Security in retirement: towards a new pensions system

Presented to Parliament by
the Secretary of State for Work and Pensions
by Command of Her Majesty
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Contents

Regulatory Impact Assessments and technical appendices are published alongside this document.

Prime Minister's Foreword

I am proud of what the Government has achieved for pensioners. We said our first priority would be tackling pensioner poverty. There is more to do, but since 1997 two million pensioners have been lifted out of poverty. Thanks to measures like the Pension Credit, Winter Fuel Payments, free TV licences and above-inflation increases in the basic State Pension, pensioners are now less likely to be poor than the population as a whole.

But while pensioner poverty was the most pressing problem, we also have to address, like countries across the world, the long-term challenges and opportunities of an ageing society. In particular, we need to put in place an affordable and sustainable pension system which meets the needs of generations to come and encourages people to save for their retirement. It was to chart the way to meet these challenges that we set up the independent Pensions Commission four years ago.

The reforms we are proposing are based on its report. They take forward our modernisation of the welfare state and simplify the pension system and its contributory principle, create and reward a new culture of saving, are fairer to women and carers and continue to target most resources on those most in need.

It is a bold blueprint. It involves difficult decisions for everyone – Government, business, the pensions industry and individuals. But thanks to the work of the Pensions Commission, we know already that there is wide support for the principles behind these reforms.

Over the coming months, we will work to build on this support to forge a national consensus. We know this will not be easy but tackling long-term challenges rarely are. Our objective is to put in place a sustainable, affordable and trusted pensions system which will meet the needs of those in retirement and our country in the future.

Tony Blair

The Rt Hon Tony Blair MP

Foreword

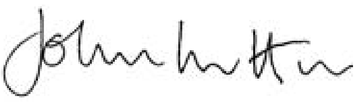
Today we face the challenge of profound social and demographic change that demands a new kind of policy response. The immediate crisis of pensioner poverty is being successfully addressed, but the next challenge is just around the corner. In the next 50 years, the number of people over pension age will increase by more than half and there will be only two people working for every one person in retirement – compared with four today.

Millions of people today are not saving enough for their futures. And our pension system suffers from structural problems. Because of the historical legacy of complexity few people understand how it fits together. It is unfair to many who are caring for others, and particularly to women. It reflects a view of family relationships that dates back to the early years of the State Pension itself.

As the Pensions Commission has made clear, we face some stark choices about the path ahead. We don't want the retirees of the future to be worse off than those today. But neither should our response be simply to spend more public money on the State Pension alone. A new balance must be struck between State, employers and individuals to share the responsibility to save and provide for the future.

To meet these new challenges any reforms must meet five key tests. They must promote personal responsibility, be fair – particularly to women and carers, and provide greater simplicity so that roles are clear. They must be affordable, and offer a sustainable solution that commands a national consensus. Our proposals for reform are designed to meet these fundamental requirements.

The proposals in this paper set out a new structure for the UK pensions system for the long term. I'd like to thank the Pensions Commission for their hard work in creating the basis for consensus. We can now lay the foundation on which this generation and the next can work and save for a long and healthy retirement. And they can do so in confidence that the reforms we are proposing will last between the generations.



The Rt Hon John Hutton MP

Executive summary

Executive summary

Progress since 1997

Tackling pensioner poverty – our first priority

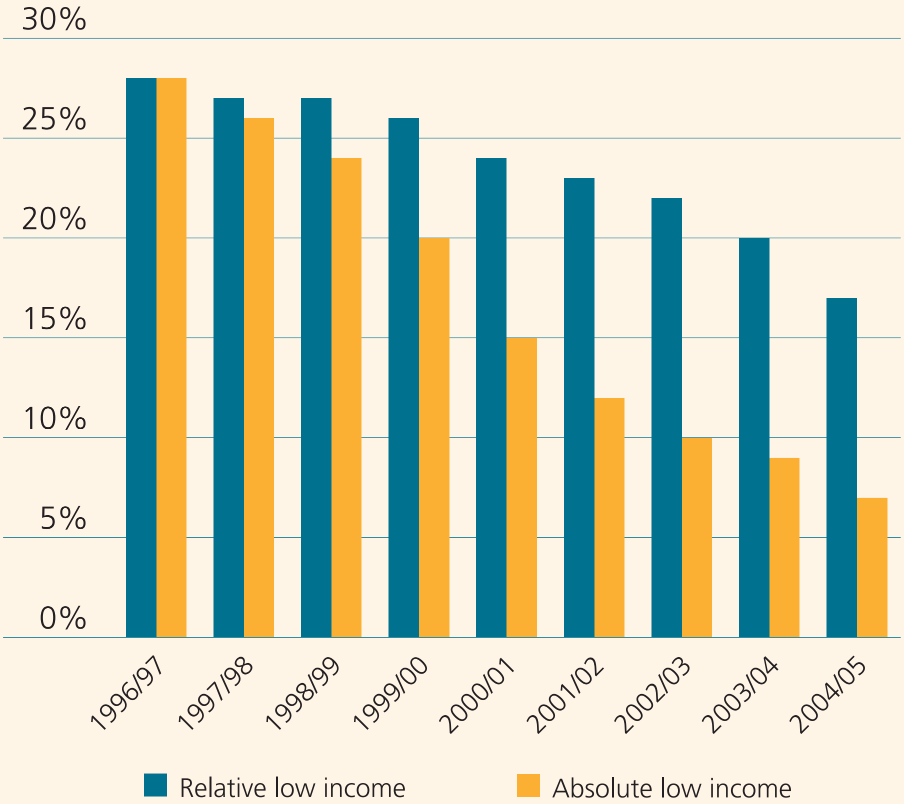
1. Government has a responsibility to protect its citizens against poverty and insecurity in retirement. The actions we have taken since 1997 – establishing Pension Credit, Winter Fuel Payments and real terms increases in the value of the basic State Pension – have helped pensioners escape from poverty.

2. This Government introduced the Minimum Income Guarantee for pensioners, now part of the Pension Credit, which has raised the minimum income pensioners are entitled to from £68.80 a week in 1997 to over £114 today. More than 2 million pensioners have been lifted out of absolute poverty, and 1 million out of relative poverty. And we have seen sustained increases in pensioner incomes, with the poorest benefiting most. Pensioners are now less likely to be poor than younger people. In addition, the savings reward in Pension Credit has tackled the penalty of the 100 per cent marginal deduction rate that many savers faced, for the first time rewarding 1.9 million pensioner households who saved for retirement.

3. The years of economic instability and high unemployment in the 1980s and early 1990s were damaging to pensions and pensioners. High inflation eroded the value of savings. Unemployment, which hit 3 million twice, denied millions the opportunity to build additional pension entitlements. Uneven and unsustainable growth made it harder to plan for the future with confidence. Thanks to the Government's commitment to maintain economic stability, invest in Jobcentre Plus and the New Deal, and make work pay, Britain now has the highest employment rate of any of the G8 countries. Some 2.3 million more people are now in work compared to 1997.

4. These policies have brought significant benefits for pensioners. The high rate of employment has given more people the opportunity to save for their retirement, and has helped contribute to stable growth in the economy. The Government is committed to maintaining this macroeconomic stability.

Figure 1 Percentage of pensioners in relative and absolute low income



Source: Households Below Average Income

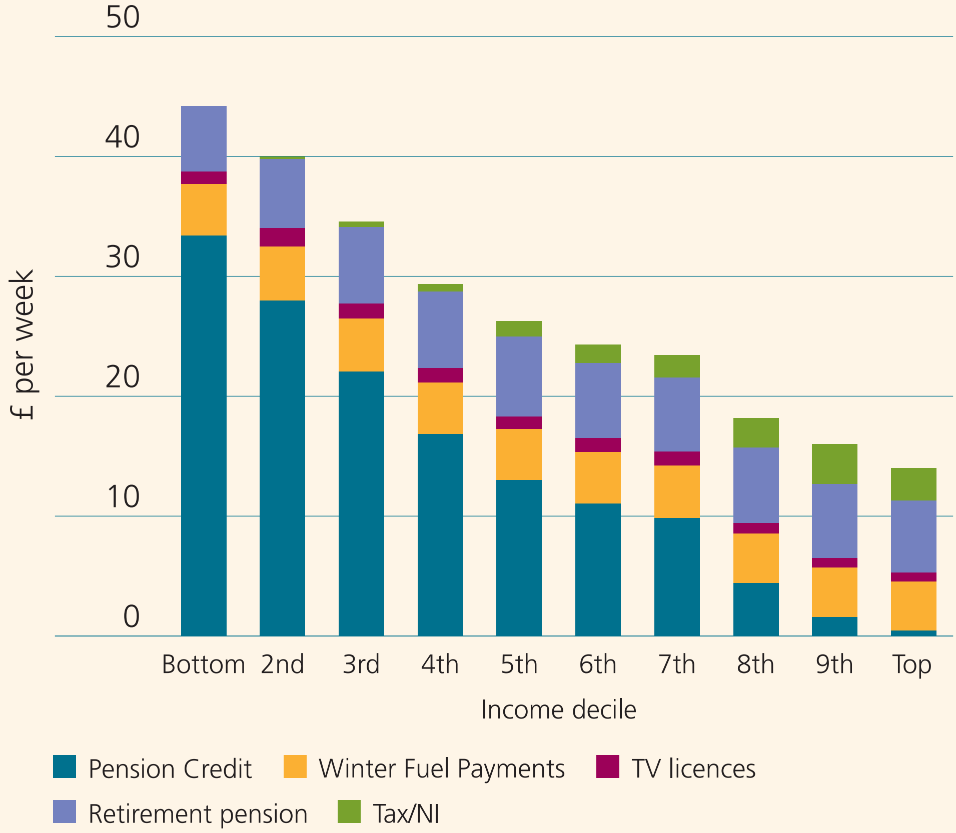
Notes: Relative low income gives the numbers below 60 per cent of contemporary median net income.
Absolute low income gives the numbers below 60 per cent of 1996/97 median net income held in constant real terms.
In each case income is measured after housing costs.

Improving the pensions system

5. We now spend £10.5 billion a year (nearly 1 per cent of GDP)[1] more on pensioners than we would have done if we had simply continued the policies we inherited in 1997. Combined with growth in private pension saving, this has meant pensioner incomes have risen across the board, with the poorest benefiting most. We have achieved these gains while maintaining the affordability of the system as a whole.

[1] Throughout this paper and the accompanying Regulatory Impact Assessment, the costs of reform of private pensions are presented on a 2005/06 price base (the latest year for which actual prices are available). Estimates of expenditure on state pensions are presented on a 2006/07 price base, consistent with our latest estimates of long-term public expenditure projections. Both reflect best practice for their respective purposes. The difference in base year has a slight impact on costs in £, but the estimates are consistent when looked at in terms of percentage of GDP.

Figure 2 Gains for pensioners from this Government's policies since 1997



Source: DWP Policy Simulation Model – see technical appendix for more details

Notes: Gains from 2006/07 policies compared with the 1997/98 system of benefits indexed to 2006/07 prices.
Pension Credit includes Housing Benefit and Council Tax Benefit knock-on effects.

6. In addition to tackling pensioner poverty, the Government has taken significant steps to improve other aspects of the pensions system since 1997.

7. We introduced the State Second Pension in 2002, crediting in low earners and some carers who missed out on its predecessor, the State Earnings-Related Pension Scheme (SERPS). Consequently, some 4 million people now have the chance to build up a decent additional pension for the first time. We introduced stakeholder pensions and required that all employers with five or more employees should provide access either to a stakeholder pension or to an occupational scheme, as an important step towards encouraging more private saving and bringing down the cost of saving.

8. The Pensions Act 2004 has improved security and confidence for occupational pension scheme members. The Pension Protection Fund (PPF) means that over 10 million members of salary-related pension schemes know that they will receive compensation if their employer becomes insolvent and the pension scheme is under-funded. The Financial Assistance Scheme (FAS) will help groups close to retirement who lost out before the PPF was established. Following the Prime Minister's announcement to expedite the review of the FAS planned for CSR07, the Government has decided to extend the FAS so that it will assist eligible people who were within fifteen years of their scheme pension age on or before 14 May 2004. This should ensure that up to a further 30,000 people who lost significant amounts when their pension schemes were wound up, will benefit from the new arrangements. Under this extension, scheme benefits will be tapered so that the Government will pay the full 80 per cent to those within seven years of scheme pension age, 65 per cent to those within eight to eleven years of scheme pension age and 50 per cent to the remainder.

9. The Pensions Regulator will help to protect members' benefits and promote good administration of work-based pension schemes. It has wide powers to investigate schemes and take action where necessary and takes a proactive, risk-focused approach to regulation. The Regulator also provides practical support for the regulated community. And the Finance Act 2004 swept away the complexity of many separate taxation regimes, replacing them with a single, flexible regime based on the simple concept of a lifetime allowance of £1.5 million for tax-privileged pension saving.

10. We have also supported private saving by helping people to make better informed choices about their retirement, introducing a range of pension forecasts to give individuals an understanding of the income they are likely to receive in retirement. Since their introduction, the Government has issued just over 20 million of these forecasts and we are developing web-based retirement planning services.

11. We have taken steps to outlaw age discrimination and promote older working. We have set a long-term aspiration to reach an employment rate equivalent to 80 per cent of the working-age population, including a million more older workers.

12. As the Pensions Commission made clear, private pension incomes are at an all-time high. Living standards have risen for all, but, over the past 25 years at least, more for pensioners than for working-age adults.

The case for further reform

13. So we have already made great strides to tackle the immediate problem of low pensioner incomes and put in place necessary reforms to help people plan for the future. But we have long recognised that further steps would be needed to ensure that people could get the retirement income they expect in the future. In December 2002 we established the independent Pensions Commission, to review the regime for UK private pensions and long-term saving. We asked it to consider the longer-term

challenges faced by the pensions system and whether the existing voluntary pensions regime represented an adequate response. The Pensions Commission concluded that there is no immediate 'pensions crisis', but it outlined those key longer-term challenges, and the need for early action.

Demographic and social change

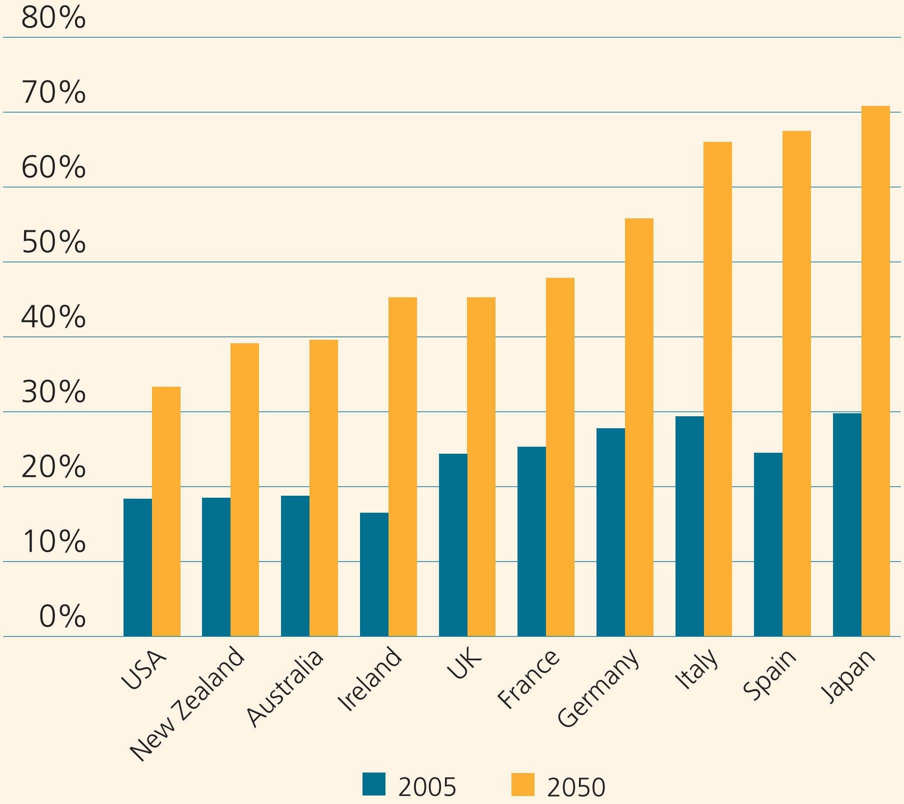
14. Today, people can expect to live longer than ever before. In 1950, a man aged 65 could expect on average to live to the age of 76. Today, he can expect to live to 85, and by 2050 to 89. Women will live for even longer – on average, perhaps, into their early nineties. This is a huge change, ranking among the greatest social achievements of the last century.

15. At the same time, lifestyles and expectations for working life and retirement have changed dramatically since the UK state pension system was first created. In 1948, divorce and remarriage were relatively rare, and it was not unusual for a man or woman to spend their whole working life with one employer.

16. Today, men and women work throughout their lives, and we recognise the value of the service that carers, both of children and of people with disabilities, contribute to society. It is much more common for people to be involved in more than one long-term relationship in the course of a longer life. And it is more likely that people will work for a number of different employers, and mix periods of working, caring, and studying during the course of their lives.

17. Increasing longevity is something that we should celebrate, but it also raises significant challenges. These challenges aren't unique to the UK or specific to governments. Ageing societies are a challenge facing most of the industrialised world, and in many countries state spending is projected to rise to meet that challenge. Figure 3 illustrates the rising dependency ratio for other countries. Some of these countries have also shown the dangers of establishing unsustainable policies, requiring them to reduce commitments.

Figure 3 Worldwide dependency ratios



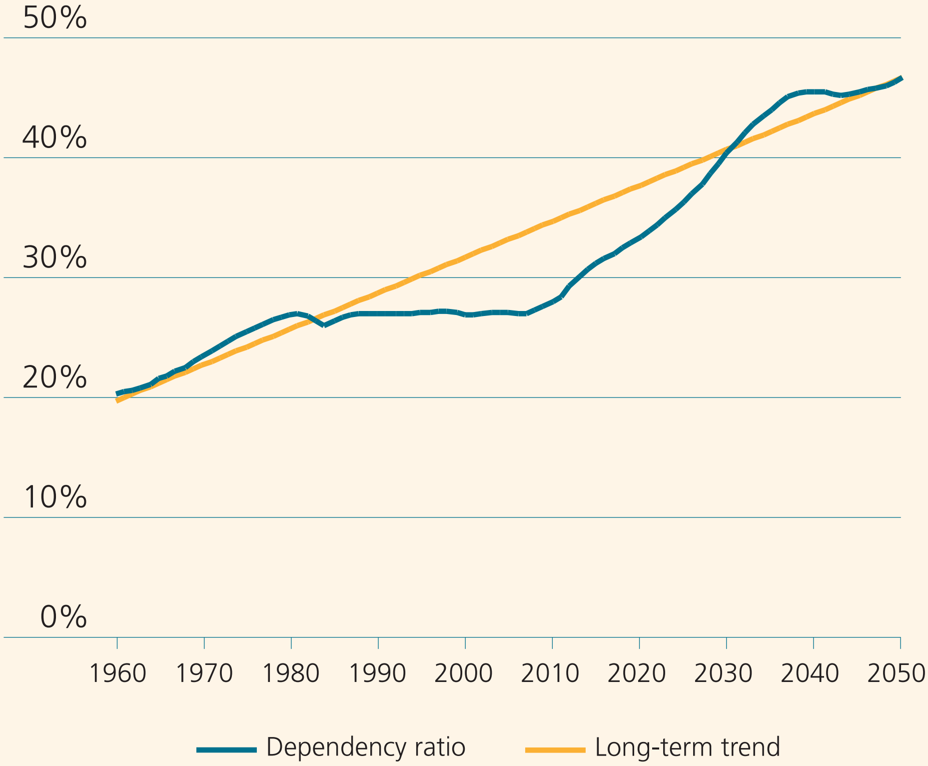
Sources: For non-EU countries, Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, World Population Prospects: The 2004 Revision; for EU countries, Ageing Society Indicators, EUROSTAT 2005

Note: Dependency ratios for EU and for non-EU countries are taken from two separate projection exercises based on different assumptions and methodologies, and thus are not strictly comparable. The definition of the dependency ratio in this chart differs slightly from that used elsewhere in the White Paper in that it represents the ratio of the population aged 65 years or over to the population aged 15–64 (rather than to that aged 20–64).

18. In addition, we are about to experience a dramatic acceleration in the dependency ratio – the balance between the numbers of people of working age and those over State Pension age. Rising longevity means this is on a long-term upward trend. However, with the large cohort of baby-boomers born just after the Second World War swelling the workforce, this ratio has been artificially depressed in recent decades. As that generation goes through to retirement, we will rapidly catch up with the long-term trend.

19. Figure 4 shows the pensioner population as a percentage of the working-age population. In 1950, this ratio stood at just 19 per cent. Today, it has risen to around 27 per cent. By 2050, once the ratio has caught up with the underlying trend, it might be 47 per cent. This demographic shift is transforming the context for pensions policy.

Figure 4 Old-age dependency ratio



Source: DWP estimates based on Government Actuary's Department's 2004-based principal projection, UK

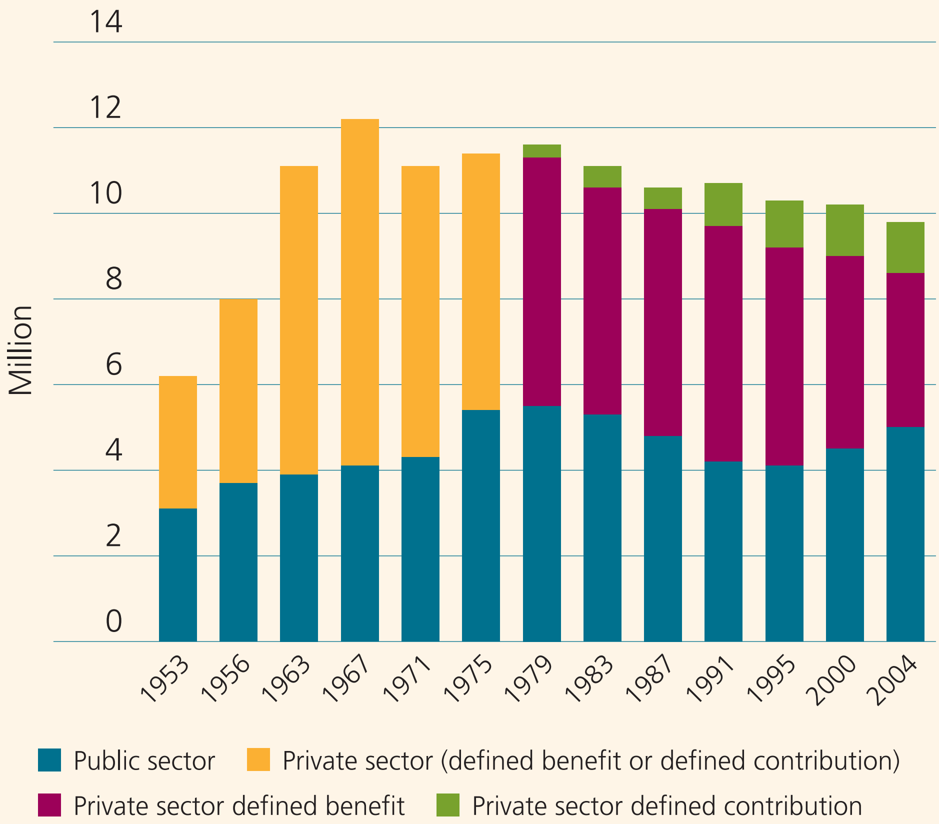
Notes: The old-age dependency ratio shows the number of people aged 65 and over divided by the number of people of working age (ie men and women aged between 20 and 64). The long-term development of this ratio was captured using a modified linear trend.

Undersaving for retirement

20. Retirement undersavers can be defined as those who are likely to receive an income that does not provide for their reasonable expectations of quality of life during retirement. These expectations will vary to reflect different circumstances and aspirations – and consequently a single, fully comprehensive measure of undersaving for retirement is not easily identifiable. However, some analysts have used the idea of replacement rates, that is income in retirement as a percentage of an individual's final salary. In providing an income for their retirement, individuals will have different intentions regarding their retirement age and different types of assets at their disposal. In addition to pensions, they may have other financial and non-financial assets, including property. Total net wealth is now higher than it has ever been before, having risen by around 60 per cent in real terms since 1997. However, the numbers of people saving in pensions vehicles are declining.

21. Since the 1970s, employers have been retreating from occupational pensions as rapid increases in life expectancy and then the end of the high equity market in the late 1990s pushed costs higher than had been anticipated when occupational pension schemes were designed. This trend has continued, with 2 million fewer members of open private sector occupational pension schemes in 2004 than in 2000.[2]

Figure 5 Active members of occupational pension schemes



Source: Government Actuary's Department's Occupational pension schemes survey

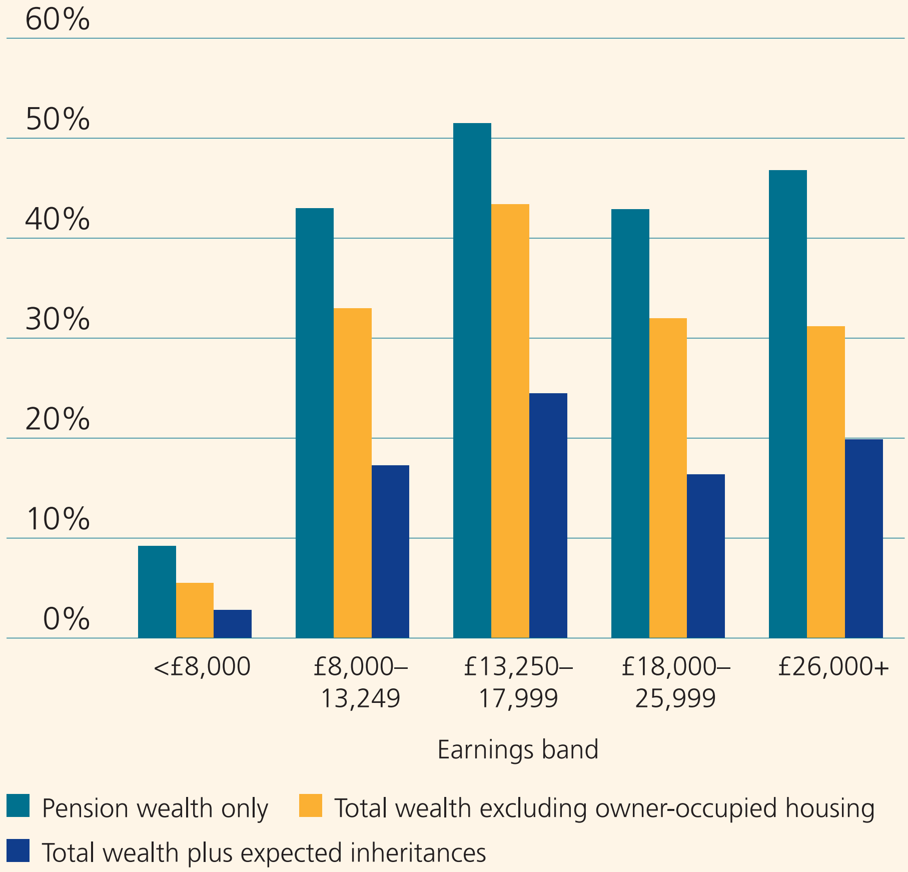
Notes: The 2004 split between private and public sectors is not perfectly comparable with splits in earlier years, since from 2000 onwards the public sector figures have included only those members who are in public service schemes. It follows that, from 2000 onwards, figures for the private sector also include members in the wider public sector (such as the Post Office and the BBC).

22. Occupational schemes have changed in nature as well as decreasing in scale, with a shift from defined benefit (DB) to defined contribution (DC).

[2] GAD survey.

23. The Pensions Commission suggested benchmark replacement rates which vary by in-work income. Their analysis found that between 9.6 million and 12 million people were saving at a rate which would not deliver them retirement incomes in line with those benchmark rates.

Figure 6 Percentage of people aged between 50 and State Pension age at risk of falling below the Pensions Commission's benchmark replacement rates[3]



Source: Further analysis of those at risk of inadequate resources in retirement (Emmerson and Tatlow, Institute for Fiscal Studies, forthcoming)

Notes: Percentages refer to percentage of individuals in families with some earned income. Includes those not in paid employment whose partner has employment income. Earnings bands represent equivalised family gross earned income, including any profits from self-employment.

24. Retirement undersaving has arisen for a variety of reasons: because individuals have not trusted private pensions, because suitable savings vehicles have not been available to them, and because, in the face of a historically complex pensions system, financial short-sightedness and inertia have left inaction as the default option.

[3] IFS analysis of ELSA (to be published 2006).

25. Stakeholder pensions reflect our belief that the workplace provides the best environment for delivering private pensions. But although over 2.7 million stakeholder pensions have been sold, they have highlighted the areas where further action needs to be taken, especially for those people not traditionally served by the savings market. Barriers to saving mean that, unprompted, people often do not take the decision to start saving – and as people move jobs, persistency in pension saving is low. This means that administration, advice and sales costs for providers are high, and makes it difficult for them to serve some sectors of the market profitably.

26. We need to do more to overcome these barriers to saving and drive costs down still further. Information and significant financial incentives are often insufficient. A long-standing feature of the UK pensions system has been its complexity, which can confuse both employers and individuals trying to make the best financial decisions for the long term. The high cost of saving for those without good employer-based provision and a lack of access to suitable products remains problematic. In other words, and as the Pensions Commission has concluded, the current structures need to be reformed to address the challenges of an ageing population.

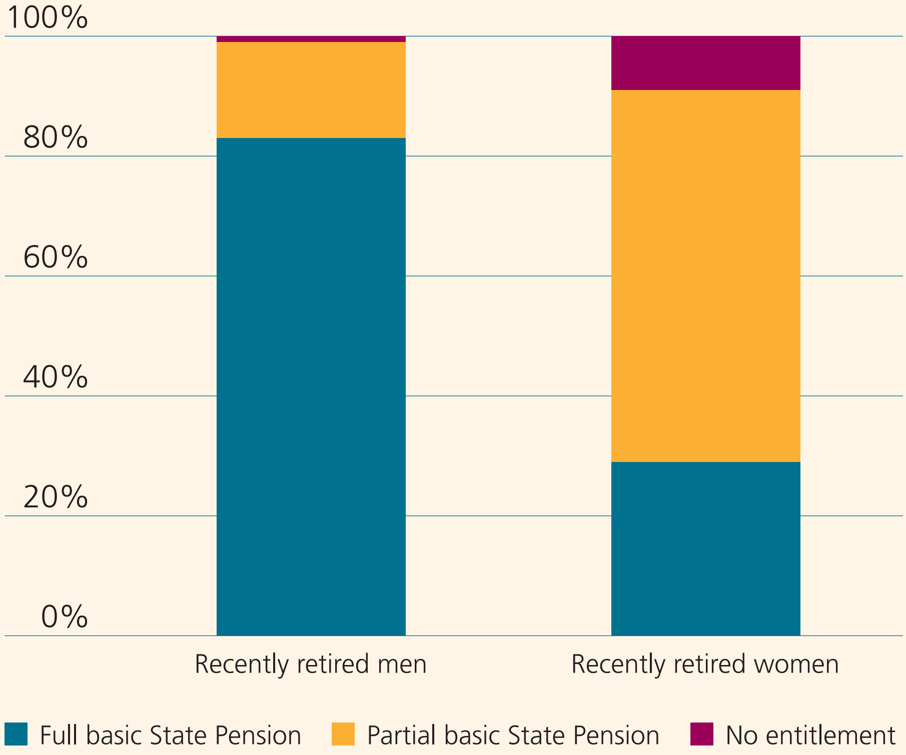
27. As well as saving more in response to increased life expectancy, many individuals will choose to work longer in order to build up a retirement income that meets their expectations. More years in work can enable greater accruals of state pension entitlements as well as providing the opportunity to save more. Since 1997, the employment rate of those aged between 50 and State Pension age has increased from 65 per cent to over 70 per cent, and there are now more than a million individuals over State Pension age who are in work.[4]

Inequalities in the state pension system

28. The pensions system we have today is rooted in the society of the 1940s. Society has moved on and, unless we act now, women and carers retiring in the next two decades will continue to suffer the effects of the system of contributions which applied during their working lives. Figure 7 shows that among those recently reaching State Pension age, around 85 per cent of men have entitlement to a full basic State Pension, compared with only about 30 per cent of women. The introduction of Pension Credit has improved the position of women, who represent two-thirds of those to have benefited from its introduction. We published a detailed analysis of the pensions position of women – past, present and future – with an analysis of the effect of existing National Insurance rules in the Department for Work and Pensions Research Report *Women and pensions: The evidence*, in November 2005.

[4] LFS 2005 spring quarter.

Figure 7 Basic State Pension entitlement of people reaching State Pension age in 2005



Source: Government Actuary's Department's Retirement Pension Model, GB

Notes: Women's entitlement is based on their own and their husband's contribution record. Includes widow's pension over age 60 and deferrers.

Complexity

29. The first State Pension – a means-tested scheme for those aged 70 or over – was introduced in 1908. Since then, a series of legal and other changes have modified, reformed and adjusted that simple provision, towards a pensions system today described by the Pensions Commission as the most complex in the world.

30. Our changes to the state pension system since 1997 have been essential to tackle the immediate problems that we found, and, as we have set out, they have been very successful. Incentives to save in the current system remain strong. Recent research has shown that incentives for many on low incomes have improved as a direct result of the introduction of Pension Credit.[5]

[5] Weale M, van de Ven, J, Sefton J, and 2005, *The effects of means-testing pensions on savings and retirement,* National Institute of Economic and Social Research (NIESR).

31. Problems with incentives could, however, develop if a pensions system evolved in which a significant majority of pensioners were entitled to Pension Credit in the long term. That has never been the intention of this Government.

History of pensions legislation

1908 The Liberal Government came forward with a plan for a non-contributory pension. Implemented from **January 1909**, this **'Lloyd George Pension'**, worth 5 shillings, was payable equally to men and women from age 70.

1911 The **National Insurance Act** required workers and employers to pay compulsory flat-rate contributions for health and unemployment cover. The insurance scheme was extended in 1926 to provide contributory pensions for old-age, widows and orphans.

1948 The **basic State Pension** was introduced as a universal State Pension in return for flat-rate contributions paid by all workers and their employers (except by married women, who could opt out).

1961 Graduated Retirement Benefit (GRB) introduced three new concepts to state provision: earnings-related contributions, an earnings-related pension, and contracting out of GRB for those with occupational pensions.

1974 A legal base for regular uprating (by the best of prices or earnings) was introduced. The 'best of' legislation ended in **1979** and was replaced by a prices link.

1978 The **State Earnings-Related Pension Scheme (SERPS)** was introduced to replace GRB, which had been wound up in 1975. **Home Responsibilities Protection (HRP)** was introduced for carers.

1995 The **Pensions Act** established an equal State Pension age of 65 – to be phased in between 2010 and 2020 – strengthened the regulation of occupational pensions, and altered the terms for contracting out of SERPS.

2002 SERPS was replaced by the **State Second Pension** providing low earners with around twice the pension they would have earned under SERPS.

2004 Pensions Act (see paragraph 8)

Alongside the contributory system, a comprehensive means-tested pension has developed. Means-tested **Supplementary Pensions** were introduced in **1941**. **National Assistance**, introduced in **1948**, was replaced with **Supplementary Benefit** in **1966**, then with **Income Support** in **1988** (developing into the **Minimum Income Guarantee** in **1999**), and with **Pension Credit** in **October 2003**.

Looking to the future

32. To address these challenges, we established the Pensions Commission in December 2002. We asked it to review the operation of the UK pensions system and make recommendations for reform. In November 2005 the Commission published its recommendations.

33. The Government has set five tests for the reform package, building on our successes and principles for reform to date. Any reformed pension system must:

- **promote personal responsibility:** tackling the problem of undersaving for retirement;
- **be fair:** protecting the poorest, and being fair to women and carers, to savers, and between generations;
- **be simple:** clarifying the respective roles of the State, the employer and the individual;
- **be affordable:** maintaining macroeconomic stability and striking the right balance for provision between the State, the employer and the individual; and
- **be sustainable:** setting the basis of an enduring national consensus, while being flexible to future trends.

34. Having assessed the recommendations of the Pensions Commission, we will:

- Introduce low-cost personal accounts to give those without access to occupational pension schemes the opportunity to save. People will be automatically enrolled into either their employer's scheme or a new personal account, with the freedom to opt out. Employers will make minimum matching contributions.
- Improve the foundation for all while continuing to tackle pensioner poverty. We will reform the state pension system by uprating both the guarantee element of Pension Credit and the basic State Pension in line with earnings growth, rather than prices. We will make the State Pension fairer and more widely available and we will raise the State Pension age in line with increasing longevity.

35. The reforms set out here will make an immediate difference to those working and saving for retirement, striking a new balance of responsibility between employer, State and individual. At the same time, we will continue to protect the poorest pensioners from poverty, and we will ensure that all pensioners share in rising national prosperity. We will bring forward legislation on these reforms during the second session of this Parliament.

A new pensions settlement: our proposals for reform

Our first priority is to make it easier for more people to save more for their retirement. To achieve this, in 2012 we will introduce the following:

36. A new scheme of personal accounts, which will provide a straightforward opportunity to contribute to a high-quality, low-cost savings vehicle. The scheme will have the following key features:

- Employees will contribute 4 per cent of a band of earnings of between around £5,000 a year and £33,000 a year.
- Employers will make minimum matching contributions of 3 per cent on the same band of earnings.
- A further 1 per cent will be contributed in the form of normal tax relief.[6]
- There will be support for all employers during the introduction of compulsory employer contributions:
  - their contributions will be phased in over a three-year period, at the rate of 1 per cent each year;
  - the contribution rate will be set out in primary legislation to create stability;
  - the priority is to design the scheme and the transition phase so that burdens on employers are minimised; and
  - we will consult on transitional support for the smallest businesses and whether a longer phasing period is needed.
- Automatic enrolment for employees into either the new personal accounts scheme or their own employer's occupational scheme providing it meets a minimum standard:
  - Employees will be able to opt out of this provision, in which case the employer would not contribute;
  - Non-employees, including the self-employed and non-workers, will be able to opt into the scheme.

The new system of personal accounts with automatic enrolment will provide a simple and straightforward way for people to take personal responsibility for the income they want in retirement.

[6] 1 per cent represents basic rate tax relief on individuals' contributions – in addition, individuals may be entitled to higher-rate tax relief and neither employers nor employees pay tax or National Insurance contributions on employer contributions.

Initial analysis suggests that the best delivery model for the personal accounts scheme is that proposed by the Pensions Commission, but the Government will conduct further analysis of this, and industry alternatives, in order to strike the right balance between value for money for the taxpayer and value for money for the saver. We will bring forward proposals later this year.

Secondly, in order to make the system of personal accounts effective, we will provide a solid foundation on which people can save. To achieve this, we will reform state pensions so that they are simpler and more generous, and will ensure that pensioners share in rising national prosperity.

37. During the next Parliament, 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 by the end of the Parliament at the latest. We will make a statement on the precise date at the beginning of the next Parliament.

We will also:

- reform the State Second Pension so that it becomes a simple, flat-rate weekly top-up to the basic State Pension. Accruals will gradually start to become flat rate at the same time as we start to uprate the basic State Pension by earnings. We estimate that the State Second Pension will become completely flat rate around 2030 or shortly afterwards; and
- ensure that, before implementing the earnings link of the basic State Pension, means-tested provision continues to be focused on those with small savings, by taking steps from 2008 to target the Pension Credit on this group.

Thirdly, from 2010, we will make the State Pension fairer and more widely available.

38. We will radically reform the contributory principle, by recognising contributions to society while retaining the link between rights and responsibilities. This will be achieved by the following measures:

- streamlining the contribution conditions to the basic State Pension by reducing the number of years needed to qualify to 30;
- replacing Home Responsibilities Protection with a new weekly credit for those caring for children;
- introducing a new contributory credit for those caring for severely disabled people for 20 hours or more per week;

- abolishing the initial contribution conditions to the basic State Pension, so that caring for children or the severely disabled will build entitlement to the basic State Pension, without having to make a minimum level of contributions; and

- making a number of other simplifications to the rules for entitlement to the basic and State Second Pensions, and abolishing a number of complicated and out-dated provisions such as adult dependency increases and autocredits.

The current system is unfair to those with caring responsibilities, who tend to be women, and means that their social contributions are not fully recognised by the state pension system. This modernised contributory system will better reflect the different ways in which people contribute to society, and will ensure that carers have improved opportunities to build State Pension entitlements.

Fourth, we will support and encourage extended working lives.

39. We will:

- gradually raise the State Pension age in line with gains in average life expectancy. The State Pension age for women is already due to rise from 60 to 65 between 2010 and 2020, to equalise with men's State Pension age. There will be a subsequent rise for both men and women which will follow the same approach, beginning with a rise from 65 to 66 over a two-year period from 2024, then again by one year over a two-year period from 2034 and from 2044; and

- take measures to support longer working, as set out in the publication *A new deal for welfare: Empowering people to work*, and consider greater flexibility around, and communication of, State Pension deferral.

We note the Pensions Commission's suggestion that the age at which people become entitled to the Guarantee Credit in Pension Credit could remain at 65, in order to protect those with the lowest life expectancies. We think this is an issue that must be considered nearer the relevant time in the light of the available evidence about inequalities in life expectancy and trends in working among older people.

We also propose to periodically commission reviews, drawing on a range of independent expert advice in the light of emerging evidence on demographic change.

40. The increased State Pension age will share the growth in life expectancy between time spent in work and time spent in retirement, and it will secure the financial stability and sustainability of the state pension system for the long term.

Finally, we will streamline the regulatory environment.

41. We will do this by:

- abolishing contracting out for defined contribution schemes at the same time as re-linking the uprating of the basic State Pension to average earnings;
- reducing burdens on schemes by bringing forward legislation to allow schemes to convert Guaranteed Minimum Pension rights into scheme benefits;
- introducing a rolling deregulatory review of pensions regulation, in light of the Pensions Act 2004;
- piloting a Pensions Law Rewrite Project; and
- re-examining the existing regulatory landscape.

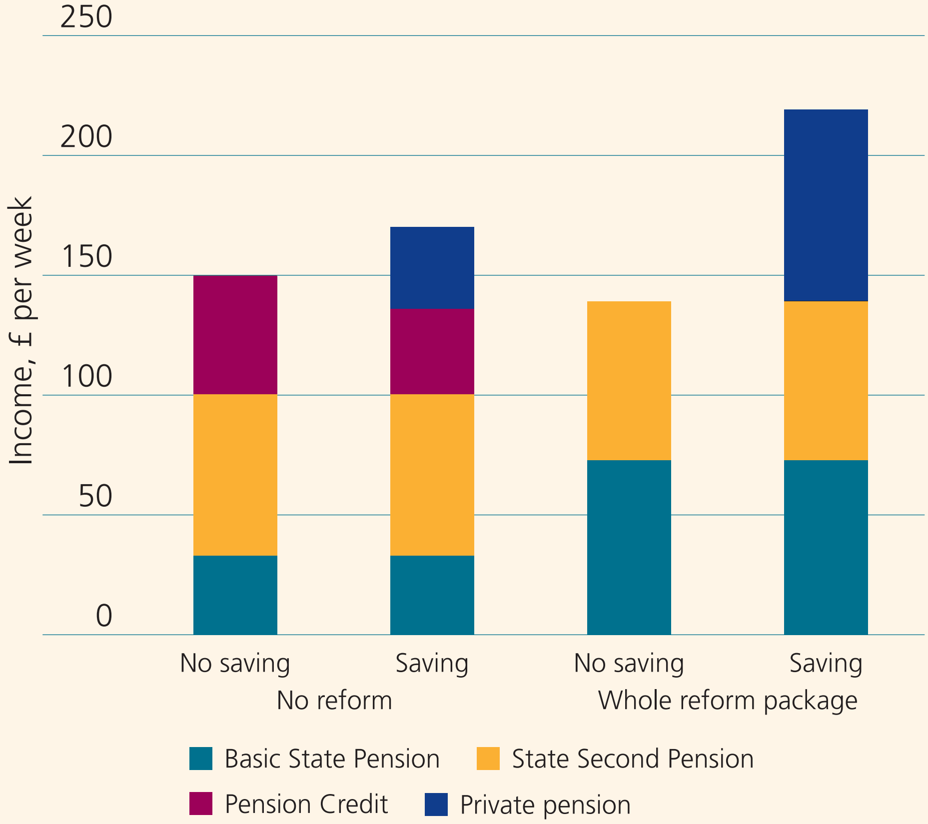
Any such simplifications will be aimed at easing the regulatory burden on employers who provide good occupational pensions. They, and other measures in the proposed reform package, will be taken forward with regard to the Government's wider agenda to promote better regulation and reduce the administrative burdens on business.

Key outcomes of the reforms

- Everyone will be able to enrol into a new, low-cost personal account;
- Automatic enrolment ensures that employees will be saving for a pension unless they actively decide not to do so;
- Up to 10 million people could be saving in a personal account;
- By retirement, their pension funds could be worth up to around 25 per cent more because of lower charges;
- In 2010, 70 per cent of women reaching State Pension age will be entitled to a full basic State Pension, compared to 30 per cent now;
- By 2025, over 90 per cent of women and men reaching State Pension age will be entitled to the full basic State Pension – compared to about 80 per cent without reform;
- By 2050, the basic State Pension could be worth twice as much as if it had been linked to prices;
- Anyone who has been in employment or caring throughout their working life could receive £135 a week at retirement in state pensions – which is £20 a week above the guaranteed income level;[7]
- Fewer pensioners – down to around a third by 2050 – could be entitled to Pension Credit.

[7] These figures are relative to average earnings. If expressed in 2005/06 prices, following these reforms, an average earner retiring in the 2050s will receive £340 per week in state pensions.

Figure 8 Income for median earner – with and without reform – outcomes in 2050/53



Source: DWP modelling

Notes: In 2005/06 earnings terms, income shown before tax.
Saving under no reform assumes saving 5% of salary between the Primary Threshold and Upper Earnings Limit into a stakeholder pension, with a 1.5% annual management charge. This is equivalent to the employee-only contribution rate into the new personal accounts.
Saving under reform package assumes saving 8% of salary between the Primary Threshold and Upper Earnings Limit into a personal account (which includes 3% employer contribution, and has 0.5% annual management charge).
No reform assumes 40 years of saving and working, retiring in 2050.
'Whole reform package' assumes 43 years of saving and working, retiring in 2053.

Meeting the five tests for reform

We believe the reform package set out in this Paper meets the five tests for reform:

Personal responsibility

42. **Automatic enrolment** will ensure that employees have automatic access to a retirement savings vehicle. We will also ensure that the self-employed and non-workers have access to the scheme of personal accounts. Everyone will have the opportunity to save easily, as an essential step towards tackling undersaving for retirement.

43. We need to be clear that **individuals must be responsible for their own plans for retirement**. The reforms will ensure the provision of high-quality savings vehicles, and a solid state foundation to private savings. But the choice of how much to save, the level of risk to take with investments, and how long to work must be available to the individual. That provides the **right balance of choice and support** for individual responsibility.

44. Through these reforms people should see greater return from their private savings than they would under today's system.

Fairness

45. **Protecting the poorest**. We are committed to uprating the Guarantee Credit for pensioners in line with earnings growth. This means that the value of the £114 guaranteed minimum income for single pensioners today will continue to keep pace with the growth in national wealth.

46. We are creating a system which establishes **a new contributory principle for state pensions**. We are committed to the principle of giving 'something for something', rewarding those who have worked and cared for decades before retiring. Our measures to reform the contributory rules for the basic State Pension and State Second Pension will achieve that.

47. Cutting the number of qualifying years required for entitlement to the basic State Pension will immediately give fairer outcomes, particularly for women. All those who have worked or cared for 30 years will get full entitlement to the basic State Pension. Under the current system, around half of women reaching State Pension age in 2010 would have received a full basic State Pension. Under our reforms, that proportion will rise to around 70 per cent. And, by 2025, over 90 per cent of people reaching State Pension age will get a full basic State Pension.

48. We will **widen access to high-quality private savings schemes.** We expect that around 6 to 10 million people might be enrolled in the new scheme of personal accounts once it is fully rolled out.

49. We have set the rate of contribution for the new scheme of personal accounts so as to strike a fair balance between the contribution needed from **employers and from employees**. We are also setting a fair and lasting balance **between the generations**. Current workers must both pay for provision for today's pensioners (through National Insurance) and save more for their own future. We have had to strike a balance between what it is right and reasonable for them to provide in order to improve the situation for those retiring in the next decades, the rate at which we can afford to uprate the basic State Pension, and the expectation on today's and tomorrow's workers to save more for themselves.

Simplicity

50. The Pensions Commission observed that "the UK has the most complex pensions system in the world". The combination of our reforms to state and private pensions will dramatically simplify the system, and make the decision to save a very straightforward one for individuals.

51. Our reforms of state provision will **simplify** the system considerably. The earnings-linked foundation of the basic State Pension will ensure that the decision to save can be more straightforward. Our reforms to coverage will ensure that many more people can be confident of entitlement to the full basic State Pension.

52. **Automatic enrolment gives access to private savings vehicles** to people of working age. For eligible employees, unless they choose to opt out, joining that scheme will be automatic. Taken together, these reforms will mean that it is much simpler for individuals to save.

53. We will also **simplify the rules and structure for private provision** through:

- changes to contracting out which will help to simplify the savings decision; and
- a review of current legislation and the regulatory landscape.

Affordability

54. Figure 9 shows the latest cost figures based on a 2012 start-date for the earnings uprating of the basic State Pension. As paragraph 37 sets out, our objective, subject to affordability and the fiscal position, is to uprate the basic State Pension by earnings from 2012 but in any event at the latest by the end of the Parliament. We will make a statement on the precise date at the beginning of the next Parliament.

Figure 9: Projected costs of State Pension reform, UK

Cost of state reform package (£ billion, 06/07 prices)

£bn, cash	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2030	2040	2050
Reform costs:																
Pension Credit reforms	0.6	1.2	1.8	2.9	4.2	5.5	6.8	8.1	9.4	10.7	12.1	13.5	15.1	38.6	86.0	201.7
Basic State Pension reforms	0.0	0.0	0.0	0.0	0.7	1.4	2.2	3.1	3.9	4.9	5.9	6.9	8.2	34.2	84.9	157.6
State Second Pension reforms	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.3	3.5	13.2	26.9
State Pension Age change	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	–11.4	–35.2	–104.0
Total costs of State Pension reform	0.6	1.2	1.8	2.9	4.9	6.9	9.1	11.1	13.3	15.6	18.0	20.5	23.6	64.9	148.8	282.4
Total pensions expenditure with reform	74	78	82	85	90	95	100	106	111	117	123	129	136	248	434	728
£ bn, 2006/07 prices																
Reform costs:																
Pension Credit reforms	0.6	1.1	1.6	2.6	3.6	4.6	5.5	6.3	7.1	7.9	8.7	9.5	10.3	20.0	33.8	60.1
Basic State Pension reforms	0.0	0.0	0.0	0.0	0.6	1.2	1.8	2.4	3.0	3.6	4.2	4.8	5.6	17.7	33.3	47.0
State Second Pension reforms	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.2	1.8	5.2	8.0
State Pension Age change	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	–5.9	–13.8	–31.0
Total costs of State Pension reform	0.6	1.1	1.6	2.6	4.2	5.7	7.3	8.7	10.2	11.6	13.0	14.4	16.1	33.6	58.4	84.1
Total pensions expenditure with reform	70	72	73	75	77	79	81	83	85	86	88	90	93	128	170	217
per cent of GDP																
Reform costs:																
Pension Credit reforms	0.0	0.1	0.1	0.2	0.2	0.3	0.4	0.4	0.4	0.5	0.5	0.5	0.6	0.9	1.3	1.9
Basic State Pension reforms	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.2	0.2	0.2	0.2	0.3	0.3	0.8	1.3	1.5
State Second Pension reforms	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.2	0.2
State Pension Age change	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	–0.3	–0.5	–1.0
Total costs of State Pension reform	0.0	0.1	0.1	0.2	0.3	0.4	0.5	0.5	0.6	0.7	0.8	0.8	0.9	1.6	2.2	2.6
Total pensions expenditure with reform	5.2	5.2	5.2	5.1	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.9	6.5	6.7

Notes:

- Source: The figures are based on DWP long-term projections of United Kingdom benefit spend consistent with the Budget Report 2006 and DWP estimates of the costs of reform measures.
- Pension Credit reform costs include cost of earnings uprating the Guarantee Credit from 2008/09 and reforms to Savings Credit.
- Basic State Pension reform costs include net cost of earnings uprating the basic State Pension, improvements to BSP coverage, and reforms to ADIs.
- State Second Pension reform costs include net costs of changes to S2P accrual and coverage.
- State Pension age reform costs include savings on pensioner benefits and additional spending on working age benefits.
- Pensions expenditure includes Basic State Pension, State Second Pension, Pension Credit and other pensioner benefits: Winter Fuel Payments, over 75s TV licences, age-related payments and Christmas Bonus. Costs of State Pension reform also include changes in spending on Housing Benefit and Council Tax Benefit among pensioners and additional spending on working age benefits that results from increasing state pension age.
- Costs associated with Personal Accounts have not been included.
- Figures exclude administrative costs and tax revenue implications of reform.
- Abolition of Contracting Out for DC schemes from 2012 decreases Contracting Out rebate revenue foregone – by £4bn to £5bn per year in 2006/07 prices; this is not included in the figures. Abolition also increases S2P expenditure in the future – this is included in the figures.
- The savings from SPA equalisation in the period 2010 to 2020 are reflected in the expenditure totals.
- Figures refer to financial years – 2020 is 2020/1.
- Increases in GDP from higher employment as State Pension age rises after 2020 are not taken into account.

Sustainability

55. Fundamental to the problems we face with pension provision today is a lack of trust and understanding between individuals, employers and the state as to their respective roles and responsibilities in pension provision. We need to reset that balance. But we also need to reform the system so as to give trust and confidence to all parties that this is **a sustainable deal for the long term**. We need consensus that this is a sensible way to strike the balance. And we need to set up the system in such a way that it can respond flexibly to future societal changes.

56. The **National Pensions Debate** was established in February 2005, with the second phase beginning in December that year. Overall, the Government has heard the views of nearly 10,000 people in face-to-face discussions and via DWP's website.

57. This was just part of an extensive programme of Government consultation with stakeholders. We are confident that the solution we have reached strikes the right balance between the views of all those parties affected. The National Pensions Debate clearly shows that out of the four alternatives identified by the Pensions Commission, people want a solution that strikes a balance between saving more, redirecting state spending on pensioners, and a rise in the average retirement age. Our proposed reforms strike exactly that balance.

Northern Ireland

58. The provision of social security and pensions in Northern Ireland is governed by the long-established and widely accepted policy of parity with Great Britain. The Government believes that this should remain the basis of future provision in Northern Ireland and will have regard to it in implementing any proposals set out in this paper.

Conclusion

59. These reforms set the direction for the long-term future of pensions and retirement savings. They will create a system that is coherent, comprehensive and which will stand the test of time. The reforms meet our five key tests and strike the right balance between the responsibilities of the state, the individual and the employer.

60. We welcome comments on these proposals.

The National Pensions Debate

The National Pensions Debate was launched in February 2005 with the publication of *Principles for reform: The national pensions debate*. Over the course of 2005, Ministers from the Department for Work and Pensions (DWP) met with members of the public and regional stakeholders across the UK, aiming to:

- raise awareness of the tough decisions that society faces in ensuring a fair and adequate retirement income for all in the future; and
- allow the UK public to have their say on emerging options for reform of the UK pensions system.

Background

Between June and November 2005, Ministers held eight National Pensions Debates in different regions across the country, to raise awareness of the tough pensions choices we face and to allow the public to engage in the debate and share their thoughts and experiences regarding pensions. At the same time, Ministers engaged with regional stakeholders on these issues.

With the publication of the independent Pensions Commission's proposals for reform in November 2005, the focus of the National Pensions Debate switched to deliberative consultation, using the broad framework of the Pensions Commission's second report as a basis for discussion with both stakeholders and the general public.

Stakeholders

In order to build consensus for a long-term pensions settlement, on 18 January 2006 DWP Ministers held the first of two seminars with Age Concern, the Association of British Insurers, the Confederation of British Industry, Help the Aged, the Investment Management Association, the National Association of Pension Funds and the Trades Union Congress. These and other organisations were also engaged in the debate through meetings with Ministers.

At an event on 28 February 2006, representatives of the pensions industry presented for in-depth debate alternative models to the Pensions Commission's proposed National Pension Savings Scheme. The event was attended by DWP Ministers, MPs, Lords, Pensions Commissioners, Regulators and representatives of employers, consumers, the financial sector, and government departments.

National Pensions Day

As part of the ongoing National Pensions Debate, regional events were held in Southampton on 18 February 2006 and in Manchester on 25 February 2006. These events were also used to inform the development of a National Pensions Day. Materials at the events were refined following feedback from participants and observers.

A Citizens Advisory Panel was set up to consider the materials and provide a realistic viewpoint on their content. The panel was made up of members of the public and matched the demographic profile of the sample that was used for the deliberative events.

The National Pensions Day, which took place on Saturday 18 March 2006, was a deliberative consultation exercise organised by DWP in conjunction with the research-based consultants, Opinion Leader Research. Over 1,000 participants attended six events held simultaneously across the UK. These events took place in London, Birmingham, Newcastle, Glasgow, Belfast and South Wales. Those attending were asked to consider and vote on the broad framework of the Pensions Commission's proposals.

Views were also collected through an online debate and via feedback from stakeholder-run events.