the contracting out rebate for DB schemes should be increased in an attempt to halt the decline of what is generally recognized as the most satisfactory form of occupational pension provision:

> If the Government is not able to increase contracting out rebates to what we believe are realistic levels, we welcome the proposal to abolish DC contracting out.
>
> However, the "loss" made by scheme sponsors on DB contracting out adds to the financial pressures on scheme sponsors to stop DB accrual. We trust that the Government will honour its commitment to review the contracting-out rebates for DB schemes following the publication of the White Paper and that, as a result, the full increase recommended by the Government Actuary for the 2007/2012 quinquennium will be implemented, albeit now one year late. If not, in practice we believe the Government's decision to retain DB contracting out will soon be overtaken by events and be shown to be irrelevant.
>
> Indeed, we believe that the contracting out terms for salary-related schemes should reflect the improved level of security now required in private sector schemes and should be made age-related in order to be equitable to closed schemes, where the average age of active members rises from year to year.[175]

On the question of GMP conversion, the **Association of Consulting Actuaries** comments on the White Paper's failure to address possible conflicts with EU legislation:

> **Dealing with past rights: Guaranteed Minimum Pension conversion**
>
> We have supported this concept in the past partly as a method of possibly solving the issue of equality of pensions given the existence of sex based differences due to guaranteed minimum pensions.

[174] Department for Work and Pensions, Pensions Bill – Regulatory Impact Assessment, November 2006, http://www.dwp.gov.uk/pensionsreform/pdfs/RIAChapter4.pdf (retrieved 11 January 2007)

[175] http://www.aca.org.uk/Public_content/ACA_WhitePaper_final_response_140906.doc

> The proposal in the White Paper does not comment on the problems identified on previous occasions concerning the lack of certainty as to whether EU legislation and case law would allow conversion into normal scheme benefits to take place without a levelling up to avoid sex discrimination - which would eradicate any savings and indeed be likely to involve a material increase in employer cost.[176]

B. Dispute resolution

1. Background

Section 50 of the *Pensions Act 1995* introduced a two-tier system for dealing with internal disputes about occupational pensions (eg over the value given to accrued benefits on transfer to another scheme, or the level of ill health benefits). The *Pensions Act 2004* amended this, replacing the two tier system with a single tier system, while allowing trustees to retain a two tier system if they wished.[177] The idea was to simplify procedures for occupational schemes.

In January 2005, the DWP issued a consultation document on draft *Occupational Pension Schemes (Internal Dispute Resolution Procedures) Regulations 2005*,[178] and in April 2005, the Pensions Regulator issued a related draft *Code of Practice on Dispute Resolution – reasonable periods.*[179]

The original intention was that the changes would come into effect in September 2005. However, in January 2006, the DWP announced that the consultation had revealed that the proposed changes could have the opposite effect from that desired, so they would not be brought into effect:

> Following comments received as a result of consultation on the associated draft regulations and draft Code of Practice (for which we are grateful), the Department has reviewed the effect of the proposed change and now believes that it would not have the desired effect of simplifying procedures or introducing greater flexibility. In fact it could place additional burdens on schemes. It has therefore been decided to not to bring in the new legislation. The existing section 50 will therefore remain in force but will be amended at the first suitable opportunity in order to give schemes more flexibility.[180]

2. The Bill

Clause 16 is the second attempt to amend section 50 of the 1995 Act. Trustees or managers of an occupational scheme will have the option of adopting a two stage

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[176] http://www.aca.org.uk/Public_content/ACA_WhitePaper_final_response_140906.doc
[177] For more background see Section II G of Library Research Paper 04/18 on the *Pensions Bill 2003-04*
[178] http://www.dwp.gov.uk/consultations/consult/2005/pensions/consultation-january-2005.pdf (retrieved 3 December 2006)
[179] Pensions Regulator press release, 1 April 2005, http://www.thepensionsregulator.gov.uk/mediaCentre/pressReleases/pn05/pn05-05.aspx (retrieved 3 December 2006)
[180] DWP Update on Internal Dispute Resolution, 17 January 2006, http://www.dwp.gov.uk/consultations/consult/2005/pensions/internal_dispute.pdf (retrieved 3 December 2006)

dispute resolution procedure. Schemes must provide for a dispute to be considered by the trustees or managers, but they can choose for disputes to be considered by another person first.

C. Actuarial guidance

Clause 17 and Schedule 5 of the Bill will remove the requirement that the Secretary of State should approve actuarial guidance in certain cases. The Regulatory Impact Assessment provides a convenient summary of the background to this change:

> In order for actuaries to calculate pensions liabilities consistently, all actuaries are required to use agreed guidelines. These guidelines are called either "Guidance Note" (GN) or "Technical Memorandum" (TM). There are seven GNs and one TM referred to in pensions legislation. The Secretary of State is required by primary legislation to approve three of these GNs and the TM.
>
> Historically the actuarial profession has produced these GNs. The professional bodies for actuaries - the Institute of Actuaries in England and Wales and the Faculty of Actuaries in Scotland - have combined the role of regulator with that of professional body. Because of the professions' dual role the Faculty and Institute of Actuaries are required to obtain the Secretary of State's approval of the GNs and TMs to maintain the public's confidence.
>
> The Morris Review of the Actuarial Profession recommended in March 2005 that the Financial Reporting Council (FRC) should establish a new regime to set actuarial standards and to oversee the regulation of the profession. The FRC is the UK's independent regulator for corporate reporting and governance. The Government accepted this recommendation and the FRC has now set up the Board for Actuarial Standards (BAS) to promote confidence in corporate reporting and governance by setting high quality actuarial standards. The Faculty of Actuaries and the Institute of Actuaries continue to exist as the professional bodies for the profession in their respective jurisdictions.
>
> On 6 April 2007 BAS will adopt and take responsibility for the existing versions of the pensions GNs and the TM. Since the FRC and through it BAS are the UK's independent regulator for corporate reporting and governance, the requirement for the Secretary of State to approve certain GNs and the TM will be removed from primary legislation.[181]

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[181] *Pensions Bill 12 of 2006-07, Regulatory Impact Assessment* http://www.dwp.gov.uk/pensionsreform/pdfs/RIAChapter4.pdf (retrieved 3 December 2006)

IV Personal Accounts

1. Background

a. Voluntary private pensions

This section sets out the background to the proposals for a new scheme of personal accounts. It then looks at some of the issues and questions that have arisen in the debate surrounding the proposals. The details of the personal accounts scheme will be the subject of a second Personal Accounts Bill. However, the current Bill contains provision for the establishment of a Personal Accounts Delivery Authority which will initially act in an "advisory capacity", for example, on "finalising the detailed policy design and developing a commercial and procurement strategy within the framework set by legislation." For this reason, some of the wider issues are relevant also to this Bill.

The Pensions Commission was established to "review the evolution of the UK's system of pension provision and to advise on whether the existing system of voluntary private pensions would deliver adequate results. The Pensions Commission said that "since 1978, the UK has had for employees (but not for the self-employed) a compulsory 'second tier' pension system. This requires employees either to be members of SERPS/S2P or to be 'contracted out' into an equivalent private system."[182] Beyond this, there is a third tier of private pensions, namely all those tax incentivised pension arrangements that are not directly funded by the state. The Pensions Commission concluded in its Second Report, that:[183]

> Rather than growing however, voluntary pension saving is in serious decline, and previous government initiatives to stimulate its growth have not succeeded.
>
> - In 2003/04, 46% of those in work were not contributing to a private pension. This reflects an increase in those not contributing of around 400,000 people since 2002/03. Participation rates in schemes voluntarily provided by employers (a subset of total private provision) have also continued a slow decline.
>
> - A primary policy initiative that focused on increasing participation, the Stakeholder Pension, while achieving some reduction in costs, has not achieved any measurable increase in participation. Eighty per cent of all employer designated Stakeholder schemes are "empty shells": nominated schemes but with no members.
>
> - Where employers do provide pensions, the shift away from Defined Benefit (DB) schemes has continued even more rapidly than we predicted in the First Report. There are now fewer than 2 million active members of open private sector DB schemes. In the First Report we suggested that the number would be unlikely to

[182] Pensions Commission First Report page 70

[183] Pensions Commission, *A New Pension Settlement for the Twenty-First Century: The Second Report of the Pensions Commission,* 30 November 2005, page ix http://www.pensionscommission.org.uk/publications/2005/annrep/main-report.pdf

> stabilise above 1.6-1.8 million: a much lower figure now looks likely. It is difficult to see private sector DB provision, certainly final salary in form, playing more than a minimal role in the future UK pension system.
>
> -This rapid retreat from DB provision, and slow retreat from any provision, reflects the profound shift in employer attitudes to pension provision which the Employer Task Force and the Pensions Commission's focus groups of small and medium-sized employers have highlighted.[184]

b. Stakeholder pensions

The Pensions Commission argued that previous government initiatives to stimulate the growth of voluntary pension saving had not succeeded:

> A primary policy initiative that focused on increasing participation, the Stakeholder Pension, while achieving some reduction in costs, has not achieved any measurable increase in participation. Eighty per cent of all employer designated Stakeholder schemes are "empty shells": nominated schemes but with no members.[185]

The Pensions Commission's proposed system of personal accounts can be seen as a response to the failure of stakeholder pensions (introduced in April 2001 under the *Welfare Reform and Pensions Act 1999*) to make any step change in the level of voluntary private saving in the target group – in that case, those earning between about £9,000 and £20,000 a year, for whom the existing pension arrangements were "often unsuitable or expensive."[186]

The 1998 Green Paper, *A new contract for welfare: partnership in pensions* (which preceded the 1999 Act) outlined proposals for the introduction of stakeholder pensions to "help many more middle earners save for a comfortable retirement."[187] It noted that while occupational pension schemes continued "to provide some of the best arrangements, reinforced by valuable contributions for employers", they were not an option for "the 35 per cent of employees whose employers do not offer a scheme, nor for the self-employed." Furthermore, personal pensions did not always meet the needs of this group, in part because of management charges which could significantly reduce the value of savings by the time of retirement. [188]

The introduction of stakeholder pension schemes in April 2001 was proposed to address this gap in provision. Key issues raised during the scheme design phase included the

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[184] Pensions Commission, *A New Pension Settlement for the Twenty-First Century: The Second Report of the Pensions Commission,* 30 November 2005, page 48
Internet: http://www.pensionscommission.org.uk/publications/2005/annrep/main-report.pdf
(retrieved 2 January 2007)

[185] Ibid, page 48

[186] Department for Work and Pensions, *A new contract for welfare: partnership in pensions*, December 1998, Cm 4179, page 47 and Chapter 7, para 5, 6 and 10

[187] Ibid, page 47

[188] Department for Work and Pensions, *A new contract for welfare: partnership in pensions*, Cm 4179 December 1998, p 48, para 6

new requirements to be placed on employers to provide access to the scheme and the level of annual management charges.

Charges and advice

The 1998 Pensions Green Paper identified the level of charges as one of the factors making personal pensions unsuitable for middle earners.

> 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.[189]

The Treasury Committee looked at the experience of stakeholder pensions as part of its recent inquiry into the Pensions Commission's proposed National Pensions Savings Scheme. It commented that:

> 17. Stakeholder pensions have from the outset been faced with uncertainties about the extent to which they can be sold without regulated advice, not least because of the complex interaction between occupational and personal pensions. Following a Government decision in 2004, the FSA has now introduced a Basic Advice regime for the regulation of advice on the sale of Stakeholder products, although there remain several ways in which Stakeholder pensions can be sold, including through a full advice process. Significant concerns persist amongst providers about the limited impact of Basic Advice, the general regulation of sales and the costs such regulation entails.
>
> 18. One of the central founding principles of the Stakeholder pension was that there would be a limit on the Annual Management Charge (AMC) that could be levied, alongside prohibitions on certain other charges. The cap on the AMC was initially set at 1%, which providers claimed prevented effective promotion and distribution of Stakeholder pensions. In 2004, the Treasury announced that, for people joining a Stakeholder scheme on or after 6 April 2005, the cap would be 1.5% for the first ten years, reducing to 1% for subsequent years for those remaining in the scheme. The then Financial Secretary to the Treasury told our predecessors in 2004 that the increase of 50 basis points was a "charge explicitly for advice".

It concluded that "experience of Stakeholder pensions indicates that market operators may exert pressure for any charge cap to be increased and may tend to serve the most profitable parts of a market, not those most in need."[190]

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[189] Ibid, p 48, para 6

[190] Treasury Committee, *The design of the National Pension Savings Scheme and the role of financial services regulation,* Fifth Report of Session 2005-06 HC 1074-I, paras 17, 18 and 75

Employer access arrangements

Employers who did not offer an occupational scheme (or contribute to their personal pension) were to be "required to identify a stakeholder pension scheme and to facilitate access to it for their employees." There was no requirement on employers to make contributions, although it was open to them to do so. They were, however, 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."[191]

The Government originally proposed to allow only limited exemptions from these requirements. Employers were to be exempt in respect of employees earning below the lower earnings limit.[192] The CBI and the Federation of Small Businesses both criticised these proposals and argued that they would place a large burden on small employers.[193] The Government's final decision was to exempt employers with less than five employees.[194]

Professional Pensions reported on 2 March 2006 that:

> Around 70,000 UK firms with five or more employees are breaking the law by failing to provide stakeholder pensions, government figures show. Pensions reform minister Stephen Timms said 80pc of those firms had fewer than 10 employees. Firms with five or more employees must set up a stakeholder scheme unless they offer an occupational pension scheme to all their workforce or make a contribution of at least 3pc to a personal pension. But the Occupational Pensions Regulatory Authority only fined one company for failing to provide a stakeholder scheme.[195]

Take-up of and contributions to stakeholder schemes

The DWP's *Employer Pension Provision Survey 2005* found that:

> Twenty-nine per cent of employers provided access to Stakeholder Pensions, a decrease from 35 per cent in 2003; only 7 per cent of employers contributed to a Stakeholder pension, but this was an increase from 5 per cent in 2003, covering 20 per cent of employees.[196]
>
> Half of the SHPs in the survey had just one member whilst a further 27 per cent had between two and four active members. Just over two thirds (68 per cent) of these firms that were providing Stakeholder pensions, with at least one active

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[191] Department for Work and Pensions, *A new contract for welfare: partnership in pensions*, December 1998, p 57, para 54

[192] Department for Work and Pensions, *A new contract for welfare: partnership in pensions*, December 1998, p 57

[193] CBI news release, *Direction of Government consultation on stakeholder pensions "encouraging" - CBI*, 29 June 1999 and "Small firms must offer stakeholder pensions", *Times*, 30 June 1999

[194] McKay S, *Employer Pension Provision Survey,* DWP Research Report No. 329, March 2006, p 5

[195] Professional Pensions, *Small firms flout stakeholder law,* 2 March 2006

[196] DWP Press Release, 29 March 2006*, Publication of DWP research report 329: Employers' Pension Provision Survey 2005*

> member, were making a contribution towards them for at least some of their members and among these firms, the median level of employer contribution was six per cent of employees' salary.[197]

Pensions World reported in March 2006 that:

> According to Fidelity, the simple reason for individuals not saving in stakeholder schemes is that "people do not prioritise saving, or have opted to invest in other assets, principally property."[198]

On 9 October 2006, Pensions Minister, James Purnell, reported that figures from the Association of British Insurers showed that around 2,880,000 stakeholder pension policies had been sold since their introduction in April 2001.[199]

c. *The Pensions Commission's proposal for a National Pension Savings Scheme*

The Pensions Commission said that a wide-ranging debate since the publication of its Second Report revealed "almost universal acceptance that the combination of the present state pension system and the present voluntary system of private pension saving is not fit for purpose and will result in pension provision which is increasingly inadequate and unequal."[200]

It argued that reforms to the state pension system were needed "to make it more understandable and less means-tested" in order to "improve the effectiveness of voluntary private pension savings." However, it was "not convinced by the argument that state pension reform can be sufficient in itself to remove barriers to adequate private pension provision." It therefore recommended "the creation of a National Pension Savings Scheme (NPSS) applying the principle of automatic enrolment at the national level." Key objectives for the scheme were:

- *"Overcoming inertia and greatly increasing participation in pension savings.* All employees not covered by other adequate pension arrangements should be automatically enrolled into the scheme but with the right to opt-out. A modest level of matching contribution by employers should be compulsory…"
- ***"****Aiming for a "base load" of earnings replacement."* The Commission recommended that total default level contributions should be set at around 8% of earnings about the 'Primary Threshold' (the level of income at which income tax and national insurance become payable). The Commission estimated that "on reasonable assumptions about rates of return and years of contribution this might secure the median earner a pension at the point of retirement of about 15% of median earnings on top of the 30% which state provision will deliver under our proposals."

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[197] McKay S, *Employer Pension Provision Survey 2005*, DWP Research Report No 329, 29 March 2006
[198] *Half bake*d?, Pensions World, March 2006, page 26
[199] HC Deb, 9 October 2006, c 33W
[200] Pensions Commission, *Implementing an integrated package of pension reforms: The Final Report of the Pensions Commission*, 4 April 2006, page 10
http://www.pensionscommission.org.uk/publications/2006/final-report/final_report.pdf

- *"Encouraging the maintenance of existing high quality pension provision."* The Commission said that "where employers already provide more generous contributions than those defined as the default within the scheme, procedures will be required to allow them to opt-out from the national scheme and automatically to enrol employees into these alternative arrangements."
- *"Ensuring low cost of operations."* "The scheme should aim to deliver to all employees and the self-employed the opportunity to save for a pension at the Annual Management Charge (e.g. 0.3% per year or less) today enjoyed only by employees of large firms, by public sector employees or by high income individuals." [201]

d. The Government's proposals for a personal accounts scheme

The Pensions White Paper, published on 25 May 2006, announced the Government's intention to tackle barriers to saving and "create an environment in which individuals take personal responsibility for ensuring that their aspirations for retirement income are met":

> In order to do this we will:
>
> – introduce a new pension saving scheme of **low-cost, portable personal accounts,** making private saving truly accessible for all;
> – introduce **automatic enrolment** into a private pension for all employees, to maximise coverage and combat savings inertia;
> – set a **national minimum employer contribution of 3 per cent**, between earnings of around £5,000 and £33,000 a year; and
> – set a **minimum overall level of contribution of 8 per cent** for the personal accounts of employees and encourage additional contributions from employees.[202]

The Government published its summary of responses to the White Paper consultation on 30 October 2006. This said that "among the responses that mentioned personal accounts, the vast majority welcomed the idea of a low-cost, portable personal account scheme".[203]

e. Legislation and further consultation on personal accounts

The Government is consulting further on the details of the personal accounts scheme in the Personal Accounts White Paper published on 12 December. The consultation period will run until 20 March 2007.[204]

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[201] Pensions Commission, A New Pension Settlement for the Twenty-First Century: The Second Report of the Pensions Commission, 30 November 2005, p 7
Internet: http://www.pensionscommission.org.uk/publications/2005/annrep/main-report.pdf
(retrieved 2 January 2007)

[202] Department for Work and Pensions, *Security in retirement: towards a new pensions system*, (the Pensions White Paper), 25 May 2006, p 31
Internet: http://www.dwp.gov.uk/pensionsreform/pdfs/chap1.pdf (retrieved 3 January 2007)

[203] Department for Work and Pensions, Security in retirement: towards a new pensions system, Summary of responses to the consultation, CM 6960, 31 October 2006, p 32

[204] Department for Work and Pensions, *Personal accounts: a new way to save,* Cm 6975, 12 December 2006, p 152

To enable preparatory work on the design of the scheme to be undertaken, the current Bill provides for the establishment of the Personal Accounts Delivery Authority (**Clauses 18 to 21** and Schedule 6). In the first instance this will be tasked with "the limited remit to undertake preliminary work on a range of commercial, financial and technical products leading up to the issue of Invitation to Negotiate."[205]

The Government's intention is that:

> people will be able to start contributing to the personal accounts scheme in 2012. This is based on a planning assumption that the Government is able to obtain parliamentary time during the 2007/08 session for a Personal Accounts Pensions Bill, and can achieve Royal Assent in summer 2008. [206]

The Work and Pensions Committee had recommended that any Bill on personal accounts should be made available for pre-legislative scrutiny. However, in response to its report, the Government said that its timetable was "extremely tight, with little room for slippage" and that "on this occasion pre-legislative scrutiny would mean that personal accounts could not be implemented in 2012."[207]

The Personal Accounts White Paper explains that the objectives of the personal accounts scheme will be set in statute and are likely to include:

> - optimising levels of participation and contribution among the target group;
> - setting an investment strategy in the best interests of members;
> - minimising burdens on employers;
> - considering the impact on other high-quality pension provision;
> - assuring security of administration;
> - governing in the best interests of members and beneficiaries;
> - ensuring that the board acts impartially, prudently, responsibly and honestly;
> - delivering appropriate levels of choice;
> - achieving both the lowest possible charges for members and charges that are fair between members; and
> - ensuring that funds are invested in the best interests of the members.[208]

The *Financial Times* commented that "some crucial decisions were deferred to the body that will be responsible for delivering it." Furthermore "the white paper leaves a string of issues for further consultation, not least the charging structure for the new accounts, the compliance regime, and whether some employees should not be automatically enrolled." Lord Turner, chairman of the Pensions Commission, was reported to welcome the

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http://www.dwp.gov.uk/pensionsreform/pdfs/PA_PersonalAccountsFull.pdf (retrieved 3 January 2007)

[205] Department for Work and Pensions, Pensions Bill – Regulatory Impact Assessment, November 2006, para 3.6. http://www.dwp.gov.uk/pensionsreform/pdfs/RIAv6.pdf

[206] Department for Work and Pensions, *Report on Pension Reform: Government response to the Fourth Report of the Work and Pensions Select Committee, Session 2005-06 [HC 1068-1],* Cm 6956, 30 October 2006, para 14 www.dwp.gov.uk/pensionsreform/pdfs/pens-wp-select-cttee-response.pdf

[207] Ibid, para 18 and 19

[208] Department for Work and Pensions, *Personal accounts: a new way to save,* Cm 6975, 12 December 2006, para 3.17 http://www.dwp.gov.uk/pensionsreform/pdfs/PA_PersonalAccountsFull.pdf (retrieved 3 January 2007)

Personal Accounts White Paper proposals “saying they were ‘99 per cent’ in line with its recommendations.”[209]

2. Personal accounts - key issues

The Government’s summary of responses to the May 2006 White Paper consultation sets out reactions to the key issues regarding personal accounts, some of which are broadly summarised below. There has also been some initial response to the proposal in the Bill for a Personal Accounts Delivery Authority and to the Personal Accounts White Paper.

a. Automatic enrolment

The Pensions Commission’s remit included advising on whether there was a need to “move beyond the voluntary approach” to private pension saving.[210] In its Second Report, it concluded there were strong arguments against a purely voluntary approach. This was because “the overwhelming evidence is that many people do not make rational long-term decisions in their own self-interest without encouragement and advice.” Furthermore the willingness of companies to provide pensions for “for self-interested business reasons (i.e. to gain recruitment and retention benefits in the labour market) has irreversibly declined” and there is a “segment of the market (individuals of middle and lower income working for small and medium sized companies) which cannot be served profitably by the financial services industry except at Annual Management Charges (AMCs) which are in themselves impediments to pension saving.”[211] It argued, however, there were three strong arguments against compulsion. This was in part because “it seems likely that permanently maintaining an earnings-related element within the PAYG system is untenable within acceptable public expenditure limits”. Furthermore, individual preferences (for example, between saving more and retiring later) differ. So do individual circumstances, with an increasing number of people able to use housing assets to “fund at least part of their consumption in retirement.”[212]

The Government proposes that “from 2012, everyone with annual earnings above about £5,000 will be automatically enrolled, either into a personal account or an exempt work-based pension scheme.”[213] The summary of responses to the Pensions White Paper consultation said that “there was very strong support for automatic enrolment from those responses to the consultation which mentioned it. However, a small number of responses though that we should go further and make it compulsory for individuals to

[209] “Pensions plan defers crucial decisions” *Financial Times*, 13 December 2006
[210] Pensions Commission, *Pensions: Challenges and Choices: The First Report of the Pensions Commission,* October 2004, page v
http://www.pensionscommission.org.uk/publications/2004/annrep/index.asp (retrieved 1o January 2006)
[211] Pensions Commission, *A New Pension Settlement for the Twenty-First Century: The Second Report of the Pensions Commission,* 30 November 2005, page 154-5
Internet: http://www.pensionscommission.org.uk/publications/2005/annrep/main-report.pdf (2 January 2007)
[212] Ibid, page 155-6
[213] Department for Work and Pensions, *Personal accounts: a new way to save,* Cm 6975, 12 December 2006, para 1.12
http://www.dwp.gov.uk/pensionsreform/pdfs/PA_PersonalAccountsFull.pdf (retrieved 3 January 2007)

save in a personal account."[214] The Government explained the reasons it was proposing automatic enrolment:

> With automatic enrolment, although there is a presumption that people will save, they have the freedom to opt out of the scheme if they want to. This will increase the number of people with some pension provision, and ensure that inertia does not result in people not saving for retirement. The expected effect of this automatic enrolment means that the Government is not planning to make saving into personal accounts compulsory.[215]

b. Suitability and means-testing

The **Pensions Policy Institute** (PPI) argues that "inevitably, auto-enrolment raises questions about the suitability of personal accounts for the employees who are auto-enrolled": PPI defines personal accounts as "being 'suitable' if individuals do not lose out as a result of their saving. This is a less stringent definition than ensuring that saving in Personal Accounts is the right thing for all consumers, which would be more consistent with the FSA's definition of 'suitability:'"[216]

In debate in the House of Commons, the Secretary of State for Work and Pensions said:

> if we are to establish a new national pension savings scheme along the lines suggested, we have to be absolutely sure that it will be safe automatically to enrol people in it, so that they will always be better off inside it than remaining outside it and relying on means-tested support from the state.[217]

The Work and Pensions Committee commented that:

> 67. Those at risk of being no better off despite having saved are those who end up eligible for Guarantee Credit in retirement. Some 6% of pensioner households are expected to be eligible for Guarantee Credit only in 2050. The Government acknowledges, however, that there is an element of uncertainty in such long-term projections (see para 287).[218]

c. Information and advice

The **Pensions Policy Institute** says that:

> If Personal Accounts are not suitable for everybody, then this does not necessarily mean that individuals should not be auto-enrolled. But it does have important implications for

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[214] Department for Work and Pensions, Security in retirement: towards a new pensions system, Summary of responses to the consultation, CM 6960, 31 October 2006, page 36, para 7

[215] Department for Work and Pensions, *Security in retirement: towards a new pensions system, Summary of responses to the consultation,* CM 6960, 31 October 2006, page 36, para 8

[216] Pensions Policy Institute, *Are Personal Accounts suitable for all?,* 29 November 2006, Executive Summary http://www.pensionspolicyinstitute.org.uk/uploadeddocuments/PPI_Are_Personal_Accounts_suitable_for_all_29Nov06.pdf (retrieved 1 December 2006).

[217] HC Deb, 8 May 2006, c 7

[218] Work and Pensions Committee, Pension Reform, Fourth Report of Session 2005-06, HC 1068-I, para 67

> what information is needed to help people make informed decisions about whether they should opt out.[219]

In evidence to the Treasury Select Committee, the **Financial Services Authority** acknowledged "the centrality of removing the requirement for individual suitability advice, and therefore regulation of such advice" from the personal accounts scheme.[220] Lord Turner said:

> I think it is important to understand how we got to what we call regulated advice. Twenty years ago we did not call what IFAs do "advice". We called it "sales". They were trying to sell insurance and pension policies. Because we realised that a sales force remunerated by commission might tend to sell things which were not in people's interests—and there were some very overt and worrying manifestations of that—we then regulated that process to make it not sales but advice, but that very process of regulating it added an enormous amount of cost. We have just got to find a way of taking that individual advice out. We believe that the generic advice to people, for instance categories of advice in the literature, through citizens' advice bureaux, which says, "For the vast majority of people this savings scheme will make sense. If, however, you are a high APR credit card debtor you should consider not joining", is something which we believe people are capable of absorbing without individual advice. The other thing I would stress is that a lot of people are making decisions like this without individual advice today, in the occupational pension scheme environment.[221]

In evidence to the Work and Pensions Committee, the **Resolution Foundation** argue that the model proposed for the personal accounts system will still leave people with "complex and important decisions to make about their pensions".[222] It stressed the importance of making generic financial advice available for this group.[223] Teresa Perchard of **Citizens Advice** said:

> In the debate about pensions, people talk about advice but they are talking about advice in order to make the sale, or a pension product, not advice in the round, about you, your money, your future prospects, your family, how to manage that money effectively and then keeping that under review. I think that is where we need to shift to, to look at advice in the round for individuals, which also helps people to deal with concepts and choices more effectively than they have done in the past.[224]

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219 Pensions Policy Institute, *Are Personal Accounts suitable for all?,* 29 November 2006, Executive Summary, page 8 http://www.pensionspolicyinstitute.org.uk/uploadeddocuments/PPI_Are_Personal_Accounts_suitable_for_all_29Nov06.pdf (retrieved 7 January 2007).

220 Treasury Committee, *The Design of the National Pension Savings Scheme and the Role of Financial Services Regulation*, Fifth Report of Session 2005-06, HC 1074-I, para 38

221 Ibid, Q 211

222 Work and Pensions Committee, *Pension Reform,* Fourth Report of Session 2005-06, HC 1074-II, Ev 273, para 15

223 Ibid, Ev 273, para 15

224 Ibid, Q 508

Generic advice is information, advice and guidance that does not involve recommending a course of action in relation to a specific provider's product. It is defined by the Financial Services Authority as:

> Services and tools that use information about individuals' circumstances to help them to identify and understand their financial needs and to plan their finances.[225]

The **Work and Pensions Committee** said that:

> We conclude that a strong case has been made for the provision of free generic financial advice to those on below median incomes and recommend that DWP, DTI, and the Treasury continue to work with organisations such as Citizens Advice and the Resolution Foundation to develop a model to meet the needs of this group and make the necessary resources available.[226]

The Treasury Committee concluded that:

> A key facet of promoting financial inclusion lies in ensuring that consumers have access to appropriate financial advice. We note evidence suggesting that 8 million consumers who earn between £10,000 and £22,000 find it difficult to access generic financial advice, separate from the sales process. It is clear that improving access to financial advice would have benefits for individuals, the Government and the financial services industry. All too often in pronouncements from Government and regulators, consumers are told to seek advice, but with little consideration as to where they should turn. The implementation of a National Pension Savings Scheme and moves to make individuals more responsible for their retirement planning will increase the need for many consumers to access generic advice and support in order to plan for their retirement.[227]

The Economic Secretary to the Treasury, Ed Balls, told the Treasury Committee that:

> A priority for me as the Treasury Minister responsible for this will be to make sure that between now and the end of the spending review we come up with a credible strategy, with support within Government and across the broader sector, which can take forward these initiatives, learning from where we have got to in the work of the task force, to the period beyond 2008. I want to make sure that financial inclusion plays an important part in the spending review and hopefully that will be the vehicle by which we can take forward some of the post-2008 issues you referred to. [228]
>
> .

The Personal Accounts White Paper explains that:

> 3.26. All stakeholders agree that providing good quality information will be critical to the success of personal accounts. It is too early to specify the details of the

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225 Financial Services Authority (July 2004), *Building financial capability in the UK: the role of advice, www.fsa.gov.uk/pubs/other/role_advice.pdf*

226 Work and Pensions Committee, *Pension Reform,* Fourth Report of Session 2005-06, HN 1068-I, para 453.

227 Treasury Committee, *Financial inclusion: credit, savings and advice,* Twelfth Report of Session 2005-06, HC 848—I, para 127

228 Uncorrected Transcript of Oral Evidence taken before Treasury Committee on 22 May 2006, to be published as HC 848-viii, Q997

> information products linked to personal accounts – and this is an area where the Government will need to work closely with the delivery authority.

Early development work had indicated that information of a range of types would be needed for employees, employers, the self-employed and third-party intermediary organizations.[229] Employees, for example, would need to "understand automatic enrolment and possible reasons for opting out."[230]

d. Compulsory employer contribution

Where an employee is auto-enrolled into the personal accounts scheme, the employer will be compelled to make a minimum contribution (3% of the relevant band of earnings).[231] The **Pensions Commission** said that this had, unsurprisingly, been controversial, although employer representatives differed in their views. While the **CBI** and **British Chambers of Commerce** opposed it, **EEF: The Manufacturers' Organisation** had previously argued for full compulsion. However, the Pensions Commission considered the employer contribution to be "an essential element within the proposed package and it is likely that without it, participation rates within the NPSS would be significantly reduced."[232]

The summary of responses to the May 2006 White Paper consultation said:

> 15. The Government has considered the level of the employer contribution and considers that as a minimum contribution, 3 per cent on a band of earnings for employers is appropriate, as it strikes a balance between affordability for employers and providing an incentive to save for employees. We also looked closely at what the band of earnings should be, and whether £5,000 is about the right figure for the lowest band.
>
> 16. We believe it is, because those earning below that figure will not see a big income drop in retirement and may well see an income increase. We have chosen around £5,000 as the appropriate cut-off because we think it will be worthwhile to save for most people earning above this level. Since other elements of the state system – the Basic State Pension and the Pension Credit standard minimum guarantee – will rise in line with earnings, it is sensible that the cut-off point will increase in line with earnings too.
>
> 17. The Government proposes to take forward the minimum employer contribution as outlined in the White Paper.
>
> The White Paper had developed "a package of measures to help employers manage the transitional impacts of minimum contributions", including setting the

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[229] Department for Work and Pensions, *Security in retirement: towards a new pensions system*, (the Pensions White Paper), 25 May 2006, para 3.26
Internet: http://www.dwp.gov.uk/pensionsreform/pdfs/white_paper_complete.pdf (retrieved 3 January 2007)
[230] Ibid para 3.29
[231] Ibid, page 16
[232] Pensions Commission, *Implementing an integrated package of pension reforms: The Final Report of the Pensions Commission*, 4 April 2006, page 19-20
http://www.pensionscommission.org.uk/publications/2006/final-report/final_report.pdf

> minimum level of contributions in legislation and phasing in the contribution “over a period of three years, at a rate of 1 per cent each year”.[233]

e. *Delivery model and choice of provider*

The May 2006 Pensions White Paper proposes two alternative delivery models for the provision of a system of personal accounts:

> Option 1: The Pensions Commission’s approach – competition for contracts
> 1.67 The Pensions Commission suggested that all personal accounts should be provided by a single organisation. The day-to-day running of the scheme would be outsourced to a number of pension administrators. Everyone would deal with the NPSS and would receive consistent service standards and outcomes. Individuals would be able to make decisions about whether to opt out of the scheme, whether to contribute above the minimum and their preferred approach to investment.
>
> Option 2: An alternative approach – competition through branded providers
> 1.68 Another option to deliver personal accounts would be to build on existing pension provision. Automatic enrolment, collection and compliance would be as outlined in this paper. However, rather than using a single organisation, a number of pension providers would offer personal accounts. This option has a number of differences to the one proposed by the Association of British Insurers (outlined in Box 1d). For example, it would have a centralised function to collect and reconcile contributions, allocate default providers and collate information. People would be able to choose the provider that was right for them (or they would be allocated one).[234]

In its summary of the responses to the consultation, the Government said:

> 2. During the consultation, a number of organisations proposed alternative approaches to administering personal accounts, which were variants of the approach set out in the White Paper. Most of the approaches retained the same core functions of automatic enrolment, central collection of contributions and portability of accounts between employers.[235]

The December 2006 Personal Accounts White Paper said that;

> The Government has undertaken a thorough evaluation of all the proposed alternative approaches for delivering personal accounts. This has revealed that each approach has advantages and disadvantages. Focusing on the needs of the target group shows that the NPSS approach would be the most effective delivery model.
>
> This is because the NPSS:

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[233] Department for Work and Pensions, *Security in retirement: towards a new pensions system, Summary of responses to the consultation*, CM 6960, 31 October 2006, Chapter 2, paras 15-17

[234] Department for Work and Pensions, *Security in retirement: towards a new pensions system.* May 2006, CM 6841, para 1.68-9

[235] Department for Work and Pensions, *Security in retirement: towards a new pensions system. Summary of responses to the consultation,* October 2006, CM 6960, pages 33-4

> - is the simplest model for individuals – balancing simplicity for the majority with choice for the significant minority who want it;
> - delivers low charges – providers do not compete directly for individuals' accounts so there is less marketing expenditure and switching of accounts. Low charges will ensure larger pensions for scheme members; and
> - minimises delivery risk – it is not a government model: instead, it utilises the skills, expertise and capacity of the private sector to develop, build and deliver personal accounts.[236]

The *Financial Times* reported that:

> With the white paper essentially following the Pensions Commission's proposal, it won plaudits from the Trades Union Congress and the consumers' association Which? which had strongly opposed reliance on the Association of British Insurers' competing proposal for branded providers. But retaining branded funds as a third-tier choice meant that "we live to fight another day", according to Stephen Haddrill, director general of the ABI.[237]

f. Impact on existing provision

The Pensions Commission said in its Final Report that:

> One criticism which has been made of the NPSS proposal is that it might encourage "levelling down" from existing pension provision, i.e. that companies faced with the need to automatically enrol employees either into their own existing scheme or into the NPSS and faced with a defined national minimum contribution will reduce employer contribution rates. Since average employer contribution rates to DC schemes are presently about 6%, this risk clearly exists………
>
> The risk of levelling down cannot however justify rejecting automatic enrolment, nor justify rejecting a minimum matching employer contribution. As Figure 3 showed, an estimated 56% of the private sector workforce including the self-employed now has no occupational or personal pension provision to supplement state provision, and this proportion is growing, up from 51% in 2002/03, and 44% in 1996/97. With state pension provision becoming increasingly flat-rate and, even under the Pensions Commission's proposals, becoming on average less generous, the priority must be to increase funded pension saving among those who have no private pension provision, even if this increases somewhat the danger of levelling down for the minority who already enjoy some private provision.
>
> Moreover if the risk of levelling down to the NPSS minimum is severe, there must be a significant danger that employer pension provision will in any case decline, since the danger of levelling down implies that many employers are currently including higher employer pension contributions in their total remuneration packages with no confidence that these are playing an economically efficient role

[236] Department for Work and Pensions, *Personal accounts: a new way to save,* Cm 6975, 12 December 2006, page 61 http://www.dwp.gov.uk/pensionsreform/pdfs/PA_PersonalAccountsFull.pdf (retrieved 3 January 2007)

[237] *Pensions plan defers crucial decisions,* Financial Times, 13 December 2006

> in recruiting and retaining people of appropriate skills. Indeed in the absence of an NPSS minimum this levelling down could be to a floor of 0% rather than 3%.[238]

In evidence to the Treasury Committee, Lord Turner said that:

> We have 56% of the private sector workforce who are in no non-state pension scheme whatsoever. So is the social priority to bring that 56% up to a minimum or to guard against a levelling down among the 44% who do already get something? I think actually the social priority is to get people up to a minimum.[239]

In evidence to the Work and Pensions Committee the Secretary of State said that "rational economic theory would suggest there will have to be some levelling down" but stressed that "the evidence we have seen suggests that levelling down is likely to be small." He continued:

> this was one of the principal concerns that Ministers had studying the Second Report of the Turner Commission preparing ourselves for the White Paper. We did look very, very carefully at the impact of this and the evidence, such as it is, suggests that it is small. This is something we have to watch very carefully in the future. [240]

The Personal Accounts White Paper published in December 2006 identified a number of measures intended to ensure that personal accounts complement rather than replace existing pension provision.[241]

g. Charges

The Personal Accounts White Paper says:

> The Pensions Commission report concluded that its proposed National Pension Savings Scheme (NPSS) could be run at an AMC [Annual Management Charge] of 0.3 per cent in the long term. Our analysis indicates that in the long term it would be possible to run personal accounts at a charge of, or possibly even below, the 0.3 per cent level. In the short term, charges will be comparable with the Commission's estimate when this is adjusted to take account of the likely need to finance the scheme over a shorter timescale, and the need for a compliance regime.[242]

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[238] Pensions Commission, *Implementing an integrated package of pension reforms: The Final Report of the Pensions Commission*, 4 April 2006, pages 37-8 http://www.pensionscommission.org.uk/publications/2006/final-report/final_report.pdf

[239] Treasury Committee, Fifth Report of Session 2005-06, The Design of the National Pension Savings Scheme and the Role of Financial Services Regulation, HC 1074-II, Q 222

[240] Work and Pensions Committee, Pension Reform, Fourth Report of Session 2005-06, HC 1068-II, Q 261

[241] Department for Work and Pensions, *Personal accounts: a new way to save,* Cm 6975, 12 December 2006, page 37 http://www.dwp.gov.uk/pensionsreform/pdfs/PA_PersonalAccountsFull.pdf (retrieved 3 January 2007)

[242] Department for Work and Pensions, *Personal accounts: a new way to save,* Cm 6975, 12 December 2006, para.4.5 http://www.dwp.gov.uk/pensionsreform/pdfs/PA_PersonalAccountsFull.pdf (retrieved 3 January 2007)

The Government believes that "charges in the scheme can be radically lower than those currently offered to our target group" and that "personal accounts could deliver an AMC possibly as low as 0.5 per cent in the short term and below 0.3 per cent in the long term."[243]

The Personal Accounts White Paper explains that there are a number of ways in which charges can be levied on personal accounts and includes consultation questions on which overall charge structure is most appropriate.[244]

h. Investment strategy

Personal accounts will offer a structured choice of investments for members. There will be a:

> - default fund for members who do not wish to exercise a choice;
> - a small number of bulk-bought funds at low charges; and
> - a wider range of funds, which we expect to include social, environmental and ethical investments, and branded funds.[245]

The Government anticipates that the default fund will have the following characteristics:

> - the default fund will be structured to deliver an appropriate trade-off between risk and return for the target group;
> - the default fund will be invested across many different asset classes to reduce specific investment risk; and
> - the default fund will be life-styled so that, for example, an individual's investments will be moved out of equities into bonds as they approach retirement age to ensure the timing risk related to accessing an annuity is reduced.[246]

In a second Pensions Bill, the Government proposes to take primary powers "to require the executive delivery authority, advised by an investment committee, to develop an appropriate investment strategy within a framework prescribed by legislation."[247]

i. Participation of the target group in personal accounts

The May 2006 Pensions White Paper explained that the Government has a "central estimate" of the rate of opt out of personal accounts of around one third. "We estimate that the range of op-out rates will be between 20% and 50%".[248] The accompanying Regulatory Impact Assessment said:

> despite uncertainty around the number of people who will choose to opt out, it is estimated that, in total, a fully rolled-out personal accounts scheme would have

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[243] Ibid, para.4.7
[244] Ibid, para.4.10-13
[245] Ibid, para.5.7
[246] Ibid para.5.11
[247] Ibid, para.5.12
[248] Department for Work and Pensions, *Security in retirement: towards a new pensions system*, (the Pensions White Paper), 25 May 2006, page 75, (note to Figure 1.xiv) Internet: http://www.dwp.gov.uk/pensionsreform/pdfs/white_paper_complete.pdf (retrieved 3 January 2007)

> between 6 and 10 million members at any time, with a central estimate of 8 million members out of a total working-age population of 37.1 million.[249]

The Work and Pensions Committee identified participation rates among target groups, such as the self-employed and employees in small businesses as a “challenge given that there is to be no automatic enrolment process for the self-employed and concerns expressed by small business representatives about the new obligations the scheme will impose on them.”[250]

j. Operational governance and management of the personal accounts scheme

The Pensions Commission said that:

> The establishment of the NPSS [National Pension Savings Scheme] involves significant operational set-up risks, and these would not be eliminated by outsourcing the operations. The implementation of the system must therefore be very carefully planned.[251]

It also said that “high quality operational management will clearly be essential to the NPSS's success. So too will a governance structure, which provides assurance of independence”.[252] It said that while there were many details still to be determined, its thinking was that:

> The most appropriate institutional structure is likely to be that the NPSS is a non-departmental public body, with its own board. Within the range of possible structures, this is likely most effectively to balance: (i) the need for an institution which is clearly separate from direct government influence, particularly in its decisions on the range of investment fund choices; and (ii) the need for an institution which is clearly public and non profit-making
>
> - The most sensitive and judgemental decisions which the NPSS would need to make will relate to the range of investment fund choices made available, the procedures by which private fund managers would compete for mandates, the description of the risk return characteristics of different funds provided to scheme members, and the definition of the default fund. Key issues to be determined will therefore include how far these decisions should be constrained by legislation, and what governance arrangements should be put in place to ensure professional competence and integrity in the use of discretionary powers. The Pensions Commission's current but tentative thinking, is that:

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[249] Department for Work and Pensions, Security in retirement: towards a new pensions system, Regulatory Impact Assessments and technical appendices, 25 May 2006, para 2.59

[250] House of Commons Work and Pensions Committee, *Pension Reform,* Fourth Report of Session 2005-06, HC 1068-I, para 458

[251] Pensions Commission, *Implementing an integrated package of pension reforms: The Final Report of the Pensions Commission,* 4 April 2006, page 35 http://www.pensionscommission.org.uk/publications/2006/final-report/index.asp (retrieved 10 January 2007).

[252] Pensions Commission, *A New Pension Settlement for the Twenty-First Century: The Second Report of the Pensions Commission,* 30 November 2005, page 402

> - Legislation should define fairly clearly the default fund and the government bond fund options, and should provide some general guidelines on the range of other funds to be made available, but leave significant latitude for detailed decisions."
>
> - A dedicated Investment Funds Board may be required as a subcommittee of the main board of the NPSS, to allow detailed and expert consideration of issues relating to the range of appropriate funds.
>
> - Appropriate reporting processes to Government and Parliament will need to be designed.[253]

The **Investment Management Association** (IMA) said in evidence to the Work and Pensions Select Committee Inquiry on Pension Reform that the key to the success of the personal accounts scheme would be achieving a high participation rate:

> This requires the building of long term confidence in the scheme, credible overall arrangements for the scheme and above all a long term political commitment to it. This clearly points to the need for a single governance body for the NPSS, independent of government and with an overriding statutory duty of care to scheme members.[254]

IMA argued that:

> 10. With respect to governance, the IMA believes that the obvious starting point for NPSS is to borrow from the trustee-based occupational pensions model. Oversight – particularly with respect to the choice of managers and investment strategies – would therefore come from an independent Board which reports to Parliament.
>
> 11. The expertise of the private sector would be involved in providing both account administration and, critically, asset management. Under the supervision of the NPSS Board, the most competitive aspects of private sector investment expertise would be harnessed to provide a high quality, good value service while simultaneously ensuring that participant interests are continually represented.[255]

Which? also argued that the personal accounts system should be:

> Managed by an independent board consisting of consumer, employee, employer representatives with an explicit legal duty to look after the interests of scheme members, and legally accountable to the public.[256]

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[253] Pensions Commission, *A New Pension Settlement for the Twenty-First Century: The Second Report of the Pensions Commission,* 30 November 2005, page 402
[254] Work and Pensions Committee, Pension Reform, Fourth Report of Session 2005-06, HC 1068-II, Ev 235, para 4 and 5
[255] Work and Pensions Committee, *Pension Reform,* Fourth Report of Session 2005-06, HC 1068-II, Ev 233
[256] ibid Ev 160

V The Personal Accounts Delivery Authority

The Government is consulting further on the details of the personal accounts scheme in the Personal Accounts White Paper. It intends to introduce a *Personal Accounts Pensions Bill* "during the 2007/08 session" with the aim of achieving "Royal Assent in summer 2008."[257] However, the current Bill establishes a Delivery Authority in order to harness private sector expertise in:

> finalising the detailed policy design and developing a commercial and procurement strategy within the framework set by legislation.[258]

The Personal Accounts White Paper explains that:

> Chapter 2 explained the Government's choices of the NPSS approach as the best way to deliver a low-cost, portable account for the target group. The full details of what this will mean in practice will be refined as the policy and commercial processes are developed further. It is clear, however, that four key functions will be central to successful delivery: the clearing house, account administration, fund management and accessing pension savings. These are represented in Figure 3.1.

Governance arrangements - Oversees all responsibilities in the best interests of members - Ensures performance			
- Clearing house	**Administrator**	**Fund managers**	**Accessing pension savings**
- Enrols individuals - Collects contributions - Allocates to funds - Maintains records	- Deals with customer contact - Manages changes of customer details - Issues regular statements - Manages changes of fund choice	- Investing and managing contributions - Reports to clearing house	- Providing information on options to savers - Managing the process of accessing pension savings

257 Department for Work and Pensions, *Report on Pension Reform: Government response to the Fourth Report of the Work and Pensions Select Committee, Session 2005-06 [HC 1068-1],* Cm 6956, 30 October 2006, para 15

258 Department for Work and Pensions, *Personal accounts: a new way to save,* Cm 6975, 12 December 2006, para 3.6

> 3.4 All of these processes and underpinning systems exist already in the private sector. The Government anticipates that some companies will focus on delivering one part of the process, for example fund management: others will provide an end-to-end service for investors. Their expertise will be essential to help build the personal accounts system and then to run it effectively.[259]

The Personal Accounts White Paper explains that the work "to ensure that financial, commercial and operational implications are fully understood, and the most effective systems and structures are put in place to deliver personal accounts" will fall broadly into three stages:

> Stage 1 – finalising the detailed policy design and developing a commercial and procurement strategy within the framework set by legislation.
> Stage 2 – implementing the commercial and procurement strategy: design, build and test of systems.
> Stage 3 – managing a fully operational personal accounts scheme.[260]

The different responsibilities for each stage are set out in Figure 3.2:

<table>
<tr><td>Mid 2007-2008</td><td>2008- handover</td><td>Steady state</td></tr>
<tr><td colspan="3" align="center">Parliament</td></tr>
<tr><td colspan="3" align="center">DWP: policy and legislation</td></tr>
<tr><td>Advisory delivery authority

Advising on commercial strategy and delivery</td><td>Executive delivery authority

Procurement
- Clearing house
- Account administration
- Fund managers
- Compliance</td><td>Personal accounts board

Delivery
- Clearing house
- Account administration
- Fund managers
- Compliance
- Accessing pension savings</td></tr>
</table>

a. *Stage One – Personal Accounts Delivery Authority*

To enable preparatory work to be done to, the current Bill (**Clauses 18-21** and **Schedule 6**) contains provision to establish a Personal Accounts Delivery Authority (PADA), referred to in the Bill as "the Authority".

The Regulatory Impact Assessment says that:

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[259] Department for Work and Pensions, *Personal accounts: a new way to save,* Cm 6975, 12 December 2006, page 80, paras 3.3-3.4 http://www.dwp.gov.uk/pensionsreform/pdfs/PA_PersonalAccountsFull.pdf (retrieved 3 January 2007)

[260] Ibid, para 3.6

> 3.1 In order to achieve commencement of the personal accounts scheme in 2012, as proposed in the White Paper, the commercial processes would need to be sufficiently progressed to be ready to issue Invitations to negotiate in July 2008.
>
> 3.2 To enable the commercial process to remain on schedule, a substantial amount of preparatory work will be needed. This work will begin in the Department for Work and Pensions with analysis and advice to ministers on the consequences of policy options. To further this work the Bill provides for the establishment of a delivery authority that can bring in the necessary expertise to ensure this project is a success.[261]

The Personal Accounts Delivery Authority is initially being established:

> with the limited remit to undertake preliminary work on a range of commercial, financial and technical products leading up to the issue of Invitation to Negotiate.[262]

It will "act initially in an advisory capacity on the detailed scheme design and the commercial and procurement strategies."[263] It will "precede the governance body/board of the personal accounts scheme."[264]

b. Stage Two – executive stage of the Delivery Authority

The Personal Accounts White Paper contains questions for further consultation on how the functions and role of the delivery authority should be extended in the future.[265]

> 3.11. The proposed second Bill will include powers to give the advisory delivery authority executive powers. This is expected to allow the authority to enter into formal negotiations, finalise contracts, and manage the development of the systems and structures needed before the scheme can go live. The delivery authority will finalise commercial contracts, create the infrastructure for personal accounts, design the investment strategy and take full responsibility for the delivery of the scheme.
>
> 3.12 During this second stage the delivery authority is likely to be responsible for::

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[261] Department for Work and Pensions, *Pensions Bill – Regulatory Impact Assessment,* November 2006, para 3.1-3.2. *http://www.dwp.gov.uk/pensionsreform/pdfs/RIAv6.pdf*

[262] Ibid*,* para 3.6

[263] Department for Work and Pensions, *Personal accounts: a new way to save,* Cm 6975, 12 December 2006, para 3.7
http://www.dwp.gov.uk/pensionsreform/pdfs/PA_PersonalAccountsFull.pdf (retrieved 3 January 2007)

[264] *Department for Work and Pensions, Pensions Bill – Regulatory Impact Assessment, November 2006,* para 3.3, *http://www.dwp.gov.uk/pensionsreform/pdfs/RIAv6.pdf*

[265] Department for Work and Pensions, *Personal accounts: a new way to save,* Cm 6975, 12 December 2006, para 3.8-9
http://www.dwp.gov.uk/pensionsreform/pdfs/PA_PersonalAccountsFull.pdf (retrieved 3 January 2007)

> - procurement – commercial contracting that will create the infrastructure for personal accounts;
> - project management – responsibility for programme delivery and management of delivery against targets;
> - design and development of the investment strategy – agreeing the statement of investment principles, determining the level of choice available to members, designing the default fund and contracting with fund managers;
> - engaging with stakeholders – working with stakeholders across government, industry, employers and consumers to ensure that delivery remains focused on the objectives for the target group;
> - marketing and communications – designing and developing information and marketing strategies; and
> - setting up the most effective arrangements to ensure constructive engagement with members.
>
> 3.13 The second Bill will also set out the legal framework for governing the scheme after launch. It will include the objectives and statutory requirements of the personal accounts board. Within this framework the organisation will have the flexibility to deliver the scheme in the best interests of its members.

c. *Stage Three – Personal Accounts Board*

At the third stage, a personal accounts board will be established "to be responsible for the management of personal accounts". The Personal Accounts White Paper explains that:

> 3.15…..There is a clear distinction between the work of the delivery authority and the personal accounts board. For instance, the delivery authority with executive powers, is likely to be responsible for designing the investment strategy which will be in place when personal accounts are launched, whereas the personal accounts board is likely to be responsible for regularly reviewing that investment strategy, in the light of participation rates, evaluation of evidence on how the scheme is operating, and feedback from members or their representatives.
>
> 3.16. The Government anticipates that there may be an overlap period during which the delivery authority and the personal accounts board are both in place, so that the delivery authority can address any operational issues which arise around the time of the launch. The full personal accounts board structure has yet to be determined but it will comprise executive and non-executive members responsible for ensuring the delivery of the scheme's objectives.[266]

The Personal Accounts White Paper explains that the objectives of the personal accounts scheme will be set in statute and outlines what these are likely to include.[267] It explains that:

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[266] Department for Work and Pensions, *Personal accounts: a new way to save,* Cm 6975, 12 December 2006, para 3.15-16
http://www.dwp.gov.uk/pensionsreform/pdfs/PA_PersonalAccountsFull.pdf (retrieved 3 January 2007)

[267] Ibid, para 3.17

> 3.19 The board will be responsible for three distinct areas:
> - setting the **strategic direction** of the scheme and how the objectives set by government will be achieved;
> - **overall management of the scheme** – oversight of scheme delivery; monitoring levels of service to members; setting standards for collection; verification and payment; and information to members; and
> - **investment strategy** – ensuring that contributions are invested in the best interests of members; deciding on the range of choice available to investors; the strategy for investment of the default fund; and appointment and management of fund managers.
>
> 3.20 It is anticipated that the personal accounts board will be a body corporate, established under statute and self-financing. It will be subject to the normal scrutiny and accounting procedures, accountable to Parliament and will provide an annual report and accounts (see Figure 3.3). The board will be responsible for employing its own staff: it is expected that this will not be a large organisation as most of its functions will be contracted out.[268]

The Personal Accounts White Paper asks the following consultation questions:

> The Government is interested in views on how members' interests can best be represented in the governance of personal accounts.
>
> The Government would welcome views on what sort of information should support personal accounts, and the responsibilities of different organisations in communicating this information.[269]

2. The Bill

The Bill provides for the establishment of the Delivery Authority in its first stage (see above). To enable preparatory work to be done, the current Bill (**Clauses 18-21** and **Schedule 6**) contains provision to establish a Personal Accounts Delivery Authority (PADA), referred to in the Bill as "the Authority".

a. Status of the Personal Accounts Delivery Authority

Clause 18 (2) provides that "the Authority is not to be regarded as the servant or agent of the Crown or as enjoying any status, immunity or privilege of the Crown." The Regulatory Impact Assessment notes that:

> The establishment of a delivery authority distanced from Government and with private sector expertise has been welcomed by a wide range of stakeholders, including the ABI, Which? and the Investment Management Association as the best way to take forward the work needed to develop a system of personal accounts."(para 3.4)

[268] Ibid, para 3.19-20
http://www.dwp.gov.uk/pensionsreform/pdfs/PA_PersonalAccountsFull.pdf (retrieved 3 January 2007)
[269] Ibid, page 88

It will be established "upon Royal Assent of the Bill" and will "cover the whole of Great Britain and Northern Ireland."[270]

b. Functions of the Authority

Clause 19 sets out the initial functions of the Authority:

> The Authority may do anything it thinks appropriate for preparing for the implementation of, or for advising on the modification of, any relevant proposals about personal accounts.(Clause 19 (1)).

This relates to "the Authority's advisory role in understanding the commercial and operational implications on the implications of policy proposals. This could amount to suggesting additions, omissions or variations in the proposals to reflect, for example industry best practice.[271] "Relevant proposals about personal accounts" are defined as being proposals by the Secretary of State which are "connected with the establishment of a national low-cost portable pensions savings scheme, and any additional proposals that relate to this subject matter, or relate to matters that are incidental or supplemental to the proposals or to consequential or transitional matters."[272]

The Regulatory Impact Assessment explains that:

> 3.14 In its initial remit, the delivery authority would be limited to:
> • advising the Government on the operational and commercial implications of policy options; and
> • preparing specific products which comprise a financial, technical commercial strategy prior to issuing an Invitation to Negotiate.

The Authority may do "anything which is calculated to facilitate, or is incidental or conducive to, the discharge of its function under this section." It may not "implement any proposals requiring the approval of Parliament in advance of Parliament giving its approval." **(Clause 19 (4)).**[273]

The Secretary of State may issue guidance to the Authority about the discharge of its functions. If he does so, the Authority must have regard to it **(Clause 19, para 6 and 7).** The Authority is not permitted to borrow money for the purpose of, or in connection with, performing its functions **(Clause 19 (5).)**

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[270] *Pensions Bill: Explanatory Notes, Bill 12-EN 06-07,* para 3.28
http://www.publications.parliament.uk/pa/cm200607/cmbills/012/en/index_012.htm
[271] Ibid para 330
[272] Ibid para 331
[273] *Pensions Bill: Explanatory Notes, Bill 12-EN 06-07*, para 331
http://www.publications.parliament.uk/pa/cm200607/cmbills/012/en/index_012.htm

c. Membership of the delivery authority

The membership of the Delivery Authority is set out in Schedule 6 (which is introduced by **Clause 18 (3))** There will be:

- A chairman;
- A Chief Executive;
- Other non-executive members;
- Other executive members; and
- Other staff.[274]

Both the Secretary of State and the Authority must aim to ensure that the Authority's membership is between 3 and 9 members at any time **(Schedule 6 para 1 (4)).** The "intention is that people will be recruited to key leadership positions, including the chair, chief executive and commercial director, by mid 2007."[275]

d. Appointment of members and employees

The initial appointments to the Authority will be made by the Secretary of State. The chairman of the authority will continue to be appointed by the Secretary of State. The other initial executive and non-executive members will be appointed by the Secretary of State but thereafter by either the chairman and other non-executive members, or the Authority, subject to the approval of the Secretary of State. **(Schedule 6, para 1 and 6).** Schedule 6 also deals with issues such as the tenure of office, remuneration and pensions.

e. Accountability

The Authority is accountable to the Secretary of State for Work and Pensions.[276] At the end of each financial year, the Authority is required to "send to the Secretary of of State a report on the exercise of the Authority's functions during that year." The Secretary of State must lay this report before Parliament. (**Schedule 6, para 17**.)

f. Costs of establishing the Delivery Authority

The Government estimates that "establishing the delivery authority would have a funding requirement of £21 million between 2006/07- 2008/09." This will be funded from within "the DWP DEL budget."[277]

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[274] See also Ibid, para 347

[275] Department for Work and Pensions, *Personal accounts: a new way to save,* Cm 6975, 12 December 2006, para 3.10
http://www.dwp.gov.uk/pensionsreform/pdfs/PA_PersonalAccountsFull.pdf (retrieved 3 January 2007)

[276] *Department for Work and Pensions, Pensions Bill – Regulatory Impact Assessment*, para 3.15, November 2006, http://www.dwp.gov.uk/pensionsreform/pdfs/RIAv6.pdf (retrieved, 7 January 2007)

[277] Ibid, para 3.36

g. *Alternative options to a Delivery Authority*

The Regulatory Impact Assessments explains that there are other ways in which this work could be done, for example, the preparatory work could be done by DWP. One disadvantage of this is said to be the fact that

> civil servants are unlikely to have sufficient levels of experience successfully to guide and prepare the processes necessary to secure the services and infrastructure most appropriate to the creation of a personal accounts scheme.[278]

An alternative would be to contract consultants to work for DWP*.* This would have the advantage of enabling private sector expertise to be engaged. However, it is considered unlikely to "convince stakeholders that processes are sufficiently and transparently removed from Government" and "would not provide clear and transparent lines of accountability for underachievement or deviation from the remit, for example, failure to minimise the impact of set-up costs incurred on the live-running scheme's annual management charge."[279] "Accurate financial costings" for these alternative options are "not available", but "they would also involve a funding requirement."[280]

3. Issues

The Personal Accounts White Paper explains that the intention is to harness "the skills and expertise of the private sector to deliver personal accounts within a framework specified by government."[281] It explains that the objectives of the personal accounts scheme will be set in statute and are likely to include:

- optimising levels of participation and contribution among the target group;
- setting an investment strategy in the best interests of members;
- minimising burdens on employers;
- considering the impact on other high-quality pension provision;
- assuring security of administration;
- governing in the best interests of members and beneficiaries;
- ensuring that the board acts impartially, prudently, responsibly and honestly;
- delivering appropriate levels of choice;
- achieving both the lowest possible charges for members and charges that are fair between members; and
- ensuring that funds are invested in the best interests of the members.[282]

The **Association of British Insurers** (ABI) has said that:

> While the White Paper has set out the framework in which personal accounts will work, it is clear that the delivery authority has a lot of work to do……..Like the

[278] Ibid, para 3.20
[279] Ibid, para 3.35-27
[280] Ibid, para 3.35
[281] Department for Work and Pensions, *Personal accounts: a new way to save,* Cm 6975, 12 December 2006, para 3.2
http://www.dwp.gov.uk/pensionsreform/pdfs/PA_PersonalAccountsFull.pdf (retrieved 3 January 2007)
[282] Ibid, para 3.17

> Pensions Bill, the White Paper poses more questions than it answers, as many crucial decisions, such as the precise nature of how personal accounts will be run, by whom and at what cost, have been delegated to the delivery authority. Many other structural and practical decisions, such as the design of investment options and the provision of information to consumers will also fall to the authority. Its responsibilities, and those of the personal accounts board, are immense.[283]

As regards the successor to the Delivery Authority, the Personal Accounts Board, the White Paper says that this "will also ensure that the needs and requirements of individual groups, for example women, within the wider target group are considered:"[284]

> It will be essential to the success of the scheme that members' needs remain at the core of operational decision-making and are fully considered in the development of investment strategy, additional levels of choice and the charging structure.
>
> Best practice in engaging with consumers is an area that is developing rapidly. It would not be wise to try and anticipate now what might work best when personal accounts are introduced.[285]

However, as regards the Delivery Authority, **Which?** argues that the "Pensions Bill does not currently specifically state mandatory consumer representation on the Delivery Authority." It argues that:

> If the Delivery Authority is to succeed, it must:
>
> 1 Appoint two mandatory non-executive consumer directors who represent consumer interests and are recognised by consumer groups
> 2 Offer consumer groups the right to comment on non-executive consumer director appointments
> 3 Appoint a lay chairman, who is not perceived to have a conflict of interest with the financial services authority
> 4 Establish a consumer committee chaired by a non-executive consumer director.[286]

It also argues that "consumer groups must be consulted on consumer representative appointments." This, it says, which "add status and significance to their appointments."

In his speech to the ABI, the Secretary of State said that:

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283 Helen McCarthy, '*First steps on the road to harmony*', Financial Advisor, 21 December 2006
284 Department for Work and Pensions, *Personal accounts: a new way to save,* Cm 6975, 12 December 2006, para 3.18
http://www.dwp.gov.uk/pensionsreform/pdfs/PA_PersonalAccountsFull.pdf (retrieved 3 January 2007)
285 Department for Work and Pensions, *Personal accounts: a new way to save,* Cm 6975, 12 December 2006, para 3.21-22
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286 Which?, *Pensions Bill 2nd Reading Briefing*, January 2007

> We will seek to use the best experience and skills of the private sector to deliver the scheme - and give a significant degree of autonomy in operational decision making.[287]

The ABI commented that:

> The government has made clear that the delivery authority will be staffed by people with expertise in business and financial services. This is good news, and the government should ensure that experts in pension management and administration are among the leadership and senior staff of the authority.[288]

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[287] Rt Hon John Hutton MP, Secretary of State for Work and Pensions, speech to Association of British Insurers' Saver Summit, 23 November 2006, http://www.dwp.gov.uk/aboutus/2006/23-11-06.asp (retrieved 23 November 2006)

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