HM Government

United Kingdom National Strategy Report on Adequate and Sustainable Pensions

An update report to the European Commission on the UK's progress since 2002

July 2005

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Introduction

1. In 2001, the European Union (EU) extended the open method of co-ordination to the area of pensions to 'help Member States progressively develop their own policies so as to safeguard the adequacy of pensions whilst maintaining their financial sustainability and facing the challenges of changing social needs'. Within the focus on the three key areas of adequacy, financial sustainability and modernisation, the following 11 objectives[1] were set out:

Adequacy

- Preventing social exclusion.
- Enabling people to maintain living standards.
- Promoting solidarity.

Financial sustainability of pension systems

- Raising employment levels.
- Extending working lives.
- Making pension systems sustainable in a context of sound public finances.
- Adjusting benefits and contributions in a balanced way.
- Ensuring that private pension provision is adequate and financially sound.

Modernisation: responding to changing needs

- Adapting to more flexible employment and career patterns.
- Meeting the aspirations for greater equality of men and women.
- Demonstrating the ability of pension systems to meet the challenges.

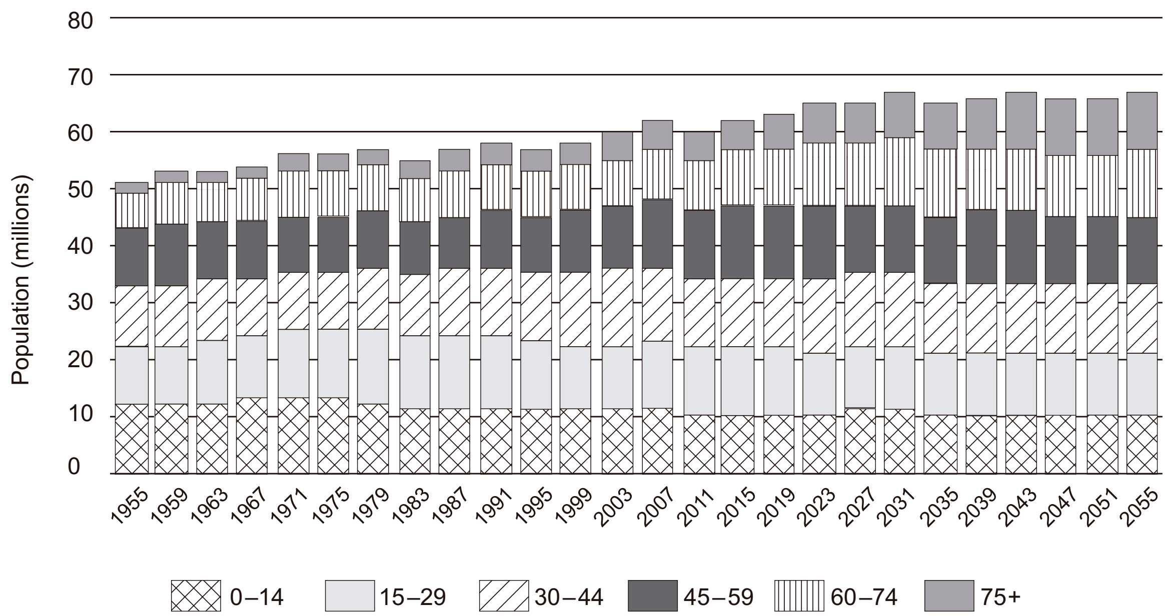
[1] Appendix 1 indicates where each of these objectives are addressed in the report.

2. Member States were invited to prepare national strategy reports on pensions describing how they were trying to meet these objectives. The first set of reports was submitted in September 2002.

3. Since the initial report, the UK Government has taken significant steps in both state and private pension provision. This introduction provides a brief overview before the report itself provides a more detailed account of those developments and looks forward to the challenges ahead.

The challenge

4. The UK, in common with many countries in the developed world, faces a challenge over the coming 50 years as a result of the changing age profile of its population. People are living longer – the Government Actuary's Department projects that in the UK, by 2055, the average man of 65 is likely to have around 22 years of life ahead of him, compared with only 12 years for a 65 year old in 1950, and 19 years today. By the mid-century, the average woman of 65 will expect to reach almost 90. At the same time, there have been long-term improvements in health; more of us – 8 in 10 men and 9 in 10 women – are surviving middle life to reach 65 and there is a long-term trend for families to have fewer children. Taken together, these factors mean both that the numbers of people aged over 50, over 65 and especially over 85 are set to increase rapidly, and that they will form a larger proportion of the total population. The graph below shows how the age profile of the population changes over time.



5. In many ways, the UK faces a lesser challenge than some other major countries in coping with demographic change – fertility rates here have not fallen as far below replacement levels as some, and the UK economy is in a stronger position than many others to weather the challenge. The UK Government is clear that the UK cannot necessarily rely on existing

structures to provide the same outcomes as the century progresses. It has embarked on a programme of reform, seeking to develop policies that will endure for the long term. The UK Government believes that significant progress has been made since 2002, but recognises that more needs to be done.

Overall approach to reform

6. The UK Government is committed to providing a clear and sustainable framework for retirement provision in which the state, employers, the financial services industry and individuals all play a part. Since the publication of the Government's Green Paper[2] in December 2002, measures designed to achieve this end have been developed and taken forward through legislation and through the publication of *Informed choices for working and saving*[3]. The UK Government's policies aim to deliver:

- **a guarantee of a decent minimum income in retiremen**t – provided by the state and below which no pensioner need live. The UK may be distinct because they regard 'target' retirement income as something for individuals and families to choose themselves: the state's role is in setting basic foundations to build upon;

- **transparency** – the UK Government's Informed Choice programme is helping people to make informed and effective choices about working and saving for their retirement;

- **simplicity** – the UK Government is simplifying the tax regime for pensions and ensuring that people have access to simple and flexible savings products;

- **security** – the Pension Protection Fund and a new proactive Pensions Regulator will improve protection for members of occupational pension schemes; and

- **opportunities for extended working lives** – the UK Government is combating age discrimination and enhancing the options for those choosing to defer taking their State Pension, providing people with greater opportunity and rewards for working longer if they wish to do so.

7. Central to meeting the long-term challenges and underpinning all of this is the need to achieve sustained productivity growth and maintain macro-economic stability. First, productivity growth will provide higher living standards for all, including older people. Second, it is only in a world of macro-economic stability and employment opportunity for all that individuals and families will be able to plan for their retirement, and make real and meaningful choices about their working lives and savings. In particular, pension reforms can only be effective in coping with demographic pressures when linked with employment levels and ensuring older people have viable options to continue working. Of those aged between 50 and State Pension age (SPA), the employment rate has risen from 65% in 1997 to 70% now. Furthermore, there are now nearly one million people over State Pension age in

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[2] *Simplicity, security and choice: Working and saving for retirement* (Cm 5677, published 17 December 2002).
[3] *Simplicity, security and choice: Informed choices for working and saving,* Department for Work and Pensions (DWP), February 2004.

employment. Thirdly, because some types of savings income may not be protected from high or unexpected increases in prices, it is important to maintain low and stable rates of inflation.

Reform of the state system

8. The UK Government believes the prevention of poverty in retirement is a fundamental role for the state. Too often, either pension policies themselves, or the way they have been delivered, have let down those in most need. In recent years, the priority has been to tackle pensioner poverty in the UK. The introduction of Pension Credit in October 2003 has been the UK Government's key response, and latest statistics show that 1.9 million pensioners have been lifted out of absolute poverty since 1996/97 – reducing the numbers in poverty by two-thirds.[4]

9. While additional help has been focused on the poorest pensioners, the UK Government has also ensured that all pensioners share in the growing wealth of the nation through other measures, notably Winter Fuel Payments and above-inflation increases in the basic State Pension.

10. The UK Government has also reformed the pension system to provide additional help for future pensioners, by significantly increasing both the coverage of state second-tier pensions and the amount accrued by low and moderate earners through the introduction of State Second Pension.

Reform of the private pension system

11. Beyond the foundation of a guaranteed minimum income provided by the UK Government, it is for individuals and families to decide for themselves what income they wish to receive in retirement. The UK Government is working with employers and providers of pension services to provide timely, accurate and tailored information which will enable people to make informed choices about their retirement provision.

12. The UK Government recognises that reform and clarity is also needed around the tax treatment of pension saving. The existing eight taxation regimes create complexity, each with its own set of rules. Following an announcement in the UK Budget 2004, the Finance Act 2004 legislated for a single regime for tax-privileged pension savings, which will come into effect in April 2006. As well as providing individuals with greater flexibility and choice over their retirement savings, tax simplification will benefit employers and pension providers through a reduction in administrative costs.

13. In addition to information and transparency, individuals need access to simple, good-value products. The introduction of 'stakeholder' pensions has ensured that value-for-money, flexible private pension arrangements are available to all.

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[4] *Principles for reform: The national pensions debate*, DWP, February 2005.

14. The UK Government also has a role in ensuring that there is appropriate regulation of the pensions and savings industry. To rebuild confidence in saving, the UK Government acted to ensure that victims of personal pension mis-selling were compensated where this was appropriate. More recently, the UK Government has established the Pension Protection Fund (PPF). This is the UK's first initiative for ensuring that individuals in defined benefit pension schemes receive a meaningful proportion of their expected pension income if their sponsoring employer becomes insolvent.

The future

15. The UK Government established the Pensions Commission in December 2002 to review the regime for UK pensions and long-term savings, and to assess how effectively the current voluntarist approach is developing over time. In its first interim report, issued in October 2004, the Pensions Commission argued that if future generations of pensioners were not to become relatively poorer than the current generation, there were three options: higher average retirement ages; higher savings; or higher taxes/National Insurance contributions.

16. The UK Government welcomed the first interim Pensions Commission Report, which furthered understanding of the challenges posed by an ageing population, and looks forward to the Commission's second report on policy recommendations in autumn 2005. The UK Government will respond to the long-term savings issues raised by the Commission. The nature of any response will be guided by the imperative of maintaining long-term adequacy and fiscal sustainability.

17. In the meantime, in February 2005, the UK Government published *Principles for reform: The national pensions debate*. This report set out the principles for wider reform of the pension system. The principles are:

- The pension system must tackle poverty effectively.
- The opportunity to build an adequate retirement income should be open to all.
- Affordability and economic stability must be maintained.
- The pensions system should produce fair outcomes for women and carers.
- Reform should seek to establish a system that people understand.
- Reform should be based around as broad a consensus as possible.

18. These principles will guide the work in designing a pension settlement that meets the challenges for the UK in the future set out in the Pensions Commission's first report.

Adequacy

19. The UK population, as in many other European countries, is ageing. The old age dependency ratio (the number of people over SPA as a proportion of the population aged 16 to 64) is expected to increase by a third over the next 25 to 30 years. This is partly due to projected birth rates being below the replacement rates and partly due to rising longevity. Without the increase in women's SPA age from 60 to 65 over the period 2010 to 2020, the disparity in the old age dependency ratio would be greater.

20. The UK Government realises that an ageing population presents a number of challenges to the pension system, which need to be addressed so that more and more people can fully enjoy the benefits of rising longevity. To meet these challenges, the UK Government:

- aims to target State Pension spending at those who need it most;
- aims to extend working lives, by helping older people to remain in work longer, if they wish to do so. Longer working lives will allow people to save longer, and therefore have a better chance to accumulate adequate pension provision, as well as reducing the period of retirement that any savings have to support. This will help secure a higher income in the retirement phase by reducing the number of years it must cover; and
- expects that private forms of pension provision should increase over time and have an important role to play in overall pension provision. It is envisaged that the stakeholder pension (introduced in 2001) and the UK Government's Informed Choice programme (raising awareness among individuals below SPA through provision of information) will help this expansion.

Tackling poverty

21. Over the last 25 years, average pensioner incomes have increased twice as fast as earnings in the UK. The average net income of all pensioner households in Great Britain doubled in real terms between 1979 and 2004, while average earnings grew by 50% over the same period. A large part of this increase is due to the spread of occupational pension schemes.[5]

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[5] *Principles for reform: The national pensions debate*, DWP, February 2005.

22. However, in the past the growth was not equally shared – between 1979 and 1997 the incomes of the richest fifth grew over twice as fast as the incomes of the poorest fifth, and in 1997, 27% of pensioners were in poverty.[6]

23. It is for this reason that the UK Government brought in measures such as Pension Credit to tackle pensioner poverty. The overall effect of the changes is that since 1997, growth in pensioner incomes has continued to exceed earnings growth, and this time it is spread equally across the income distribution. That means that 1.8 million pensioners, 1.3 million of whom are women, have been taken out of poverty,[7] and now a pensioner is less likely to be in poverty than a non-pensioner.[8]

24. For future pensioners, the UK Government's priority has been to enable people to build up a decent second pension and encourage saving through the private sector. The reforms to the additional State Pension are enabling 6 million low earners, 9 million moderate earners, 2 million carers and 2 million disabled people, with broken work records, to build up new or better supplementary pension rights.[9]

Pension Credit: how does it work?

25. Pension Credit is an income-related benefit ensuring that no one aged 60 or over need live on less than £109.45 (€158) per week (£167.05/€240 for couples). These amounts may be more for people who have caring responsibilities, are severely disabled or have certain housing costs. Around £7 billion has been set aside to increase pensioners' income in the form of Pension Credit in 2005/06.

26. Pension Credit also ensures that pensioners aged 65 or over who have made modest savings are rewarded. The saving credit element of Pension Credit can increase pensioners' income by up to £16 (single person) or £22 (couple) per week in 2005/06. Pensioners with income up to £151 (single person) or £221(couple) per week can still gain from Pension Credit.

27. The income test for Pension Credit is designed to be much less intrusive than that for traditional income-related benefits. Claims for Pension Credit can be made by telephone and take on average twenty minutes.

28. With Pension Credit, savings of £6,000 or less are ignored, and as a result most pensioners getting Pension Credit will see any income they receive from their savings ignored entirely.

29. From age 65, most Pension Credit recipients will not have to report any changes in income for a period of up to five years. The UK Government's aim is for Pension Credit to become increasingly accepted as part of the older people's entitlements with a simplified claims process and reduced need for complex information.

[6] Defined as 60% of contemporary median income after housing costs basis.
[7] *Principles for reform: The national pensions debate*, DWP, February 2005.
[8] See, for example, *Poverty and inequality in Britain*, Institute of Fiscal Studies, 2004.
[9] *Principles for reform: The national pensions debate*, DWP, February 2005.

30. As well as Pension Credit, there are other important elements of support such as Winter Fuel Payments of up to £300 for those aged over 80, free TV licences for those aged over 75, free local off-peak bus travel, and help towards expenses such as council tax. In Scotland, pensioners can also have free installation of central heating, and free personal and nursing care.

31. Older people are also assisted by remission of charges (such as for prescriptions and eye tests from age 60). Those receiving Pension Credit are potentially eligible for substantial help through assistance programmes to help prevent fuel poverty. Pension Credit recipients are also exempt from local authority charges for social care, where they exist. These forms of assistance are not relevant to all pensioners, but they can make a substantial difference to those who are eligible for them.

Access to services

32. The UK Government is also acting to improve older people's access to services. After consulting pensioners and groups who represent them, it introduced The Pension Service. This service is based on what people have said they wanted – an improved and modernised service to pensioners through a network of modern pension centres across the country.

33. These pension centres are now fully operational, helping pensioners with their take-up of benefits, the basic State Pension and Pension Credit. Pensioners can also use The Pension Service as a gateway to other services they receive, such as Housing Benefit[10] and Attendance Allowance.[11] Pension centres are provided in locations accessible to pensioners, and are backed up by a local service delivered in partnership with voluntary organisations who are used to dealing with pensioners' needs. This provides a more joined-up service to customers and encourages take-up of benefits and entitlements.

The devolved administrations

34. There needs to be a strategy for pensions that works for the whole of the UK. The devolved administrations in Scotland, Wales and Northern Ireland have responsibility for health and social care, housing and local government, and all services which are critical to the well-being of older people. Their powers differ and in some cases they have chosen different paths to respond to local needs and priorities. Scotland has adopted a different approach to funding social care, where Community Planning Partnerships have the key role in improving public service delivery at local authority level. The Scottish Executive is also funding the Age Concern Scottish Helpline for Older People (providing £145,083 in 2005/06). The Welsh Assembly has published its own older people's strategy, within the framework of its devolved powers.

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10 Housing Benefit is a social security benefit scheme to help pay for basic housing costs.
11 Attendance Allowance is a benefit (payment) for people over 65 years old with disabilities, who need extra help with day-to-day care.

Supporting people in building up a second pension

35. While the basic State Pension provides a solid foundation for further pension saving, most people need additional saving to meet their ambitions for retirement income. Contributions to the earnings-related State Second Pension or broadly equivalent provision via a contracted-out occupational or personal pension are therefore mandatory for all employees and their employers subject to certain earnings rules.

36. The State Second Pension replaced the State Earnings-Related Pension Scheme (SERPS) in 2002. This reform focused extra help on people with low and moderate earnings, who were unable to make significant private provision for their retirement. Additionally, the State Second Pension makes provision for certain carers and long-term sick and disabled persons.

37. Thus employees earning more than the annual National Insurance Lower Earnings Limit but less than a new statutory Low Earnings Threshold (£12,100 in 2005/06), as well as qualifying carers and long-term ill and disabled people, are treated as if they had earnings of £12,100. The overall effect is that, after a full working life, low-paid employees will get at least twice the amount of State Second Pension they would have got from SERPS.

38. Moderate earners (those earning up to £27,800 a year in 2005/06) also gain in comparison with SERPS, but on a sliding scale. People earning more than £27,800 get the same State Second Pension as they would have got from SERPS. This is in line with the UK Government's strategy of targeting additional resources, to ensure that extra help from the state is concentrated on those who are less able to rely on their own voluntary provision.

39. Individuals can choose to contract out of the State Second Pension and accrue a supplementary pension within either an occupational or a personal pension scheme. Under these arrangements, employees forgo all or part of their State Second Pension entitlement and, in return, the UK Government provides a contracting-out National Insurance rebate. The employee pays a lower level of National Insurance contributions and/or receives an annual payment, while employers with occupational pension schemes pay lower rate National Insurance contributions.

Occupational pensions

40. The UK Government's strategy is about striking a balance: a good pensions policy has to protect the poorest, but also provide incentives for people to save. It has to ensure that all pensioners share fairly in rising prosperity, but also be fair to future generations by avoiding saddling them with excessive tax increases.

41. Supplementary and voluntary initiatives have always formed a major part of UK pension provision, complementing the state scheme. Two-thirds of present pensioners receive some income from a private pension. Though the contribution of individual personal pensions is growing, the vast bulk of private pension provision in the UK is via occupational pension schemes.

42. It is not compulsory for UK employers to provide an occupational pension scheme, or for employees to join such a scheme where it is offered. However, both provision and take-up of occupational pensions are high. Currently, data shows around 10 million employees (nearly half of all employees) are acquiring rights in occupational schemes.[12]

43. The majority of employees in occupational schemes are members of large defined-benefit (DB) schemes.[13] They offer a pension related to years of service and salary in final years of employment. They are funded pension schemes – employers have to make sure there is enough money invested in the scheme's pensions fund to pay the pensions. If there is a shortfall the employer has to make it up. The new Pension Protection Fund (PPF) makes these pension promises more secure for employees (paragraphs 109 et seq. have more information on PPF).

44. However, the coverage of money-purchase defined-contribution (DC) schemes is growing and most new schemes have taken this form.[14] In this form of occupational pension, the contributions paid by employer and employee are invested, and the amount of pension received depends on how well the investments perform.

45. As in other countries, there is a growing trend in the UK towards hybrid and non-conventional pension schemes.[15] These can take many forms including sequential hybrids (members start in a DC scheme and then transfer later to a DB arrangement); combination hybrids (members accrue rights in both DC and DB parts of the scheme at the same time); and cash balance (where the characteristics are similar to a DC scheme in some respects, but the employer offers a guaranteed rate of investment return). With DB schemes, the sponsoring employer bears most of the risks inherent in pension provision – those related to investment, longevity, and inflation. With DC schemes, this situation is more or less reversed, with the risk burden falling largely on the plan member. Hybrid schemes represent an intermediate position whereby the total risk is shared in some way between employers and employees.

46. Occupational pension schemes are proactively monitored by the Pensions Regulator and are subject to strict rules on their maintenance and funding (paragraph 112 has more information on the Pensions Regulator).

Stakeholder pensions

47. The UK Government recognised the importance of encouraging the take-up of pensions, and as a result introduced stakeholder pension schemes in April 2001. This form of private pension account has been designed to provide a pension option for people with moderate incomes who do not have access to a company pension scheme. By law, stakeholder pensions must meet a number of minimum standards to ensure they offer savers value for money, flexibility and security. These include:

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[12] *Occupational pension schemes 2004*, GAD, 12th survey, published June 2005.
[13] *Occupational pension schemes 2004*, GAD, 12th survey, published June 2005.
[14] *Occupational pension schemes 2004*, GAD, 12th survey, published June 2005.
[15] *Occupational pension schemes 2004*, GAD, 12th survey, published June 2005.

- the capping of annual management charges;
- the prohibition of penalty charges for transferring into or out of a stakeholder pension or for stopping paying contributions for a time; and
- a requirement for schemes to be run by trustees or by an authorised stakeholder pension scheme manager with responsibility for ensuring that the scheme meets various legal requirements in its operation.

48. Employers with five or more employees are required to offer their workers access to a stakeholder pension scheme, unless they provide an occupational pension scheme that is open to all their staff or they offer contributions to a personal or stakeholder pension equivalent to at least 3% of an individual's wages.

49. From April 2005, the UK Government has introduced lifestyling into the stakeholder pension to further reduce the risk to scheme members. Lifestyling is an option which means that as the member approaches retirement, their pension savings can be moved gradually from equities to fixed income investments. This reduces the risk to the member of a sudden downturn in the market in the period leading up to their retirement.

50. At any one time, it is estimated that around 270,000 employers offer their workforces access to a stakeholder pension scheme.[16] Since their introduction, over 2.3 million stakeholder pensions have been sold.[17] Approximately 98% of sales have been to or for people of working age between 16 and State Pension age, with around two-thirds of sales being to people earning under £20,000 a year, and around a third of sales being to women.[18] The latest data shows that in the first half of the 2004/05 tax year, contributions into stakeholder pensions totalled approximately £1.1 billion – up by around a quarter compared with the same period in the previous tax year.[19] The competitive effect of the stakeholder pension charge cap has led to personal pension charges falling by around a third between 1999 and 2001 to around stakeholder pension charge levels.

Building on the tradition of voluntary savings: the Informed Choice programme

51. The Informed Choice agenda is designed to address the lack of adequate savings provision being made by individuals for their retirement. A UK Government Green Paper[20] identified that, although people are saving for their retirement, significant numbers of people are not saving enough in their pension scheme to give them the income that they hope for in retirement. In addition, a significant minority of people are not saving in a pension at all. Estimates indicate that some 3 million people are seriously at risk of under-saving over their

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16 *Hansard*, 27 October 2004 col.1288W.
17 *Annual summary of new life and pensions business 2004*, Association of British Insurers, 2004.
18 *Personal pensions (including stakeholder pensions) statistics: stakeholder pensions for individuals,* Tables 7.10 and 7.11, 2002/3 tax year, HM Revenue & Customs.
19 *Personal pensions (including stakeholder pensions) statistics: stakeholder pensions for individuals*, Table 7.5, HM Revenue & Customs.
20 *Simplicity, security and choice: working and saving for retirement* [Cm 5677], DWP, 17 December 2002.

lifetime and a further 5 to 10 million people may need to save more or work longer depending on their expectations of their retirement income.[21] These figures were confirmed by the Pensions Commission interim report of October 2004,[22] which found that 9 million people were under-saving for their retirement.

52. The Pensions Commission has observed that the UK has one of the most complex pension systems in the world, reflecting the cumulative impact of many changes and decisions over the last few decades. The UK Government proposes that simplification should be a key principle for reform. This will establish a system people can understand and make it easier for individuals and employers to make informed choices.

53. The UK Government believes that individuals should be empowered to make their own decisions about their retirement. This means providing people with the right information they need to make informed decisions about how to save, how much to save and how long to stay in work. The Informed Choice programme is designed to reach all people under State Pension age. A high priority is to reach those who are most at risk of under-saving and who risk a drop in living standards in retirement.

54. The UK Government also wants to achieve a shift in the attitudes and behaviours of employers. It wants all employers to offer access to pensions through the workplace, to make a significant contribution to their employees' pension as a key part of the overall remuneration package, and actively to promote their schemes to all employees, thus encouraging people who can afford to save to do so. The priority is to reach and influence those employers who make very low or no contributions to their employees' workplace pensions or who have designated a stakeholder scheme that remains empty.

55. The UK Government is piloting different ways of delivering pensions information and advice through the workplace, to evaluate which is most effective. One option is a pension information pack, which has been developed with the help of the Association of British Insurers (ABI) to help employers give information about pensions to their employees, through to one-to-one advice sessions for employees with Independent Financial Advisers. The pilot study began in July 2004 and the findings, published by the end of summer 2005, will help inform how reserve powers taken in the Pensions Act 2004 might in the future require certain employers to provide their employees with access to pension information and advice.

56. The UK Government is also working with pension providers and employers to evaluate a range of techniques to maximise membership of workplace pension schemes and to establish which are the most effective in delivering increased pension saving in the UK. An example of this work is the exploration of the effectiveness of automatic enrolment, where employees automatically become members of their employer's pension scheme but can choose to opt out. This technique is reported to increase participation rates in defined contribution schemes to around 90% compared with around 50% participation where an opt-in technique is used.

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[21] *Simplicity, security and choice: working and saving for retirement* [Cm 5677], DWP, 17 December 2002.
[22] *Pensions Challenges and Choices: The First Report of the Pensions Commission*, Pensions Commission, 2004.

57. Pension forecasts deliver information tailored to people's own circumstances. The Department for Work and Pensions (DWP) is working with employers and pension providers to produce combined forecasts, which show both state and occupational pension rights (over 2.9 million such forecasts have been issued to date). State Pension forecasts are issued automatically to individuals who do not have access to a combined pension forecast – from December 2004 to March 2005, 2 million automatic forecasts were issued.

58. Another key initiative is the development of a web-based retirement planner which will, for the first time, give people the opportunity to look at all their pension information together. The planner, to be launched in spring 2006, will allow people to:

- view an estimate of their total projected pension income from both state and private sources;
- estimate the income they think they might need in retirement;
- calculate any savings shortfall; and
- review options for addressing that shortfall.

59. If an individual is missing details of a private or occupational pension scheme of which they were a member, they may be able to trace their pension scheme using The Pension Tracing Service. From April 2005, DWP has taken responsibility for providing this service, which is now delivered through The Pension Service. It has access to a large database, maintained by the Pension Regulator, containing details of occupational and personal pension schemes, and which can be used, free of charge, to search for a scheme.

Raising awareness and education

60. Raising awareness and levels of financial education will ensure that people are properly equipped to interpret information by using the financial planning tools available. Different parts of the UK Government, including the Financial Services Authority (FSA) (paragraph 116 provides more information on the FSA), are developing a combined national strategy for improving financial capability. This strategy aims to ensure that people in the UK are better informed so as to be able to take greater responsibility for their financial affairs and play a more active role in the market for financial services. One of the priority areas for this strategy is around planning for retirement. The work will cover a wide range of personal finance issues, increasing awareness of the need to plan for retirement and providing individuals with the tools, information and knowledge they need in order to make appropriate decisions in line with their particular needs and circumstances.

61. DWP is also offering short-term funding to external organisations to provide pensions information and help with planning for retirement via The Pensions Education Fund. This is a three-year initiative only available to not-for-profit organisations (e.g. trade unions, charities, the voluntary advice sector, trade associations) and is focused on providing information in the workplace and to the self-employed. The principle of the fund is to deliver

retirement planning information to individuals via a source they can trust, for example their trade union representative. Organisations will be invited to bid for funding during summer 2005 and, following an evaluation exercise, funds will begin to be released to successful bidders in January 2006.

Partnerships

62. DWP believes that non-government organisations and the voluntary and charitable sectors have an important role to play in promoting financial education and retirement planning. The Informed Choice programme therefore builds on and strengthens active partnerships with key organisations in these groups. At present, DWP is primarily working with Citizens Advice and Age Concern to develop integrated and mutually supportive policies to raise levels of financial awareness and capability, and to promote the choices opening up for individuals to increase their income in retirement.

63. Age Concern and Citizens Advice also see engagement with DWP as an opportunity to become more involved in outreach work, providing a greater focus on planning ahead and prevention, rather than reaction, when advising clients on a range of personal financial issues. DWP is therefore exploring a broader DWP/Age Concern/Citizens Advice partnership aimed at testing a number of approaches for prompting people and supporting them in planning for their financial future in retirement.

64. DWP is also supporting Citizens Advice in its current initiative to pilot the provision of general financial advice to its clients, and is in the early stages of helping assess how it might support its clients to use the UK Government's web-based retirement planner.

65. DWP is assessing the potential for a schools-based financial education study, in collaboration with the Personal Finance Education Group. This would focus on delivering a pensions-related element of financial education that would be meaningful and engaging for children.

Incentives to save

66. The UK Government offers generous tax incentives to support people in saving for their pensions. However, the extended evolution of the system means that it can be complex. It is for that reason that, from April 2006, the UK Government will radically simplify the taxation of pensions.

67. Simplification will sweep away the numerous existing tax regimes and replace them with a single universal regime for tax-privileged pension savings. There will be two key controls in the new regime – the lifetime allowance, set initially at £1.5 million, rising to £1.8 million by 2009/10; and the annual allowance, set initially at £215,000, rising to £255,000 by 2009/10. This new regime will provide greater flexibility to around 15 million pension savers.

68. Other main changes are as follows:

- There will be a single set of rules on pensions in payment, allowing all schemes the ability to offer members a tax-free lump sum of up to 25% of their pension fund.

- More flexible working and retirement will be encouraged through changes to tax and pension rules planned for April 2006. These will enable people in occupational pension schemes to draw retirement benefits while continuing to work for the same employer.

- There will be a single set of investment rules for all pension schemes. Subject to DWP requirements, pension schemes will be allowed to invest in all types of investment, including residential property.

- The complex approval process for pension schemes will be replaced by a simplified regime requiring registration only.

69. Who will benefit from simplification?

- **Individuals** – through greater choice and flexibility as to when and how they save for their retirement, being able to pay more towards their retirement if they can and choose to do so, and feeling that they are in a scheme that they understand.

- **Pension providers** – through reduced administration costs and a reduction in the current burden caused by expensive administration checks.

- **Employers** – through lower administration costs, but more importantly through the freeing-up of tax rules which will enable them to design pension schemes that best fit their business needs.

Sustainability

70. The UK Government believes that sustainable public finances are a prerequisite to achieving high and stable rates of long-term economic growth, to be shared by all, and ensure that spending and taxation impact fairly between generations. The UK Government therefore acknowledges that social protection schemes, in addition to being adequate and accessible to all, must also be fiscally sustainable. Over the longer term, a pension system can only be adequate if it is also sustainable.

71. However, long-term fiscal sustainability is not only about the pension system. Long-term fiscal sustainability covers all aspects of future spending (e.g. health) and revenue, and will also depend on long-term economic growth prospects. Ensuring long-term fiscal sustainability will therefore not only require keeping future spending increases at bay but will also depend on implementing structural reforms that promote long-term growth. In addition to providing a stable macro-economic environment which delivers employment opportunities for all, the UK Government's key priorities in the area of pensions are to:

- promote a system that includes public and private sector involvement;
- provide information on pension entitlement, thus promoting future saving; and
- raise employment rates (especially among older workers) by promoting longer working lives.

Affordability and economic stability

72. Since 2002, the UK Government has published an annual long-term public finance report. The latest report, published in December 2004,[23] shows that, on the basis of current policies and a range of reasonable assumptions, public finances are sustainable in the long term and the UK is in a strong position to face the fiscal challenges of an ageing population.

[23] *Long-term public finance report: an analysis of fiscal sustainability*, HM Treasury, December 2004.

73. Fiscal policy in the UK is set with consideration for the short, medium and long term. The UK Government's objectives for fiscal policy are:

- over the medium term, to ensure sound public finances and that spending and taxation impact fairly both within and between generations; and
- over the short term, to support monetary policy and in particular to allow the automatic stabilisers to play their role in smoothing the path of the economy.

74. The UK Government has formulated two fiscal rules through which the objectives for fiscal policy are implemented, which also reflect the commitments to fiscal sustainability and generational fairness. They are:

- the 'golden rule' that over the economic cycle, the UK Government will borrow only to invest and not to fund current spending; and
- the sustainable investment rule – public sector net debt as a proportion of Gross Domestic Product (GDP) will be held over the economic cycle at a stable and prudent level. Other things being equal, net debt will be maintained below 40% of GDP over the economic cycle.

75. The latest illustrative long-term fiscal projections, published for the 2005 Budget, show that net debt will remain below 40% of GDP over the long term.[24]

76. The projected evolution of State Pension spending plays a major role in the long-term sustainability of the UK's public finances. The 2004 *Long-term public finance report* shows that State Pension spending (including on the Pension Credit) is projected to rise only slightly over the next 50 years, from 5% of GDP in 2003/04 to 5.6% by 2053/54. These latest projections therefore confirm the findings of earlier studies (including by the European Commission's Economic Policy Committee) that State Pension spending will remain relatively stable over time.

Growth and employment

77. The UK economy remained resilient in the face of the challenges and uncertainties that affected the world economy between 2001 and 2003. In 2004, GDP growth averaged 3.1%, faster than the G7 average and significantly above the EU average.

78. The Government is committed to employment opportunity for all and has set a long-term aspiration of achieving and sustaining an 80% employment rate. Reducing inactivity and increasing employment is important in the context of meeting the challenge of an ageing society. But it is also important on wider economic and social grounds, such as promoting a growing and enterprising economy, reducing regional disparities, tackling poverty and enabling people to fulfil their aspirations and potential.

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[24] Illustrative long-term fiscal projections, Annex A of the *Economic and Fiscal Strategy Report*, in *Budget 2005 Investing for our future: Fairness and opportunity for Britain's hard-working families*, HM Treasury, 2005, pages 175–83.

79. In 2003 employment grew by 0.8%. The overall employment rate in 2003 edged up slightly to 71.7%, with the female rate unchanged at 65.3%.[25] Unemployment remains significantly below the EU average, declining to 4.7% in 2004. Long-term unemployment also remains at historically low levels (1.1%) but concentrations of unemployment and inactivity persist in certain communities and among particular groups.

80. The UK is one of the three EU member states to have achieved both the Lisbon and Stockholm employment targets in 2003.[26] The sharp upward trend in the employment rate for older workers (those aged 50 to SPA) continued, reaching 70.4% in 2004.

81. Active labour market measures delivered by Jobcentre Plus ensure that work-focused support and advice is available to people up to and beyond State Pension age, emphasising job search and matching, targeting most help on those who are hardest to reach and whose attachment to the labour market is the weakest, including those who are inactive (rather than unemployed) but want to work.

82. Although eligibility for some benefits, for example Jobseeker's Allowance and Incapacity Benefit, usually ends at State Pension age, back-to-work help available through Jobcentre Plus has no upper age limit and is open to people who are in receipt of Pension Credit. This includes the assistance of personal advisers, all back-to-work programmes, the use of Job Points to search for job and learning opportunities, and access to the internet.

83. The reform of tax and benefit systems has been used to tackle unemployment and poverty traps by increasing incentives to take a job and progress up the earnings ladder, for example through the Working Tax Credits and the UK's national minimum wage.

Increasing the participation of older workers in the labour market

84. The UK Government is committed to removing the barriers to older workers remaining in, or re-entering, the labour market, and to providing information to allow them to make informed choices about retirement decisions. There is a range of measures in place to enable and encourage the participation of older workers both before and after State Pension age, providing back-to-work help, tackling age discrimination and providing incentives for continued or more flexible working. The UK has a base of comparatively high employment rates of older workers and UK Government targets exist to increase those rates further.

85. Employment rates have increased and the gap between the employment of those aged 50 to SPA and the overall 16 to SPA average has tended to decline since 1997, and by 2004 stood at 70.4% compared with 75.0% for people aged 16 to 65. The UK has already met the EU target for a 50% employment rate for people aged 55 to 64 by 2010.

[25] 2004 figures show overall employment rate as 74.7%: Labour Force Survey, 2004 (four-quarter average).

[26] The Lisbon target was set in 2000 with a goal to raise the overall employment rate to 70% and the employment rate for women to 60% by 2010; the Stockholm target was set in 2001 with the goal to raise the employment rate for people aged 55 to 64 to 50% by 2010. The other member states that have achieved both targets in 2003 are Sweden and Denmark.

86. The EU measure of the UK's average exit age is 64.2 for men and 61.9 for women.[27] According to DWP research,[28] among retired 50 to 69 year olds, 49% of people retiring before State Pension age gave ill-health as a reason, 18% were offered financial terms to retire early or take voluntary redundancy and a further 18% were made redundant, dismissed or had no choice. The same research showed that those in receipt of private pension income were more likely to retire early.

87. A number of research reports have also been published by DWP to improve understanding of issues about work and retirement. The first was published in February 2003[29] and examined the circumstances under which people work after State Pension age. The second was published in October 2003[30] and evaluated the effectiveness of back-to-work programmes and policies. The third was published in November 2003[31] and explored the factors that affect labour market participation among people aged 50–69. The fourth report was published in May 2004[32] and followed up the first report with qualitative research designed to further understanding of the factors affecting people's decisions to continue working after State Pension age. In addition, the National Audit Office published a review of the UK's policies on older workers.[33] The UK also supported the Organisation for Economic Co-operation and Development's thematic review of older worker policies.[34]

Providing help for people to return to work

88. In the UK, Jobcentre Plus delivers New Deal 50 plus, which is a voluntary programme specifically for older jobseekers, offering personal advice, pre-work training, work trials, volunteering opportunities and an in-work training grant of up to £1,500. This is available to all people aged 50 and over who have been on specified benefits for six months or more, and is available to their dependent partner aged 50 and over. Since it was introduced in April 2000, New Deal 50 plus has supported in the region of 150,000 job starts among older people. The New Deal for Disabled People offers specialist support to people with illness, incapacity or disability as well as helping people who may be at risk of losing their job through ill-health to stay in work. From October 2004, Pension Credit became an eligible benefit for voluntary access to all back-to-work programmes.

89. Outreach pilots are testing with voluntary and private sector organisations innovative ways of increasing the awareness of those over 50s who have become disengaged from the labour market, of the job opportunities and back-to-work help that is available through Jobcentre Plus.

90. Mandatory back-to-work activity pilots are testing whether intensive back-to-work help, provided on a mandatory basis through New Deal 25 plus to people aged 50–59, helps to increase their employment.

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27 EU figures for 2003.
28 *Factors affecting the labour market participation of older workers,* DWP Research Report 200.
29 *Working after State Pension age: Quantitative analysis*, Smeaton and Mckay, DWP Research Report 182, 2003.
30 *A review of 'what works' for clients aged over 50*, DWP W174, 2003.
31 *Factors affecting the labour market participation of older workers,* DWP Research Report 200.
32 *Working after State Pension age: Quantitative research*, Barnes, Parry and Taylor, DWP Research Report 208, 2004.
33 *Welfare to Work: Tackling the Barriers*, NAO, 2004.
34 *Ageing and Employment Policies UK*, OECD, 2004.

91. The Incapacity Benefit (IB) Green Paper *Pathways to Work* (2002) set out a long-term strategy for encouraging and assisting people with health problems and disabilities to return to work. This strategy is critical to support older people, as 1.3 million of the 2.7 million people claiming IB in the UK are over 50.

92. As the first step in this strategy, Pathways to Work pilots have been introduced in seven Jobcentre Plus districts (three of which commenced in October 2003 and four from April 2004) to test a range of measures to find what is effective at achieving a work focus and movement into employment. These pilots will run until April 2006 and new IB customers are required to maintain contact with skilled personal advisers through a series of mandatory, intensive, work-focused interviews (WFI) in the crucial early stages of their claim. All IB customers have direct voluntary access to a 'Choices Package' offering a comprehensive range of existing and new specialist programmes, including joint programmes with the NHS for improving a person's ability to return to work, as well as clear financial incentives to make work pay. It was announced in the 2005 Budget that early in 2006, a mandatory WFI regime will be extended to those IB customers who started their claims in the two years prior to the start of the pilots.

93. The UK Government's Pathways to Work pilots for people with health conditions and disabilities are showing extremely encouraging initial outcomes. From evidence from the pilots, there is a six-fold increase in the numbers participating in back-to-work support and an 8–10% increase in the numbers of IB customers leaving benefit in pilot areas compared with the rest of the country. There is already expansion of the intensive, compulsory personal adviser interventions and it was announced last December that these policies would be rolled out to one-third of the country over the next 18 months.

94. DWP's *Five Year Strategy*[35] also announced major changes to the structure of IB. Legislation to abolish IB for new cases and create two new benefits – Rehabilitation and Support Allowance (RSA) and Disability and Sickness Allowance (DSA) – is being introduced. RSA will be for the large majority of new claimants who have the most potentially manageable conditions and for whom the prospects of a return to work are strong if the right support is provided and accessed. People receiving this benefit will be required, as part of their conditions of entitlement, to take steps to prepare for a return to work. People on DSA will be those with the most severe functional limitations and this additional mandatory requirement will not apply to this group. This approach will further incentivise and direct people with the capacity to get back to work to do so.

Recruitment, retention and age discrimination

95. The UK Government's wider active ageing strategy focuses on increasing the recruitment and retention of over-50s and encouraging all employers to adopt age positive employment practices in the time leading up to the implementation of age legislation by 2006 in line with the European Equal Treatment Directive.

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[35] *Department for Work and Pensions Five Year Strategy: Opportunity and security throughout life,* DWP, 2005.

96. The legislation will outlaw age discrimination in employment or vocational training. As part of this legislation, employers will only be able to set a compulsory retirement age below 65 if they can objectively justify it. Employers will also be required formally to consider requests from employees to work beyond 65. After five years, legislation will be formally reviewed to consider whether a default retirement age is still required.

97. The UK Government is already tackling age discrimination through the Age Positive Campaign and its associated website www.agepositive.gov.uk, which encourage employers to recognise the business benefits of recruiting, training and retaining older workers as part of an age-diverse workforce. Over 100 organisations have the status of 'Age Positive Champion' in recognition of their good practices and their help in encouraging other employers to realise the benefits of being age-positive.

98. This year has seen the launch of a new high-profile national guidance campaign to equip all employers with practical information and guidance on adopting age-positive employment practices, including flexible approaches to retirement, to support the recruitment, training and retention of older workers. Since May 2005 1.4 million employers have received important information about the clear business case for removing ageism from employment.

99. Following on from this, the UK Government has announced that a Commission for Equality and Human Rights (CEHR) will be established in October 2007. The CEHR will provide institutional support for age discrimination issues for the first time. It will enforce the age legislation covering employment and training, and promote awareness and best practice for people of different ages. This will include advice and guidance, and in some cases legal representation.

Encouraging people to stay in the labour market beyond State Pension age

100. The UK Government is committed to reducing the 'cliff edge' of retirement and promoting opportunities for flexible retirement. Its policies are not intended to force people to work longer. They are about increasing choice and opportunity for people to make informed decisions about work, savings and retirement.

101. Measures introduced by the Pensions Act 2004 made deferral of State Pension a more attractive option from April 2005, offering unlimited deferral and more generous returns. This includes an incremental rate of 10.4% for each full year of deferral and, for the first time, the choice of a lump sum instead of an enhanced weekly State Pension for those who defer their State Pension for 12 months or longer. A person with typical State Pension entitlement who defers their State Pension for five years will be able to choose between a lump sum of £20,000 to £30,000 or a 50% increase in their weekly pension for life. The first lump-sum payments will be available in April 2006. This provides a real incentive for people to continue working if they so wish.

102. More flexible working will be encouraged through changes to tax and pension rules planned for April 2006 that will allow all individuals to draw their occupational pension while continuing to work for the same employer, whether on a full or part-time basis. Currently this option is only available to a limited number of members of pension schemes.

103. From 2010, State Pension age for women is being gradually increased from 60 to 65 to equalise with men's State Pension age in 2020. The UK Government is also raising the earliest age from which a private or occupational pension can be taken from 50 to 55 by 2010. The UK Government has proposed to increase the normal pension age for members of public-sector pension schemes from 60 to 65, initially for new members.

104. The UK Government is committed to taking the long-term decisions that will ensure individuals have a choice about when to retire, and when to continue working, based on their personal circumstances and decision-making, and to ensuring that information is available and understandable to support this. However, this is set in the context of rights and responsibilities in an ageing population. Longer, healthier lives must mean longer working lives, and individuals will increasingly want to, and be expected to, work longer.

105. The UK Government is ensuring that flexibility is combined with fairness, providing security and support for those that need it, and ensuring that everyone has the opportunity to work and save for longer if they choose to.

Funding and regulation of pensions: protecting their future

106. The UK Government also has a role in ensuring that there is appropriate regulation of the pension and savings industry. To rebuild confidence in saving, the UK Government introduced legislation in the Pensions Act 2004 to ensure that victims of personal pension mis-selling were compensated where this was appropriate.

107. Generally speaking, employers sponsoring defined benefit (DB) occupational pension schemes have to bear any balance of cost from funding/investment shortfalls, and the shortfall becomes a debt owed to the scheme by the employer.

108. Most occupational pension schemes are established under trust law. The trust arrangement guarantees the fund's independence from the employer because it places the responsibility of running the scheme onto a third party that is legally separate from employers and members. In addition, there are restrictions on the kinds of investment a scheme or an employer may make.

109. However, members of DB occupational pension schemes are now protected by the Pension Protection Fund (PPF). The PPF started operating in the UK in April 2005. It provides protection to members of eligible DB and hybrid occupational pension schemes when the sponsoring employer becomes insolvent leaving the pension scheme underfunded. The PPF will assume responsibility for an eligible scheme and members will receive compensation payments.

110. The PPF ensures people still have the secure retirement they were expecting by providing a meaningful level of compensation when the employer becomes insolvent, regardless of the level of funding in the scheme.

111. In order to have sufficient funds to pay compensation, the PPF charges a compulsory annual levy on all eligible pension schemes and takes in the assets of any scheme for which it assumes responsibility. The PPF pays compensation to both DB and DC occupational pension schemes in cases of fraud and misappropriation of scheme assets.

112. Additionally, the new Pensions Regulator, which was established in April 2005, has a proactive approach focusing on fraud, poor administration and underfunding. It has powers to impose civil penalties and, where appropriate, to prosecute those responsible through the criminal courts. It also has a specific function of providing information, education and assistance to certain categories of people involved in administering, advising on and facilitating the operation of certain schemes.

113. The PPF protects members of pension schemes who have lost their company pensions since April 2005, but the UK Government is also sympathetic towards people who have lost large amounts of their company pensions before this date, and has now decided that it is appropriate for £400 million of taxpayers' money to be used to assist this group.

114. The Government believes that £400 million is the appropriate provision to make and that this should make a considerable contribution to helping those members facing the most significant losses in their expected pensions. The Financial Assistance Scheme (FAS)[36] will not give everyone all of what they want – the primary objective is to provide significant help to those who have lost the most.

115. For those scheme members who are within three years of their scheme pension age, or above their scheme pension age, from 14 May 2004, the assistance will top up to a level broadly equivalent to 80% of their core pension benefits. The FAS will offer assistance to top up core pension benefits to a maximum of £12,000 per year and payments will only be made to those who are entitled to at least £10 a week, or equivalent, from the assistance scheme.

Financial Services Authority

116. The Financial Services Authority (FSA) is the statutory regulator for all financial services products including personal pensions. It is independent of the UK Government and formally assumed its powers in December 2001. The broad framework of the FSA and its high-level statutory objectives are set by legislation.[37] The FSA's statutory objectives are market confidence, public awareness, consumer protection, and reduction of financial crime.

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[36] The Pensions Act 2004 contains the Financial Assistance Scheme (FAS), which will offer help to some people who have lost out on their occupational pension because their scheme was under-funded when it wound up and their employer has been unable to make up the deficit. It is intended to have the legislative framework in place by spring 2005, and the first payments will be made as quickly as possible after that.

[37] Financial Services and Markets Act 2000.

Pensions Ombudsman

117. Occupational and personal pensions generally fall under the jurisdiction of the Pensions Ombudsman, although the Financial Services Ombudsman also has a role in complaints about the selling and marketing of personal pensions. The Pensions Ombudsman is independent of the UK Government and can investigate and determine claims of poor administration and disputes of fact or law between scheme members and their pension scheme; trustees of different schemes; and employers and schemes. The Ombudsman will issue a determination on all cases investigated, which can be enforced through the courts.

Modernisation

Promoting a public debate and building consensus on reforms

118. The UK Government has carried out consultation exercises on each element of its series of pension reforms. In each case, the views of leading pensioner organisations, pension providers, individual pensioners, trade unions and industry representatives were sought and their responses to these consultations published. The UK Government has also been engaging in ministerial pension debate over the principles for pension reform.

119. On poverty and social exclusion, a ‘Partnerships against Poverty’ group was established in 2001 to enable organisations with a shared aim to work together to reduce poverty and tackle social exclusion among pensioners. Northern Ireland will soon take forward work communicating with organisations that represent older people to identify their needs and how services can best be tailored to them.

120. This report has been shown in draft form to key stakeholders and non-government organisations, inviting them to share their views and comments, which have been taken into account in this final version.

Improving public services for older people

121. The UK Government takes provision of services for older people seriously. *Link-Age – Developing networks of services for older people* was published in August 2004 by DWP in collaboration with the Local Government Association, the Office of the Deputy Prime Minister and the Department of Health. The document:

- sets out a vision for joining up services to provide an integrated network for older people; and
- invites consultation from a wide range of stakeholders, particularly groups operating in local communities, responsible for making change happen on the ground.

122. The longer-term vision set out in *Link-Age* is the promotion of social inclusion for older people. Research shows that independence is what older people want in order to feel that they can participate fully in society.

123. In the shorter term, joining together specific services is the first step towards reaching the vision by simplifying the way older people access services relating to financial assistance, holistic health and social care assessments, and housing-related assistance. For example:

- **Joint Teams** – these comprise The Pension Service Local Service, Social Services and, in some cases, voluntary sector staff working in single teams to ensure that information need only be collected once, in a single face-to-face contact. There are currently 44 joint teams fully operational across the UK.

- **The Partnership Fund** – the Fund is intended to provide partners/voluntary organisations with funding to develop and implement initiatives designed to increase take-up of Pension Credit as well as other financial entitlements and services among older people.

- **Working with the voluntary sector** – the voluntary sector organisations are working together with DWP to take claims and to verify supporting evidence.

124. In developing and modernising networks of services for older people, the UK Government is aiming to deliver services to older people that are joined-up and customer-focused and which promote well-being and social inclusion. It also aims to provide easy access to services in local authority areas, either through one, or multiple access points, to ensure that in the longer term older people are well informed and that modern services respond to their needs and aspirations.

The Pensions Commission

125. The Pensions Commission was set up by the UK Government following the publication in December 2002 of the Pensions Green Paper[38] on private pension reform. The Commission has been asked to monitor and keep under review the system of supplementary pensions and long-term savings. In particular, its remit is to look at current and projected trends in: the level of occupational pension provision; the level of take-up of stakeholder and personal pensions as well as other savings and employer and employee contributions.

126. The Commission produced a very detailed analytical report in October 2004.[39] The consideration of policy issues and development of recommendations will primarily follow this analytical phase, with a report planned for autumn 2005. The UK Government will use the Commission's work as part of the process of establishing a consensus on pension reform which will last for the long term.

[38] *Simplicity, security and choice: Working and saving for retirement* (Cm 5677, published 17 December 2002).
[39] *Pensions Challenges and Choices: The First Report of the Pensions Commission,* Pensions Commission, 2004.

Fairer outcomes and gender equality

127. As the Pensions Commission found, today's pensioners are enjoying unprecedented levels of prosperity. But today's female pensioners are on average experiencing lower retirement incomes than men.

128. The State Pension system has delivered poor pension outcomes for those who have taken considerable time off paid work to care for children or adults. The vast majority of these are women.

129. Successive reforms have sought to address these problems. A wife is entitled to a State Pension on the basis of her husband's contributions, but this is only 60% of the basic State Pension her husband is entitled to. In the 1970s, Home Responsibilities Protection (HRP) was introduced, which made it easier for people to increase their entitlement to the basic State Pension in their own right by discounting those years in which they were unable to work due to caring responsibilities. And the State Second Pension, introduced in 2002, allows carers, disabled people and low earners to build up a decent second pension – 95% of carers and 63% of low earners are female.

130. For many married women, the adoption of caring and domestic responsibilities has enabled their husbands to work and build up a decent pension. So the husband's pension reflects the contribution that both have made to the marriage. Even though the value of the husband's pension has to be taken into account when the Court determines the financial settlement following a divorce, before the introduction of pension sharing it was not possible for a divorced wife to share in the receipt of this pension.

131. In order to address this, the UK Government has enabled married couples in the UK who commence divorce proceedings on or after 1 December 2000 to share the value of their pension rights including state additional pension. Pension sharing is not compulsory, but is an option available to the parties to a divorce and to the Courts in determining a fairer financial settlement. Although pension sharing applies equally to both men and women, the current distribution of pension rights means that at present the main beneficiaries are women. Pension sharing is therefore an important step towards security of income in retirement for women.

132. These steps, together with increases in female employment over recent decades, will increase women's State Pension entitlement. But gender differentials remain – more women than men work part-time and many of them are not accruing State Pension.[40] While HRP gives some protection to carers, it may not be worth a full year's contribution. However, some carers may not be covered, for example if they do not care for sufficient hours or the person they care for does not meet certain conditions.

133. In addition, since pension rights are based on accruals over a working life, it takes a long time for these changes to feed through into pensioner incomes. Currently, around 89% of newly retired women are entitled to some basic State Pension, getting around 75% of a

[40] Although some may be receiving credits or HRP.

full basic State Pension on average. By 2025, 99% of women will have some State Pension, getting on average 89% of the full State Pension. This compares with 99% of men getting on average a State Pension of 97% of the full State Pension. Similarly, women's entitlement to additional State Pension is currently very low (only about £13 per week gross for new pensioners compared with £39 for men), and while the reforms brought in by the State Second Pension mean that working-age women are just as likely as men to be accruing some additional pension rights, it will be many years before these improved accruals feed through to significant improvements in pensioners' incomes.

134. Private pensions are of course more closely related to earnings. However, it is still the case that women's work patterns tend to lead to lower private pension accruals. A woman in full-time work is more likely to be accruing an occupational pension than a man on the same income, but overall fewer women are accruing private pensions because they are more likely to be working part-time or not at all – both of which reduce the chance of having a private pension. Only one-third of part-time female employees are covered by occupational pensions, compared with half of full-time male employees.

135. Of course, some women will have access to private pension income from their husband. But this does not give them income in their own right, and the majority of annuities bought are single-life, meaning that if the man dies the income will stop – there are no survivor's benefits.[41]

136. The targeting of spending on the poorest will help women disproportionately – for example, women are more likely than men to receive Pension Credit.

137. Overall, while women pensioners who never marry can look forward to just as much income as men of the same age who never marry, married women get only a third as much income as equivalent men, and those who are widowed or divorced get on average 10% to 15% less income than men.

138. DWP has produced a report on women and pensions. This provides a detailed analysis of women's pension position and the key issues facing current and future cohorts of female pensioners.[42]

Facilitating labour mobility – occupational and personal pensions

139. The link between labour promotion and mobility also exists with regard to portability. The portability of occupational pensions has three main components: acquisition, preservation and transfer.

140. The UK has a maximum vesting period of two years.[43] The UK Government's 2002 Green Paper *Simplicity, security and choice* proposed the immediate vesting of pension rights but, after listening to views in the consultation period, the UK Government changed its

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[41] *Annuities: the consumer experience*, ABI, 2002, quoted in the Pensions Commission report.
[42] *Financial plans for retirement: women's perspective,* DWP Research Report No. 247, 2005.
[43] The statutory vesting period requirements were introduced in 1975. The original five-year period was reduced to two years in 1988.

policy. The Pensions Act 2004 provides, instead, that where a person leaves an occupational pension scheme after three months but before their rights have vested, trustees will have to offer the member the choice of a cash transfer sum (which will be the actuarial value of their rights in the scheme), which must be paid into another pensions vehicle, or a refund of the contributions paid by the member.

141. In the UK, early leavers' accrued rights in an occupational pension scheme must be preserved until the pension becomes payable at the normal pension age. At that point these rights are revalued for each year of deferral in line with the Retail Price Index, capped at 2.5%.[44] Different rules apply to Guaranteed Minimum Pensions.

142. Scheme members in the UK have a statutory right to transfer their vested rights, the cash equivalent transfer value (CETV), out of a scheme. They then cease to be scheme members. The CETV is the capital sum representing the value of the accrued pension rights. These rights must be transferred directly into another pension vehicle. This pension vehicle might be the occupational scheme of the new employer, if it is willing to accept the transfer, or a personal (including stakeholder) pension. Stakeholder pensions must accept transfers of pension rights from occupational and personal pensions; other personal and occupational pensions are able to refuse to accept the transfer.

Movement across borders

143. As well as mobility within the UK, it is important that labour mobility is promoted across the EU. Regulation EC1408/71 co-ordinates social security systems so that nationals of European Economic Area (EEA) Member States and Switzerland who exercise their right to free movement are not adversely affected by the application of different national legislations.

144. The UK State Pension is fully exportable worldwide (however, it should be noted that increases in State Pension will only apply for those pensioners who are living in another EEA Member State or in a country with which the UK has reciprocal arrangements). People who go abroad temporarily to any other country, but who remain ordinarily resident in the UK may still get the increased rate of UK State Pension; this would normally be paid in arrears when the person returns to the UK. The UK has fully implemented the Supplementary Pensions Directive, 98/49/EC, which safeguards people's rights under pension schemes when they move within the EC.[45]

Improving the methodological basis for monitoring pension policies

145. In order to develop effective long-term strategies, it is important to be able to model and test them. The UK Government is currently investing in the development of a dynamic microsimulation model, Pensim2, for long-term analysis of pension policy. The model will

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44 In most defined benefit schemes the accrued pension rights preserved are calculated according to the salary level on leaving the company multiplied by the accrual rate and years spent with the company. This is then normally indexed by inflation or 2.5%, whichever is the lower. In a defined contribution scheme the accumulated fund continues to be managed with investment returns accumulating until the 'end' of the scheme.

45 European Community.

estimate income in retirement for each member of a sample of the pensioner population under a number of assumptions, including the State Pension rules in place, the probabilities of individuals contributing to private pensions, and the performance of the economy.

146. It will be possible to vary each of these assumptions and to produce a revised estimate of income. By comparing the results of two scenarios, it will be possible to estimate how much better or worse off each member of the sample might be under a proposed policy change or an alternative macroeconomic scenario. So, for any proposed change to policy, it will be possible to gain an understanding of the gainers and losers, to estimate the effect of the change on inequality and to estimate the expenditure effects of the policy change.

Conclusion

147. The UK Government believes that individuals must take responsibility for their own retirement provision; they must make decisions about how much they are going to invest in increasing their own future retirement income. Employers also have a key role in helping their employees to build up adequate pensions: investment in an employee's pension provision should be an important part of the reward package. However, underlying the roles of both individuals and employers, there needs to be a state system that not only removes the fear of poverty in old age but also gives individuals a base upon which to build up an adequate retirement income, and which provides the information and the regulatory framework that enable people to save and safeguard their retirement income.

148. The UK Government's reforms have significantly improved outcomes for today's pensioners. However, changes in society mean that the UK cannot necessarily rely on the existing structures to provide the same outcomes as we move further into the 21st century. This publication has set out the record of successes achieved so far and the principles on which they have been based – the same principles that will be used in formulating and evaluating future reforms which may be needed to address the continuing challenge.

149. The UK Government agrees with the Pensions Commission that it would be wrong to commit to specific proposals aimed at long-term challenge without engaging with all stakeholders in the national pensions debate. Therefore, ahead of the Commission's recommendations, expected later this year, the UK Government has been engaging with the public – and other key stakeholders – over the principles for reform through a series of local events. In this way, the UK Government hopes to achieve a shared framework of criteria with which the recommendations of the Commission and others can be assessed.

APPENDIX 1

Structure and scope of National Strategy Report

	Objective	UK response	Reference page/para
Introduction			
Highlight broad issues, in particular the broad goals of adequacy, financial sustainability and modernisation at present, near future and longer term.		Overall approach and policy goals explained since 2002, under three headings – challenge, reform and future:	Pages 3–7
		• The Informed Choice programme.	
		• Pensioner poverty – Pension Credit.	
		• Sustained productivity growth and macro-economic stability.	
		• Regulation and protection.	
		• Tax treatment of pensions.	
		• *Principles for Reform: The national pensions debate*.	
Adequacy			
	Objective 1: Ensure that older people are not placed at risk of poverty and can enjoy a decent standard of living; that they share in the economic well-being of their country and can accordingly participate actively in public, social and cultural life.	Brief explanation of UK's current situation and policy objectives	Page 8
		Tackling poverty – guaranteeing a minimum income:	Page 8
		• Description of UK's mix of flat-rate/minimum pensions.	App. 2
		• Minimum Pension Guarantees –Pension Credit.	Page 9
		• Saving Credit.	App. 2
		• Winter Fuel Payments and other elements of support.	Page 10
		• Access to services.	Page 10
		UK's future prospects and policy challenges:	
		• The Informed Choice programme.	Page 13

	Objective	UK response	Reference page/para
Adequacy – *continued*			
	Objective 2: Provide access for all individuals to appropriate pension arrangements, public and/or private, which allow them to earn pension entitlements enabling them to maintain, to a reasonable degree, their living standard after retirement.	• UK's policy to support people in building up a decent second pension. • Occupational pensions explained. • Stakeholder pensions – Lifestyling. • The UK's policy for adequacy in the future – the Informed Choice Programme. • Incentives to save/taxation.	Pages 11–13 Page 13 onwards Page 16
	Objective 3: Promote solidarity within and between generations.	UK's acknowledgement of inter-generational redistribution impact of current pension system – development of 'life cycle' policies – for 'today's' pensioners; access to services, consultation on UK Government's implementation of policies, for 'tomorrows' pensioners'; from education in schools, raising employment to 80% (encouraging inactive clients back to work where possible) to deferment of State Pension, extending working lives and incentives to save.	Throughout the report
Financial sustainability			
	Objective 4: Achieve a high level of employment through, where necessary, comprehensive labour market reforms, as provided by the European Employment Strategy and in a way consistent with the BEPG.	Providing back to work help: • New Deal 50 plus; • Pathways to Work; and • The DWP's Five Year Strategy (consistent with BEPG – raising employment, flexible working, saving for future and retirement).	Pages 20–24

	Objective	UK response	Reference page/para
Financial sustainability – *continued*			
	Objective 5: Ensure that alongside labour market and economic policies, all relevant branches of social protection, in particular pension systems, offer effective incentives for the participation of older workers; that workers are not encouraged to take up early retirement and are not penalised for staying in the labour market beyond the standard retirement age; and that pension facilitate the option of gradual retirement.	• Access to services for today's pensioners. • Recruitment, retention and age discrimination. • Increasing the participation of older workers in the labour market. • Commission for Equality and Human Rights. • Age Positive campaign. • Deferral of State Pension.	Page 10 Page 22 Page 20 Page 23 Page 23 Page 23
	Objective 6: Reform pension system in appropriate ways taking into account the overall objective of maintaining the sustainability of public finances. At the same time sustainability of pensions systems needs to be accompanied by sound fiscal policies, including where necessary, a reduction of debt. Strategies adopted to meet this objective may also include setting up dedicated pension reserve funds.	Affordability and economic stability. Growth and employment. Funding and regulation of pensions: Protecting their future: • PPF; • Pensions Regulator; • FSA; and • Pensions Ombudsman.	Page 18 Page 19 Pages 24–26

	Objective	UK response	Reference page/para
Financial sustainability – *continued*			
	Objective 7: Ensure that pension provisions and reforms maintain a fair balance between the active and the retired by not overburdening the former and by maintaining adequate pensions for the latter.	Informed Choice programme – education and awareness, ‘life cycle’ programme – from children’s education, higher employment and deferral of retirement. UK has recognised that they have not solved the problems of future imbalance, but are actively seeking ways of addressing this NOW for the future – Pensions Commission.	Page 13 onwards Page 28
	Objective 8: Ensure, through appropriate regulatory frameworks and through sound management, that private and funded pension schemes can provide pensions with the required efficiency, affordability, portability and security.	Funding and regulation of pensions: protecting their future: • PPF; • Pensions Regulator; • FSA; • Pensions Ombudsman; and • Education and awareness – working with employers/employees, non-governmental organisations.	Pages 24–26 Pages 15–17

	Objective	UK response	Reference page/para
Modernisation			
	Objective 9: Ensure that pensions systems are compatible with the requirements of flexibility and security on the labour market; that, without prejudice to the coherence of Member States' tax system, labour market mobility within Member States and across borders and non-standard employment forms do not penalise people's pension entitlements and that self-employment is not discouraged by pension systems.	• Facilitating labour mobility. • Movement across borders. • Stakeholder pensions. • Pension Education Fund.	Page 30 Page 31 Page 12 Page 15
	Objective 10: Review pension provisions with a view to ensuring the principle of equal treatment between women and men, taking into account obligations under EU law.	• Fairer outcomes and gender equality.	Pages 29–31

	Objective	UK response	Reference page/para
Modernisation – *continued*			
	Objective 11: Make pension systems more transparent and adaptable to changing circumstances, so that citizens can continue to have confidence in them. Develop reliable and easy-to-understand information on the long-term perspectives of pension systems, notably with regard to the likely evolution of benefit levels and contribution rates. Promote the broadest possible consensus regarding pension policies and reforms. Improve the methodological basis for efficient monitoring of pension reforms and policies.	Informed Choice programme: • raising awareness and education; • web-based planner; • pension forecasts; • partnerships; and • improving public services for older people.	Page 13 onwards
		Promoting public debate and building consensus on reforms.	Page 27
		Improving methodology.	Page 31
Conclusion			
		Success so far – emphasises the fact that with changes in society the UK cannot rely on the existing structures – reform for the future is needed.	Page 33

APPENDIX 2

The UK State Pension system for current pensioners

1. The main pension benefits are basic State Pension (contributory), second-tier state pension (contributory) and Pension Credit (income related).

Basic State Pension

2. The basic State Pension was introduced in 1948 and remains at the core of UK pension provision, giving around £43 billion to pensioners in 2005/06.

3. The basic State Pension is a contributory system. People can build up qualifying years for the State Pension through National Insurance contributions or they can get National Insurance credits which are available for certain groups, for example, carers and disabled people.

4. The full rate of basic State Pension in 2005/06 is £82.05 per week. This is based upon a person having a full number of qualifying years – people with incomplete records receive an amount proportionate to the full rate.

Second-tier Pension

5. There have been a number of second-tier, earnings-related contributory pensions since the basic State Pension was introduced. These provide an earnings-related pension paid on top of the basic State Pension. Both contributions (through National Insurance contributions) and accruals are linked to earnings. These benefits will provide around £8 billion to current pensioners in 2005/06.

6. The State Earnings-Related Pension Scheme (SERPS) was in place from 1978 to 2002 and provides the majority of second-tier State Pension income for current pensioners. SERPS was replaced by the State Second Pension in April 2002, providing a more generous system that ensures lower earners accrue at least twice as much as under SERPS. It also gives second-tier State Pension coverage to carers and disabled people for the first time. Employees can choose to contract out of SERPS and State Second Pension into a private pension. If they choose to contract out they receive either a rebate from the State or pay a reduced rate of National Insurance contributions.

7. Although SERPS has been replaced, current pensioners still receive payment of SERPS rights, and future pensioners who have already accrued rights will receive SERPS when they reach State Pension age.

Pension Credit

8. Pension Credit is an income related benefit ensuring that no pensioner need live on less than £109.45 (€158) per week (£167.05 (€240) for couples). Pension Credit will increase pensioners' incomes by around £7 billion in 2005/06.

9. In October 2003 the Saving Credit was introduced to ensure that pensioners that have made modest savings are not penalised. The Saving Credit is increasing pensioners' income by up to £16/£22 per week in 2005/06. Pensioners with income up to £151/£221 per week are entitled to the Saving Credit.

10. Pensioners entitled to premiums within Pension Credit, e.g. for disability, will be entitled to more.

Private pensions

11. The UK has extensive private pension coverage, in the form of both occupational and personal pensions, paid on top of state pensions. Over half of employees are contributing to a private pension, and private pension income accounts for around 40% of current pensioners' incomes.

12. The UK is well placed, due to its history of private pension provision, to overcome the demographic challenge whilst keeping state expenditure on pensions sustainable in the future.

APPENDIX 3

Statistical information

Population breakdown by age groups

	Population (1,000s)			
	2005	**2010**	**2030**	**2050**
0–14	10,793	10,425	10,550	10,202
15–24	7,745	7,980	7,234	7,218
25–44	17,077	16,565	16,649	16,023
45–59	11,636	12,136	11,823	12,198
60–64	3,120	3,772	4,309	4,127
65–74	5,057	5,432	7,439	6,936
75+	4,596	4,856	7,560	10,079

Data source: Government Actuary's Department, 2003-based projections.

Life expectancy

		2005	**2010**	**2030**	**2050**
Males	At birth	83	83	84	84
	At 60	23	24	25	26
	At 65	19	20	21	22
Females	At birth	87	87	88	88
	At 60	27	27	28	29
	At 65	22	22	24	24

Definition: Cohort life expectancy.

Data source: Government Actuary's Department, 2003-based projections.

Demographic old-age dependency ratio

	2005	**2010**	**2030**	**2050**
60+/15–59	35%	38%	54%	60%
65+/15–64	24%	25%	37%	43%

Definition: The number of persons aged over 60/65 divided by the number of persons aged 15–59/64.

Data source: Government Actuary's Department, 2003-based projections.

Housing tenure status

	Owner-occupied		
	With mortgage	No mortgage	Rented
65+	7%	68%	26%
0–64	56%	18%	27%
60+	11%	65%	24%
0–59	58%	15%	27%

Data source: 2003/04 Family Resources Survey (EU SILC transition).

Household composition

	60+			65+			75+		
	Men	Women	Total	Men	Women	Total	Men	Women	Total
Live alone	20%	40%	31%	22%	46%	36%	29%	59%	48%
Live with children	3%	2%	2%	2%	1%	2%	1%	1%	1%
Live with another adult over 65	44%	41%	42%	56%	44%	49%	64%	32%	44%

Note: Percentages do not sum to 100 because not all people fall into the categories given.

Data source: 2003/04 Family Resources Survey (EU–SILC transition).

GDP per capita, recent growth and growth prospects

UK GDP per capita was £19,542 in 2004.

UK GDP grew 0.5% in 2005Q1 (Second estimate), following growth of 0.7% in 2004Q4. GDP in 2005Q1 was 2.7% higher than in 2004Q1. The Budget 2005 forecast is for the pick-up in activity to continue into next year. GDP is forecast to rise by 3 to 3½% in 2005 and by 2½ to 3% in 2006.

Data source: Economic Trends May 2005, Office for National Statistics.

Employment and unemployment rates

The employment rate is 74.9%, the unemployment rate is 4.7% (2004/05).

Definition: Figures relate to working age: 16–State Pension Age.

Data source: Labour Force Survey, January–March 2005, Office for National Statistics.

Social protection expenditure and pension expenditure

Total benefit expenditure is 9.4% of GDP, and pensioner spending is 5.2% of GDP.

Definition: Figures relate to GB 2003/04. Pensioner spending is as defined by ESSPROS.

Data source: Budget 2005 Benefit Expenditure Tables and ESSPROS 2004.

Public finance situation

Public sector net debt at end of 2004-05 was £415.3bn or 34.5 per cent of GDP, up from 32.8% of GDP at end of 2003-04.

Public sector net borrowing was £35.4bn in 2004-05. This compares with £35.7bn in 2003-04.

The sustainable investment rule is met comfortably over the projection period, with public sector net debt projected to stabilise at 37.1% of GDP by the end of the forecast period.

Data source: HM Treasury, Office for National Statistics.

People living in institutions

	Number			As percentage of population		
	60+	65+	75+	60+	65+	75+
Males	102,787	94,458	72,481	1.9%	2.4%	4.5%
Females	294,355	288,181	262,748	4.3%	5.3%	9.4%
Total	397,142	382,639	335,229	3.2%	4.1%	7.6%

Definition: Number of non-staff residents in communal establishments by age, UK.

Data source: Census (2001).

Risk of poverty by household type

	60+			65+			75+		
	Men	**Women**	**Total**	**Men**	**Women**	**Total**	**Men**	**Women**	**Total**
Live alone	26	32	30	25	34	32	29	37	35
Live with children	29	22	26	29	19	24	13	14	14
Live with another adult over 65	24	23	24	25	24	25	28	28	28

	0–59			0–64			0–74		
	Men	**Women**	**Total**	**Men**	**Women**	**Total**	**Men**	**Women**	**Total**
Live alone	24	24	24	24	23	24	24	25	24
Live with children	19	21	20	19	21	20	19	21	20
Live with another adult over 65	11	9	10	13	13	13	18	19	18

Note: The under 60/65/75 groups are not sensible comparators of the equivalent older group. For example, those who 'live with children' in the older groups are likely to be living in their child's house, while in the younger groups it is likely to be parents bringing up children. Similarly those who 'live with another adult over 65' in the top group are likely to be a married couple, while for younger people the group is more complex.

Data source: 2003/04 Family Resources Survey (EU SILC transition).

Incidence and distribution of risk of poverty by housing tenure

	Percentage							
	Risk of poverty				**Distribution of poverty**			
	Owner-occupied				**Owner-occupied**			
	With mortgage	**No mortgage**	**Rented**	**Total**	**With mortgage**	**No mortgage**	**Rented**	**Total**
60+	18	27	19	24	2	20	5	27
0–59	8	17	34	17	21	11	40	73
65+	19	29	19	26	1	17	4	22
0–64	9	18	33	17	22	15	41	78
75+	18	36	19	30	–	9	2	12
0–74	9	19	32	17	23	22	43	88

Note: The left-hand side shows the risk of poverty within each group. The right-hand side shows how many of the low-income people fall into that group, so for each age split, the percentage across the two complementary age groups and three tenures will sum to 100% (within rounding).

Definition: Percentage of group with less than 60% of national median equivalised income.

Data source: 2003/04 Family Resources Survey (EU SILC transition).

Risk of poverty calculated at different income thresholds

	40%	50%	60%	70%
60+	5	13	27	38
65+	5	14	26	41
75+	6	17	24	46

Definition: Percentage of group with less than the given percentage of national median equivalised income.
Data source: 2003/04 Family Resources Survey (EU SILC transition).

Relative risk of poverty

	Men	Women	Total
65+/0–64	1.4	1.6	1.5
75+/0–74	1.7	1.8	1.7
60+/0–59	1.4	1.5	1.5

Definition: Risk of poverty for age groups 60+ and 65+ relative to the risk of poverty for complementary age groups.
Data source: 2003/04 Family Resources Survey (EU SILC transition).

Relative median income

	Men	Women	Total
60+/ 0–59	0.78	0.75	0.76
60+/45–54	0.69	0.83	0.67
65+/ 0–64	0.76	0.73	0.74
65+/45–54	0.67	0.80	0.64
75+/ 0–74	0.71	0.72	0.71
75+/45–54	0.62	0.77	0.61

Definition: The ratio of median equivalised income of people aged 60+, 65+ and 75+ relative to median equivalised income of people aged <60, <65 and <75 respectively and of people aged 45–54.
Data source: 2003/04 Family Resources Survey (EU SILC transition).

Composition of income by source

	60+	0–59	65+	0–64	75+	0–74
Pension	57%	3%	69%	4%	73%	7%
Other social benefits	4%	8%	3%	8%	3%	8%
from work	27%	84%	16%	83%	13%	80%
from other sources	12%	5%	13%	5%	11%	6%

Note: This table gives figures for self-administered pension funds. These are funded occupational schemes. They exclude the central government scheme, which is unfunded; individual or personal schemes; and insured schemes (i.e. where the occupational pension scheme is administered via an insurance policy with an insurance company). They include the funded schemes of local authorities.

Quartile	Pension		Other social benefits		From work		From other sources	
	65+	0–64	65+	0–64	65+	0–64	65+	0–64
Q1	88%	5%	5%	47%	1%	42%	6%	6%
Q2	84%	5%	4%	23%	5%	66%	6%	5%
Q3	74%	5%	3%	9%	15%	82%	8%	4%
Q4	64%	4%	1%	4%	24%	89%	11%	4%
Q5	45%	3%	0%	1%	29%	89%	26%	7%

Definition: Pension includes both pensions and old-age benefits.

Data source: 2003/04 Family Resources Survey (EU SILC transition).

Inequality of income distribution (S80/S20)

	Men	Women	Total
60+	4.8	4.3	4.6
0–59	6.0	5.8	5.9
65+	4.1	3.9	4.0
0–64	6.0	5.7	5.9
75+	3.6	3.6	3.6
0–74	5.9	5.6	5.8

Data source: 2003/04 Family Resources Survey (EU SILC transition).

Relative income inequality

	Men	Women	Total
60+/0–59	0.6	0.6	0.8
65+/0–64	0.7	0.7	0.7
75+/0–74	0.6	0.6	0.6

Definition: Income share ratio S80/S20 relative to the income share ratio for complementary age groups.

Data source: 2003/04 Family Resources Survey (EU SILC transition).

After housing costs figures

In the UK, around two-thirds of pensioners own their own homes with no mortgage, and so have very low housing costs on average. This means that considering incomes after housing costs gives a better comparison of the living standards of pensioners compared to non-pensioners.

On an after housing costs basis pensioners are less likely than non-pensioners to be in low income – 20% of pensioners compared with 21% of the whole population has less than 60% of median national equivalised income. This has fallen by over a quarter since 1996/97.

Median equivalised income after housing costs is £255 for pensioners, £297 for the whole population.

Definition: Figures use the McClements equivalisation scale, with an equivalisation factor of 1 representing a couple without children.

Data Source: Households Below Average Income.

Theoretical replacement rates

	Base case: 100% of average earnings					⅔ of average earnings		Concave earning profile	
	2005	**In 10 years**	**2010**	**2030**	**2050**	**2005**	**2050**	**2005**	**2050**
Gross replacement rate 1st pillar	17%	15%	18%	18%	19%	25%	28%	16%	18%
Gross replacement rate 2nd pillar	50%	45%	50%	50%	50%	49%	50%	50%	50%
Total gross replacement rate	66%	61%	67%	68%	69%	74%	78%	65%	68%
Total net replacement rate	82%	76%	83%	84%	85%	91%	95%	81%	84%
MTBs as a % of the total net replacement rate	0%	0%	0%	0%	0%	0%	0%	0%	0%

Theoretical replacement rates – *continued*

	Rising earnings from 80% to 120% of average		Broken career (30 years of seniority at retirement)		Rising earnings from 100% to 200% of average		Late retire-ment	No private pension	
	2005	**2050**	**2005**	**2050**	**2005**	**2050**	**2005**	**2005**	**2050**
Gross replacement rate 1st pillar	14%	16%	17%	21%	8%	10%	20%	35%	25%
Gross replacement rate 2nd pillar	50%	50%	33%	33%	50%	50%	53%	0%	0%
Total gross replacement rate	63%	66%	50%	54%	58%	60%	73%	35%	25%
Total net replacement rate	78%	81%	64%	69%	71%	73%	89%	47%	41%
MTBs as a % of the total net replacement rate	0%	0%	0%	0%	0%	0%	0%	0%	6%

Notes: These figures show the effect of a particular career path. They do not show a typical or average replacement rate, although the assumptions made are reasonable.

Late retirement is for someone taking their pension at 67 compared with earnings at 64, to give a fair picture of the benefits of delaying retirement. For ages 65 and 66, net wages would be higher as they are no longer required to pay National Insurance contributions.

Figures include the Winter Fuel Payment (available to those over 60) for both earners and pensioners, and Pension Credit where applicable. They do not include any other pensioners' benefit.

Definition: Income from pensions and pensioner benefits as a proportion of wages in last year of employment. Assumes a 40-year career, retirement at 65, with the last 30 years as part of a defined benefit scheme giving 50% replacement after 30 years but with no lump sum.

Data source: Average wages based on New Earnings Survey data for adults in full-time employment, uprated to September 2004, as the base, with real growth of 1.8% throughout.

Current coverage rates

Total	Any private	Personal	Occupational	Employment rate
16–17	2%	0%	2%	41.4%
18–24	17%	2%	15%	67.4%
25–34	54%	12%	44%	79.7%
35–49	63%	17%	49%	81.9%
50–SPA	57%	19%	41%	69.9%
All	52%	14%	40%	74.7%

Current coverage rates – *continued*

Men	Any private	Personal	Occupational	Employment rate
16–17	3%	0%	3%	39.0%
18–24	15%	2%	13%	70.8%
25–34	53%	14%	41%	87.5%
35–49	68%	22%	49%	88.8%
50–SPA	58%	23%	37%	71.8%
All	54%	17%	39%	79.3%

Women	Any private	Personal	Occupational	Employment rate
16–17	1%	0%	1%	44.0%
18–24	20%	2%	18%	64.0%
25–34	56%	9%	48%	72.1%
35–49	58%	11%	48%	75.2%
50–SPA	56%	13%	46%	67.2%
All	50%	10%	42%	69.8%

By standard industrial classification	Any private	Personal	Occupational
Agriculture and fishing	31%	26%	5%
Energy and water	71%	15%	61%
Manufacturing	60%	17%	46%
Construction	41%	25%	17%
Distribution, hotels and restaurants	27%	10%	17%
Transport and communications	53%	13%	42%
Finance and business services	52%	17%	37%
Education, health, public administration	65%	7%	61%
Other services	30%	12%	20%

Current coverage rates – *continued*

By standard occupational classification

	Any private	Personal	Occupational
Managers and senior officials	62%	19%	46%
Professional occupations	68%	14%	58%
Associate prof. and technical occupations	65%	13%	55%
Admin and secretarial occupations	56%	9%	48%
Skilled trades occupations	45%	24%	22%
Personal service occupations	37%	8%	30%
Sales and customer service	21%	5%	16%
Process, plant and machine operatives	50%	16%	35%
Elementary occupations	29%	8%	22%

Definition: Percentages are of those in employment. Only a small number of those not in employment are contributing to a personal pension. Coverage relates to those making contributions or accruing rights in a given year, so excludes those with a 'frozen' pension.

Data source: Family Resources Survey 2003/04, Labour Force Survey.

Current level and share of the income of pensioners provided by statutory schemes, occupational schemes and individual schemes

All pensioners

	Under 75	75 or over	Total
Gross income	336	240	291
Of which			
Benefit income	148	146	147
Occupational pension	93	64	80
Personal pension income	12	4	8
Investment income	33	20	27
Earnings	46	4	26
Other income	3	3	3

Current level and share of the income of pensioners provided by statutory schemes, occupational schemes and individual schemes – *continued*

Pensioner couples	**Under 75**	**75 or over**	**Total**
Gross income	456	344	415
Of which			
Benefit income	173	181	176
Occupational pension	136	113	128
Personal pension income	19	8	15
Investment income	50	31	43
Earnings	73	8	50
Other income	4	3	3

Single male pensioners	**Under 75**	**75 or over**	**Total**
Gross income	265	225	244
Of which			
Benefit income	126	127	127
Occupational pension	74	67	70
Personal pension income	15	5	10
Investment income	26	18	22
Earnings	21	5	13
Other income	2	3	3

Single female pensioners	**Under 75**	**75 or over**	**Total**
Gross income	214	184	197
Of which			
Benefit income	125	130	128
Occupational pension	47	36	41
Personal pension income	3	1	2
Investment income	15	14	14
Earnings	21	1	10
Other income	4	3	3

Notes: Couples are assigned to the age group of the head, normally the man. Forecasts of prospective levels are not available. State Pension is included in benefit income.

Data source: Pensioners' Incomes Series 2003/04.

Total employment rate

	16–SPA	30–54
Male	79.2	88.0
Female	70.0	74.6
Total	74.7	81.1

Note: Children aged 15 are in compulsory education so are not included.
Definition: Percentage of people aged 16–64 and 30–54 in employment.
Data source: Labour Force Survey, 2004 (four-quarter average).

Current economic or effective old-age dependency ratio

The effective old-age dependency ratio is 38% for those over 60, or 29% for those over 65.

Note: Children aged 15 are in compulsory education so are not included.
Definition: Non-active population 65+ (60+) in relation to employed population (aged 16–64; 16–59).
Data source: Labour Force Survey, Winter 2004.

Employment rates of older workers

	55–59	55–64	60–64	65–69
Male	75.1	65.9	54.0	17.5
Female	61.2	47.3	29.8	10.0
Total	68.0	56.4	41.6	13.6

Note: Since the UK has already met the Stockholm target, we do not produce scenarios for it.
Data source: Labour Force Survey, 2004 (four-quarter average).

Effective age of withdrawal from the labour market

	2003
Men	64.2
Women	61.9
Total	63.0

Data source: Eurostat.

Projections of public expenditure on pensions

£ million, 2005/06 prices	2005/06	2009/10	2019/20	2029/30	2039/40	2049/50
Retirement pension	44,161	47,380	54,045	66,659	76,537	79,677
Additional pension	8,471	11,236	16,632	23,846	32,415	49,012
Other pensioner benefits	10,526	10,959	13,709	20,385	29,739	39,829
Total pensioner benefits	63,157	69,575	84,386	110,891	138,691	168,518

Notes: Retirement pension consists of the Basic State Pension and non-contributory retirement pension. Additional pension is the earnings-related part of the State Pension. Other pensioner benefits are Pension Credit, Winter Fuel Payments and other benefits, but not disability or housing-related benefits.

At the time of writing, the European Union's Economic Policy Committee's Working Group on Ageing (AWG) was in the process of updating its long-term budgetary projections. As these will become available only after the publication of the 2005 National Strategy Report on pensions, and as the previous AWG projections are out of date, no AWG-verified projections can be provided. However, the UK considers the projections presented here as representative and expects that the updated AWG pensions projections will show a similar picture.

Data source: Department for Work and Pensions long-term benefit expenditure projections.

Breakdown of expenditure growth

Change due to:	demography	25%
	benefit rates	10%
	other	65%

Note: Figures are rounded to the nearest 5%.

Data source: Department for Work and Pensions, consistent with Budget 2005 projections.

Projected public pensions expenditure per person aged 65+

£ 2005/06 prices	2005/06	2009/10	2019/20	2029/30	2039/40	2049/50
Retirement pension	4,026	4,044	4,453	4,655	4,709	4,836
Additional pension	772	959	1,370	1,665	1,994	2,975
Other pensioner benefits	960	935	1,129	1,424	1,830	2,418
Total pensioner benefits	5,758	5,938	6,953	7,743	8,533	10,229

Notes: Retirement pension consists of the Basic State Pension and non-contributory retirement pension. Additional pension is the earnings-related part of the State Pension. Other pensioner benefits are Pension Credit, Winter Fuel Payments and other benefits, but not disability or housing-related benefits.

Data source: Department for Work and Pensions long-term benefit expenditure projections, Government Actuary's Department population projections.

Projected situation of public finances

Spending, revenue and the primary balance

	2003/04	2013/14	2023/24	2033/34	2043/44	2053/54
Total spending	40.6	41.9	41.3	43.3	43.1	43.1
Revenue	37.6	39.4	38.6	39.8	40.0	40.0
Primary balance[1]	–1.2	0.6	0.4	–0.4	0	0.1

1 To derive the primary balance, it is necessary to add general government interest and dividends received to the revenue projections.

Debt payments are around 2.25% of GDP.

Note: As a result of the projected spending and revenue trends, the general government primary balance is projected to be in surplus in 2013/14 before moving into deficit by the late 2020s. The projected deficit on the primary balance is most marked around 2035, when spending pressures are projected to be the greatest. However, in the very long term the primary balance is projected to return to surplus again as a result of the fact that the ageing process has run its course and due to the continued relative decline of social security spending.

Data source: HM Treasury, 2004 Long-term public finance report.

Benefits allowing early withdrawal

The UK does not have benefits allowing an earlier withdrawal from the labour market.

Contribution rates to the state system

Contribution rates to the state pension system in 2005/06 are as follows:

- Employees contribute 11% of income between £94 and £630 per week, 1% above £630. Employers pay 12.8% on all income above £94 per week.

- Employees contracted out of the State Second Pension get a rebate of 1.6% of earnings between £82 and £630. Their employers get 1% to 3.5%, depending on the scheme.

The allocation to the National Health Service is 2.05% of the first slice of eligible earnings for employees, and the full 1% on income above £630. Employers pay 1.9%. The rest goes into the National Insurance Fund (NIF), which is used to pay NI benefits. NIF income is not specifically assigned to particular benefits but the following table shows the breakdown of expenditure.

		2004/05	
		£bn	**%**
Retirement pension:	**basic**	41.24	70
	additional	7.42	13
Incapacity Benefit		6.78	11
Bereavement benefits		0.95	2
Jobseeker's Allowance		0.50	1
Other benefits		0.51	1
Other outgoings		0.29	0
Expenses		1.32	2
Total expenditure		59.02	100

Data Source: Inland Revenue; Government Actuary's Quinquennial Review of the National Insurance Fund as at April 2000; Update of the Government Actuary's Quinquennial Review of the National Insurance Fund as at April 2000, published 2004.

Contribution rates to private pensions

%	Members		Employers		Total	
	Open	**Closed**	**Open**	**Closed**	**Open**	**Closed**
Defined benefit	4.6	3.9	12.1	17.1	16.8	21.0
Defined contribution	2.9	3.1	6.2	4.2	9.1	7.3

Notes: Includes schemes with zero contribution rates, but excludes schemes with fewer than 12 members. The difference between contribution rates to defined benefit and defined contribution schemes does not directly translate into a difference in payouts. Defined contribution schemes are more likely to be contracted in, so members will receive the state second pension on top of their defined contribution pension. Defined benefit contributions are more likely to vary across years depending on the performance of assets, and they may have older members on average (contributions for older people or an ageing scheme tend to be greater than for younger people or a less mature scheme).

Data Source: Occupational Pension Schemes 2004 – survey by the Government Actuary's Department.

Real rates of return on assets held by pension reserve funds

Figures for income in 2003 are available for self-administered pension funds only.

£ billion	**2002**	**2003**
Total assets	620.4	719.6
Total contributions less refunds	19.4	26.0
Total investment income	17.9	16.8
Transfers from other schemes	6.1	4.7
Other income	0.8	0.8
Total income	44.2	48.3
Surplus of income over expenditure	6.6	9.4

Note: This table gives figures for self-administered pension funds. These are funded occupational schemes. They exclude the central government scheme which is unfunded; individual or personal schemes; and insured schemes (i.e. where the occupational pension scheme is administered via an insurance policy with an insurance company). They include the funded schemes of local authorities.

Increase in the value of assets is not included, but will contribute to the increase in total assets in 2003 above assets in 2002 plus surplus income (factors such as increased liabilities, for example borrowing and amounts payable to stockbrokers and other creditors, will also have an effect).

The independent Pensions Commission looked at the mean real rate of return over the long term:

	Equities	Gilts
Since 1899	5.5	1.1
Since 1977	10.5	6.9

Definition: The real rate of return figures are the average of real annualised rates of return over 10-year periods since 1899 and 1977.

Data source: Office for National Statistics; *First report of the Pensions Commission*.

Composition of assets held by pension reserve funds

Figures are available for self-administered pension funds only.

	£ million 2003
Public sector securities	89,450
Corporate securities	472,796
Other long-term assets	111,301
Short-term assets	46,091
Total	719,638

Note: The above table gives figures for self-administered pension funds. These are funded occupational schemes. They exclude the central government scheme which is unfunded; individual or personal schemes; and insured schemes (i.e. where the occupational pension scheme is administered via an insurance policy with an insurance company). They include the funded schemes of local authorities.

Data source: *Investment by insurance companies, pension funds and trusts*, Office for National Statistics, 2003.

Gender differences in the risk of poverty

	Percentage points					
	60+	0–59	65+	0–64	75+	0–74
Live alone	–7	0	–9	1	–8	–1
Live with child	7	–2	9	–2	–1	–2
Live with other 65+	1	2	0	0	1	–1

Note: On national definitions, the overall rate of poverty before housing costs are taken into account is 9 percentage points higher for single female pensioners than for single male pensioners, and after housing costs it is 7 percentage points higher (with single female pensioners having the same risk of poverty as the overall population, single male pensioners somewhat less).

Definition: Risk of poverty for men minus the risk for women.

Data source: 2003/04 Family Resources Survey (EU SILC transition).

Difference between men and women in relative income

60+/ 0–59	2
60+/45–54	–14
65+/ 0–64	3
65+/45–54	–13
75+/ 0–74	–1
75+/45–54	–15

Definition: Relative median income ratio for age groups (men) minus relative median income ratio for age groups (women) calculated for various age bands.

Data source: 2003/04 Family Resources Survey (EU SILC transition).

Typical length of vesting/waiting periods

The typical vesting period is two years.

Data source: National Association of Pension Funds.

APPENDIX 4

Consultation

The Department for Work and Pensions invited members of the Partnership Group, which supports the Cabinet Sub-Committee on Older People, to comment on draft copies of the National Strategy Report. The organisations which commented are listed below:

Tameside Metropolitan Borough Council

Royal National Institute for the Blind London

Cruse Bereavement Care

DWP Pensions Stewardship

Local Government Association

Social Regeneration Unit Newham Local Government

London Borough of Hackney Council

Jewish Care

Advice Service Manager, Derby City Council

Local Government Association

Help the Aged

Muslim Council of Britain

Veterans Agency

Citizens Advice Bureaux (national)

Age Concern

Low Incomes Tax Reform Group

Stroke Association

The Royal Association for Disability and Rehabilitation

Royal National Institute for Deaf People

Manchester City Council

National Pensioners Convention

NHS Islington Primary Care Trust

Federation of Irish Societies Irish Elders Association

Durham City Council

DWP Race Equality

Durham County Council

Manchester Welfare Rights

Citizens Advice Scotland

West Lothian Council

City of Edinburgh Council

Northern Carers (Scotland)

Age Concern Scotland

Help The Aged Scotland

Scottish Parliament

East Ayrshire Council

Dundee City Council

South Ayrshire Council

Convention of Scottish Local Authorities

Poverty Alliance Scotland

Glasgow City Council Social Work Services

Inland Revenue Scotland

West Of Scotland Seniors Forum

Veterans Agency Scotland

Stirling Council

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www.dwp.gov.uk/resourcecentre/policy_strategy/nsr2005.asp

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