



**Simplicity, security
and choice:**

**Working and saving for retirement
Action on occupational pensions**





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Working and saving for retirement

Action on
occupational pensions

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

June 2003

Cm 5835

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Foreword

People are living longer than ever before. Rising longevity is to be celebrated but it brings fresh challenges. As the Green Paper¹ made clear, we need reform for the long term to enable individuals to plan for their retirement and make real and informed choices about how and when to save and how long they work so they get the income in retirement they expect.

Occupational schemes, traditionally a source of strength in the UK pensions partnership, have come under particular pressure which has undermined people's confidence in pensions.

This document sets out steps we will be taking to address these challenges. The package of measures strikes a balance between protection for members and easing burdens on companies running schemes. The document also signposts progress on the rest of our programme of reform on which we will make further announcements in due course.

The measures are designed to give all partners greater flexibility to work together to meet future challenges. I am determined that where pensions have been promised they will be delivered.

We also need to make it easier for employers to provide pensions for their employees. That's why we have taken action to cut the layer cake of regulations that has built up over the years. We must make sure regulation is transparent, proportionate and effective.

There are no quick fix solutions. We need measures which will work and which will last. In this document I believe we have met this challenge and developed a package which strikes a fair balance between tough choices – greater simplicity with strengthened protection.

It is now essential that we all – Government, employers, individuals and the financial services industry – play our part in making these proposals work, both now and for the future.

A handwritten signature in black ink that reads "Andrew Smith". The signature is written in a cursive, flowing style.

Rt Hon Andrew Smith MP
Secretary of State for Work and Pensions
June 2003

¹ 1 December 2002, *Simplicity, security and choice: Working and saving for retirement*, Cm 5677.

Summary

1. People are living longer than ever before. Rising longevity is to be celebrated, but it brings important challenges for all developed countries. The UK is better placed than most to adapt to an ageing population with one of the largest stocks of private pension savings in Europe and a state system that is fiscally sustainable.
2. An ageing society needs long-term solutions. As the Pensions Green Paper¹ made clear, individuals need to be able to plan for their retirement and make real and informed choices about how and when to save, and how long to work.
3. The Government will be driving forward this agenda over the coming months. However, as responses to the consultation made clear, occupational pensions, traditionally a source of strength in the UK pensions partnership, face particular pressures that require early action.
4. In total, more than 800 consultation responses were submitted, from a broad and diverse range of stakeholders, as well as feedback from 35 consultation events attended by nearly 2,000 people.
5. *Simplicity, security and choice: Working and saving for retirement – Action on occupational pensions* sets out steps the Government will be taking to reform occupational pensions to address the concerns raised.
6. The Government recognises the importance of protecting accrued rights, but at the same time recognises that, to meet future challenges, all partners need to be given greater flexibility to find solutions that best suit their needs, so that they can play their part in renewing the UK pensions partnership.
7. We believe these proposals achieve that balance. But we are committed to independent monitoring, so we have established the Pensions Commission to ensure that these solutions continue working over time.

Occupational pensions – improving member protection

8. In the Green Paper, the Government proposed to improve the protection offered to members of pension schemes so that they would have greater confidence that they would benefit from their saving. Over the consultation period many respondents told us they agreed, arguing that there was a particular need to take early action to ensure that members of defined benefit pension schemes were protected if their schemes were wound up.

¹ December 2002, *Simplicity, security and choice: Working and saving for retirement*, Cm 5677.

Action on occupational pensions

9. The Government will protect consumers and improve the future security of pensioners by:
 - **introducing a Pensions Protection Fund** to guarantee members a specified minimum level of pension when the sponsoring employer becomes insolvent;
 - **requiring solvent employers who choose to wind up their pension schemes to meet their pension promise in full**; and
 - **revising the priority order which applies on wind-up** to ensure the fairest possible sharing of assets.
10. In addition, the Government will introduce new protection to deal with anxieties arising from the demands of an increasingly dynamic economy where companies are taken over and people move between jobs more frequently. We will:
 - increase protection when firms are bought out by **extending the protections offered by the Transfer of Undertakings (Protection of Employment) regulations (TUPE)** to the pension schemes of workers in the private sector;
 - help people build up rights in short-stay jobs by introducing a **new approach to vesting**. At the moment, rights are only protected after two years' employment; in future, employees who have been scheme members for at least three months and leave during the vesting period will be offered the choice of a refund of contributions or a Cash Equivalent Transfer Value (CETV). This will be of particular benefit to women, who are more likely to change or leave jobs during the period; and
 - introduce a **requirement on employers to consult** before making changes to pension schemes to ensure changes are developed in partnership.
11. The Government will introduce a new system of private pension regulation with a **new Pensions Regulator**. The new Pensions Regulator will concentrate on rooting out fraud and bad practice so that everyone has confidence in the system. It will do so in a way that supports our objectives of simplicity and reduced burdens on business.

Making pension provision easier for employers

12. In the Green Paper, we said that in order to encourage greater pension provision, we needed to strike a balance between offering simplification for pension providers and employers, and ensuring that pension scheme members are reassured that their money is held securely.
13. The Government will implement a number of changes to simplify and enable greater flexibility in pension provision for employers and pension providers. In particular, we will:
 - replace the Minimum Funding Requirement with **scheme-specific funding arrangements**;
 - **reduce the cap on mandatory indexation** that is required of schemes;

- **increase the flexibility for schemes** to rationalise the structure of their benefits; and
 - **simplify the legislation** in other key areas – including tax and contracting-out – to make it easier to administer pension schemes.
14. In addition, the Government has set up an Employer Task Force, chaired by Sir Peter Davis, Group Chief Executive of J Sainsbury plc, with members drawn from employers and trade unions. The Task Force will identify what employers can do to improve and extend pension provision, and will advise Government on the employer's role.

Choice for all – planning for retirement

15. The Government wants to do away with outdated inflexible approaches to retirement. We believe people should have the choice over how they save and when they retire. However, we recognise that there are currently barriers in the system that prevent people from exercising this choice.
16. Alongside this document on occupational pensions, we can confirm that we will be taking forward a range of measures that will enable people to make their own decisions about how and when to save. For example, we will:
- work to **extend combined pension forecasting** across the private pensions industry, by encouraging voluntary provision; and
 - **open up more options for flexible retirement** and encourage people to work for longer by outlawing age discrimination, providing back-to-work help for those aged 50 and over, and introducing changes to tax rules to allow people to work at the same time as drawing a pension.
17. Extending working lives can have a significant, positive impact on retirement income, and may be of particular benefit to women, many of whom interrupt their careers to look after children. The reforms also complement the Government's existing efforts to improve the opportunities of black and minority ethnic people in the labour market. In addition, the Government will play a leading role by **raising the normal pension age for public service pension schemes**.
18. We will consult with leading employers, employee representatives and pension providers to gather and promulgate best practice.

Conclusion

19. The measures outlined in *Simplicity, security and choice: Working and saving for retirement – Action on occupational pensions* build on the existing strengths of the UK pensions system. They will renew the pensions partnership between Government, individuals, employers and the financial services industry.

Action on occupational pensions

20. We have developed a package that strikes a balance between tough choices. The measures bolster members' security, while ensuring, through simplification and deregulation in some areas, that the costs of providing good schemes do not rise. We estimate that across all schemes, depending on what employers choose to do, the impact will range from cost-neutrality to a net saving of £155 million a year.
21. It is important that employees and employers work together to define the type of pension provision that suits them best. This balanced package is designed to make it easier for pension schemes to operate, while ensuring employees have much greater confidence that pensions promised are pensions delivered.

Chapter 1: Introduction

1. People are living longer than ever before. Rising longevity is to be celebrated but it brings important challenges for all developed countries. The UK is better placed than most to adapt to an ageing population – with one of the largest stocks of private pension savings in Europe and a state system that is fiscally sustainable.
2. An ageing society needs long-term solutions. As the Pensions Green Paper¹ made clear, individuals need to be able to plan for their retirement and make real and informed choices about how and when to save, and how long to work.
3. The Government will be driving forward this agenda over the coming months. However, as responses to the consultation made clear, occupational pensions, traditionally a source of strength in the UK pensions partnership, face particular pressures that require early action.
4. The Green Paper set out our proposals to renew the partnership between the Government, individuals, employers and the financial services industry; in particular to:
 - reaffirm the role and responsibilities of employers, improving saving through the workplace, and providing greater protection for members of occupational pension schemes;
 - encourage simple and flexible savings products, broadening access to the financial services industry;
 - help people make better informed choices about their retirement; and
 - extend working lives.

The consultation on the Green Paper

5. In preparing this document, we have benefited from the many people and organisations who have responded to the consultation on the Green Paper. In the biggest ever consultation on pensions – during which we received some 800 responses from a wide range of groups and individuals – we organised a series of 35 consultation events across the country seeking the views not only of experts but of people who are thinking about their retirement. Nearly 2,000 people attended these events.
6. The Government was particularly careful to ensure that organisations representing groups that can find it more difficult to have their concerns acknowledged were invited to the series of consultation events.

¹ 1 December 2002, *Simplicity, security and choice: Working and saving for retirement*, Cm 5677.

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7. The detailed consideration of the pensions issues facing women set out in the Green Paper was welcomed by expert commentators such as the Equal Opportunities Commission, Age Concern and the Fawcett Society, and taken further at specific consultation events.
8. Representatives of black and minority ethnic groups attended the majority of the regional events, and the specific needs around communication with these groups were clearly highlighted in the consultation responses. We have also ensured that we have considered whether any of the proposals in the Green Paper might have a differential impact on particular ethnic groups.

Themes emerging from the consultation

9. Some clear messages have come out of the consultation process. In particular, there is general agreement that everyone – individuals, employers, the financial services industry and the Government – has a role to play in planning for retirement.
10. The Government believes that the best way to reform our system is to build on the current approach where individuals, where possible supported by their employers, are responsible for deciding how much to save over and above what the State provides. This allows people to plan their retirement according to their needs. The responses to the consultation told us that people valued this flexibility, and welcomed our proposals to renew it for the future.
11. As part of this approach, **the Government remains committed to maintaining the State Pension age at 65**. The responses to the Green Paper confirm our view that, although appearing attractive to some groups, raising the State Pension age is not the way to address the issues faced by older workers. Our approach was welcomed by both representatives of business and trade unions. For example, the Institute of Directors commented: *“Raising the [State Pension age] may be superficially attractive ... however, on reflection we prefer the Government’s approach.”*
12. Others highlighted the disproportionately negative impact such a change would have on poorer people. For example, Age Concern agreed that: *“... increasing State Pension age would disproportionately affect lower income people who rely more on state benefits in retirement.”* The Government’s approach was further endorsed by a wide range of groups including the Oxford Institute of Ageing.
13. Some people argued that the Government should require people to save more for their retirement. There was, however, no clear consensus. The Pensions Institute said: *“If these proposals, however worthy, fail to deliver increased pension savings, then the only alternative solution is compulsion and, if that is the case, we should not be deterred by the inevitable claim that this is just another stealth tax.”* HSBC Actuaries and Consultants Limited were more strongly opposed to additional compulsion: *“[We] believe it is right for employers and individuals to be encouraged and supported rather than forced to make private provision for retirement.”*

14. Following this consultation, **the Government does not believe that the case for additional compulsion has yet been made**. We believe that if all partners play their part, the voluntary system can fully meet everyone's needs. However, as the Green Paper acknowledged, there are currently a number of obstacles in the way of an effective voluntary system. This document sets out the first steps we will take to removing these, and **Chapter 5** sets out our continuing programme of action. With the obstacles removed, it will be for the partners to prove they can make a success of voluntarism.

Renewing the workplace partnership

15. The Government alone cannot ensure the success of the UK pensions system. To do that, all the partners need to take action, and workplace arrangements are particularly important. Indeed, as the Green Paper recognised, occupational pensions have traditionally been one of the strengths of the UK system.
16. The right form of pension arrangement is something for employers to decide with their staff, and is a choice that will vary according to the organisation's circumstances and employees' preferences. The Government should not interfere in this choice, but we are acting to help more employers to play their part.
17. Although firms can decide what pension promise to offer for the future, when rights are accrued they should be delivered. Yet the consultation showed members are increasingly worried about failure to deliver accrued rights and the position of pension scheme members when their schemes wind up.
18. So, the Government has designed a balanced package that better focuses regulation on current anxieties. In doing so, it gives firms increased flexibility to play their part in the pensions partnership, while increasing security for members and giving them much greater confidence that pensions promised will be delivered.

The Employer Task Force

19. To support us in renewing the pivotal role employers play in pension provision, we have set up an Employer Task Force whose aim is to increase and extend occupational and private pension provision and to disseminate best practice. The Task Force will also advise the Secretary of State for Work and Pensions on the role of the employer in the pensions partnership.
20. The Task Force is chaired by Sir Peter Davis, Group Chief Executive of J Sainsbury plc. Dr. David Allen, Group Managing Director of BP plc, has been appointed Vice-Chairman. Members of the Task Force include leaders from large and small businesses, from a range of sectors and with different types of pension provision. Members of the Task Force are also drawn from the trade unions.

Members of the Employer Task Force	
Sir Peter Davis, Chairman	Group Chief Executive, J Sainsbury plc
Dr. David Allen, Vice-Chairman	Group Managing Director, BP plc
Lucy Anderson	Deputy General Secretary, Amicus
Sir Bill Connor	General Secretary, USDAW
Peter Derrick	Finance Chamberlain, Corporation of London
Anna Edgeworth	Group HR Director, Wimpey
Philip Gillett	Tax Controller, ICI
Susan Karim	Managing Director, Scottish Catering Enterprises
Geoff Mellor	Pensions Director, Whitbread
David Nish	Finance Director, Scottish Power
Graham Oakley	Company Secretary, Marks & Spencer
Mervyn K Pedelty	Chief Executive, Co-operative Group
Brian Timmins	Group Chief Executive, Aircraft Research Group
Simon Topman	Managing Director, Acme Whistles
Ralph Turner	Group Benefits Manager, Emap

21. The Task Force will work to identify and promote employer-led solutions and share the many examples of best practice that already exist in both providing and marketing pensions. In developing and promoting the employer's role in pensions and encouraging employees to save, the Task Force will consider:
- how to increase employees' access to high quality pensions;
 - how to improve the advice available to enable employees to make informed choices;
 - how to encourage employees to take up pension provision; and
 - whether targeted pension solutions are needed for specific sectors.
22. The Task Force will report to the Secretary of State for Work and Pensions within 18 months, and provide interim advice on the employer's role in the pensions partnership.

23. To support our aim of renewing the wider pensions partnership between individuals, employers, the financial services industry and Government, we are also establishing an Advisory Group to ensure the Task Force has ready access to the experience and expertise of other pension stakeholders. Advisory Group members will include pension providers, pension experts and consumer organisations.

The forward agenda

24. Occupational pension schemes face particular pressures, and this document primarily sets out how the Government will act to improve member security and make the occupational pensions framework more flexible – a major step towards renewing the pensions partnership which has long been the strength of the UK system. It will be followed by further announcements in due course across the rest of our programme of reform. Our planned programme of action is outlined in **Chapter 5**.
25. Pensions require long-term planning, and the trends we described in the Green Paper mean that many of us need to consider working longer, saving more, or a combination of the two in order to enjoy the income we hope for in retirement. The proposals we outlined to enable people to make informed choices, and to realise the potential of older workers, will allow future generations of pensioners to do this more easily. Our plans to promote these important options are outlined in **Chapter 4**.

The Pensions Commission

26. It is vital that progress on this agenda is monitored independently. That is why, after setting out our proposals in the Green Paper, we set up the Pensions Commission to monitor and keep under review the system of private pensions and long-term savings, and make recommendations to the Secretary of State for Work and Pensions on whether there is a case for moving beyond the current voluntarist approach. It is chaired by Adair Turner (Vice-Chairman of Merrill Lynch Holdings Limited and Chairman of the Low Pay Commission). The other Commissioners are Jeannie Drake (Deputy General Secretary for the Communication Workers Union and Commissioner of the Equal Opportunities Commission) and Professor John Hills (Director of the Economic and Social Research Council research centre for Social Exclusion at the London School of Economics).
27. The Pensions Commission will set out its forward work programme shortly, including information on the timing of reports. However, it is anticipated that an interim report, describing in detail the present situation, current trends, and the challenges which need to be met, will be published in 2004.
28. It is critical that we make swift progress, so that future generations of pensioners are able to take responsibility for planning their retirement, to enable them to receive the income in retirement they expect. The Government is playing its part by responding to the consultation process and by bringing forward legislation at the earliest opportunity. This document sets out measures that will help our partners play a full and active part, in particular by signalling the areas where we intend to work with them. It is now for all parties to build on this document and continue the positive engagement that we have seen and welcomed during the consultation process.

Chapter 2: Occupational pensions – improving member protection

Chapter summary

The Government will improve the security of pensions by:

- **introducing a Pensions Protection Fund** to guarantee members a specified minimum level of pension when the sponsoring employer becomes insolvent;
- **requiring solvent employers who choose to wind up their pension schemes to meet their pension promise in full;**
- **revising the priority order which applies on wind-up** to ensure the fairest possible sharing of assets;
- **extending some protection under the Transfer of Undertakings (Protection of Employment) regulations (TUPE)** to the pension schemes of workers in the private sector;
- helping people build up rights in short-stay jobs by introducing a **new approach to vesting**; and
- introducing **a requirement on employers to consult** before making changes to pension schemes to ensure changes are developed in partnership.

1. Partnership between employers, trade unions and employees is essential to ensure the tradition of occupational pension provision in the UK is maintained. It is important that employers and employees work together to define the type of pension provision that suits them best. This chapter explains how the Government intends to improve the security of pension scheme benefits and ensure much greater confidence that pensions that have been promised will be delivered. In the Pensions Green Paper, the Government proposed to improve the protection offered to members of pension schemes. Our aim was to give them greater confidence that they will benefit from their efforts to save, something which would encourage people to save more.

Action on occupational pensions

2. One example that was submitted to us during the consultation process illustrates why we need to take action:

Mr A was employed by one employer for more than 20 years and expected to retire at the company retirement age of 62 with a pension of £14,750 a year. Unfortunately, the employer went into receivership, Mr A was made redundant and the pension scheme began winding up.

If Mr A took his pension now at age 58 he would have four years less in the fund than expected. This reduces his entitlement to £12,200 a year. However, because the scheme is underfunded, he was told he could expect as little as 40 per cent of his entitlement with no increases to protect against inflation – thus receiving £4,880 a year, which is at least £7,000 less than he would have received if the scheme had been fully funded.

Protecting the consumer: securing accrued rights

3. In the Green Paper, the Government highlighted the need to review the protection offered to scheme members as part of a reformed regulatory regime. We received more than 200 responses to the Green Paper relating to member protection on wind-up. We are keen to avoid increasing the total cost of pension provision and this approach has been widely welcomed.
4. As proposed in the Green Paper, we will introduce measures to ensure that, should a defined benefit scheme wind up, members will have much greater confidence that they will receive the pension their employer promised them. We will legislate so that, where pension scheme assets are misappropriated, the calculation of compensation payable will no longer be based on the Minimum Funding Requirement, but instead reflect the value of the missing assets, which is usually higher. We will also introduce the further reforms outlined below.

The Pensions Protection Fund – a new compensation arrangement for pension schemes in the case of insolvency

5. **We will establish a compensation scheme known as the Pensions Protection Fund, run by a statutory body, to protect private sector defined benefit scheme members whose firms become insolvent with unfunded liabilities in their pension scheme.** This proposal was welcomed by many respondents.
 - The National Consumer Council said: *“The [Department for Work and Pensions] should introduce a compulsory insurance scheme for occupational schemes to protect accrued rights to retirement income.”*
 - Age Concern said: *“In the case of insolvency we believe that serious consideration should be given to the introduction of an insurance system ... We believe that the increased cost to members may be an acceptable price for security.”*

Occupational pensions – improving member protection

- *Watson Wyatt, the actuarial consultants, remarked: “We believe that there should be a public debate on whether some form of mutual insurance or central discontinuance fund could improve the security of pension scheme members. We accept that there are arguments for and against the various options. Nevertheless, the research that we have undertaken suggests that this sort of approach could be viable if it was limited to employers who became insolvent.”*
6. Some respondents were concerned that introducing such a scheme could introduce an element of moral hazard. We paid particular attention to this important concern in developing our proposals, learning lessons from the compensation scheme that has been running in the United States since the 1970s.
 7. There are two key risks. The first is that the company could choose to fund to a low level, or the trustees hold a higher risk portfolio than appropriate, because of the existence of the compensation scheme. In order to minimise this risk, we will ensure that pension schemes which are underfunded will pay a higher premium to the compensation fund compared with well-funded schemes. This risk-based premium will be on top of a flat-rate levy payable by all employers with defined benefit schemes other than those public service schemes where benefits are guaranteed by government. The risk-based premium will encourage good levels of funding.
 8. The second key risk is that there could be incentives for example for directors of a company or providers of finance to seek to wind up the company, in order to avoid the debt on the pension scheme. We can minimise this risk by capping the salary which will be used to calculate any entitlement payable by the compensation scheme. Insolvency would still mean significant reputational risk for the controllers of the company and would also mean significant loss of pension for the high-earning decision makers. This will ensure that there is a built-in disincentive, particularly for Board members and other senior executives, to let the company go into insolvency.
 9. It is important that we get the cap right. We want people to have much greater confidence in the pensions they have been promised. But we must not put unnecessary costs on good employers who choose to offer good pensions. And we need to tackle moral hazard, and guard against the Pensions Protection Fund producing unintended incentives. For the scheme to work properly, it must remain in the interests of scheme members and those who control the company for the fund to be managed prudently and for the company to stay in business and meet its pension obligations; and for there to be a reputational risk in insolvency. The fund will pay a maximum of 100 per cent of pensions in payment, and 90 per cent of the benefits of those still working. Over and above this, we believe there should be a cap on the maximum amount guaranteed by the Pensions Protection Fund equivalent to the pension expected by those on a final eligible salary of between £40,000 and £60,000. As we bring forward legislation to set up the Pensions Protection Fund we will take views from the Employer Task Force and others on the right level of the cap to achieve these aims.

Action on occupational pensions

Full buy-out – ensuring the pension promise is met in the case of solvent employers

10. Currently, if a solvent employer winds up an underfunded defined benefit occupational pension scheme that they sponsor, non-pensioner members may receive Cash Equivalent Transfer Values (CETVs) which are too low to provide them with the pension they were expecting at retirement. The rights they have already accrued in the scheme can be cut drastically.
11. Companies that choose to wind up their schemes pass their investment risk on to non-pensioner members, as they transfer into money purchase arrangements. Moreover, because the actuarial assumptions underpinning the CETV calculation have become out of date, CETV levels are now providing less protection than was originally envisaged. Individuals are thus affected in two ways: they take on all the investment risk, and the transfer value they take from the scheme is too low.
12. One consequence of this is that someone who is still working when the scheme winds up can end up much worse off than someone of the same age who took early retirement. We are determined to tackle this injustice.
13. **The Government believes that a solvent employer who chooses to wind up a scheme should ensure that there are sufficient funds in the scheme to meet the full costs of the rights accrued by scheme members unless doing so would put the company itself at risk, in which case the trustees, exercising their fiduciary duties, can agree a lower amount.** We will introduce a full buy-out provision through regulations which we are consulting on as set out in the timetable in **Chapter 5**. Trustees may utilise these regulations so that they apply to schemes that start winding up on, or that start to wind up after, the date on which the draft regulations are issued.
14. In line with the full buy-out proposal **we will restrict the ability of companies to take money out of a scheme which is in surplus on its own funding basis, unless the scheme can meet its pension promise in full** – that is, it is funded to a level sufficient to allow full buy-out. Levels of contributions would continue to be subject to agreement between trustees and employers as at present.

Changing the priority order – fairer sharing of assets

15. The statutory priority order sets out how the assets of a scheme that is winding up are to be applied towards meeting the scheme's liabilities for pensions and other benefits. At present, pensioner members are ranked higher than non-pensioners, and broadly speaking all non-pensioners rank equally. This has been criticised because it means that meeting the cost of pensions in payment and their indexation, especially for pensioners with a large income, can strip significant assets from the scheme before non-pensioners are even considered. And because non-pensioners are treated the same, irrespective of their age or length of time in the pension scheme, those approaching retirement age may be left with little or no pension.

16. Once the Pensions Protection Fund and full buy-out are in place, individuals in pension schemes will be able to have much more confidence that they will receive all or most of the pension they were expecting. However, in advance of the compensation scheme coming into effect, there may still be some people who are at risk of losing out significantly. And in rare cases, employers may not be able to meet the full buy-out requirement if they would be at risk of becoming insolvent by doing so. Therefore, **we are going to publish draft regulations which will ensure that, where there are insufficient assets to meet all liabilities, they are shared out as fairly as possible between active and pensioner scheme members**. We will be consulting on these draft regulations over summer 2003, and expect them to come into force in autumn 2003.
17. Our intention is that these regulations will mean that the degree of protection will reflect the length of time a member has been contributing to the scheme; that is, those who have contributed for the longest will receive the greatest protection. This will ensure the people most dependent on a particular pension for their retirement income will take priority. The changes will also give priority to the rights of non-pensioners over the future indexation of pensions in payment so that non-pensioners have a better chance of receiving the pension they were expecting.
18. Our proposals will improve the position of working-age people with defined benefit rights in the event of employer insolvency. Women are particularly disadvantaged by the fact that the current priority order favours pensioners over working-age people. Only 26 per cent of female pensioners have any occupational pension in their own right, compared to 64 per cent of men. Among working-age people, the gap is much smaller and has closed for women working full time. The changes we are proposing to the priority order, and the introduction of the Pensions Protection Fund, will mean that the rights of pensioners and working-age people will be treated more equally. Therefore, the proposals will have a significant favourable impact on women's future incomes in retirement.

A new system of regulation

19. **We will introduce a new system of private pension regulation with a new Pensions Regulator built on the foundations laid by the Occupational Pensions Regulatory Authority (Opra)**. The new Pensions Regulator will focus on tackling fraud, bad governance and poor administration, and will encourage best practice through an increased education and guidance role. Reporting arrangements will be rationalised so that the Pensions Regulator adopts a proportionate approach, ensuring members are protected, while reducing the regulatory burden on well-administered pension schemes. We have received considerable support for this proposal.
20. It is clear that although Opra is developing a more risk-focused approach, the current legal framework means that effort has been directed towards high volumes of relatively low value reports and breaches. This is not consistent with a risk-focused and proactive approach and must be addressed in the revised legislative structure.

Action on occupational pensions

21. The new Pensions Regulator will:
 - have statutory objectives that set a clear framework for its activity and provide an overarching definition of its functions;
 - establish a high profile in the community it regulates;
 - be provided with a responsive and proportionate regulatory 'tool kit', including powers to sanction, which will enable it to take a targeted and appropriate approach to breaches of pensions legislation and to other matters of conduct that pose a risk to members' benefits;
 - work with the pensions industry to help improve standards in scheme administration; and
 - encourage compliance with regulatory provisions by, for example, undertaking compliance visits and providing guidance and educational material.
22. The aim of our approach is to create a Pensions Regulator that is able to tackle the areas of greatest risk, providing better protection to pension scheme members, and be a respected and authoritative force in the regulated community. Greater flexibility and proportionality will benefit both those the Pensions Regulator seeks to protect and those who provide and administer work-based pension schemes.
23. One issue raised by a number of respondents is the relationship between the Financial Services Authority (FSA) and the new Pensions Regulator. We will ensure that the new Pensions Regulator and the FSA complement each other as set out in the Green Paper. This reflects many of the comments we received. For example, AEGON commented:
"We welcome the proposal for a new regulator separate from, but operating alongside and complementing, the FSA. We believe that this very much complements the proposed change in approach to pensions legislation."

Codes of Practice

24. **In order to introduce the new regulatory approach, we will restructure and simplify pensions legislation.** In addition, we recognise the need to consolidate pensions legislation as soon as practicable, and will discuss this with the Law Commission, which has responsibility in this area. As part of this process, we will give the new Pensions Regulator the power to issue Codes of Practice. We consider that where the proposed new legislation can be expressed in high-level or simple terms, or has obligations which can be expressed in general terms, such as 'to achieve X within a reasonable time', the legislation can most effectively be supplemented with a Code of Practice. This will reduce the need to set out the detail in regulations.
25. The Pensions Regulator could be given a duty to issue a Code of Practice in a particular area. Only breaches of the legislative obligation would be sanctionable, and the Code of Practice would not represent the law, but the Pensions Regulator's view of it. We intend that the Codes of Practice should have evidential value in proceedings where it will be determined whether a breach of the legislative provision had occurred, including decisions by the Pensions Ombudsman.

26. This approach was welcomed by respondents to the consultation, such as Prospect, who noted that: *“One possibility that should be considered alongside simplification of regulations is the introduction of a Code of Practice, of similar status to the ACAS codes, which would cover such issues as the proper conduct of trustee meetings, scheme dispute procedures, and good practice in scheme communication with members.”*

Better informed and better trained trustees

27. **We believe that legislation will ensure that trustees have the knowledge necessary for the responsible investment of the money held in pension funds on other people’s behalf.** Some respondents were opposed to legislation, believing it either unnecessary or harmful. Others were more sympathetic, but felt that it was inappropriate to limit coverage to investment, since trustees require expertise across the full range of their responsibilities. Many commented on the need for well-trained trustees and for certainty in knowing what is required from trustees, while avoiding bureaucratic over-prescription.
28. We are persuaded by the argument that investment is not the only, nor always the most, important area of trustees’ responsibilities. The legislation will therefore provide that trustees be required to be familiar with the issues or have relevant knowledge across the full range of their responsibilities. The Codes of Practice discussed above will provide guidance on how this legal requirement could be satisfied. These may cover relevant training, qualifications and experience, as well as relevant governance issues, which might include record keeping and skills audits.

Helping people build up pension rights in a flexible economy

29. The Government recognises the anxieties that arise from the demands of an increasingly dynamic economy where companies are taken over and people move between jobs more frequently.

Extending Transfer of Undertakings (Protection of Employment) regulations to private sector transfers

30. Over the last 18 months, the Government has been consulting on extending the Transfer of Undertakings (Protection of Employment) regulations (TUPE) to pensions. The Government’s aim is to ensure that workers who already enjoy pensions contributions will not have them withdrawn by reason of a transfer, or because a company is taken over. In achieving this we want to make sure that we do not place an excessive burden on the new employer.
31. **The Government proposes a flexible and worthwhile provision for a contribution to a stakeholder pension. We envisage that this will consist of an obligation to match employee contributions up to a level of 6 per cent.** Moving forward with TUPE in this way will bolster confidence in pensions.
32. The responses to the Green Paper consultation suggest that this proposal will be welcomed both for the protection it will offer employees and because the majority of

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businesses which already offer workers pensions on transfer would gain from a level playing field.

Better protection for early leavers

33. At present, employees who leave an occupational pension scheme within a vesting period (which may be up to two years) do not build up any rights in the scheme. Instead, they are given a refund of their contributions. The Green Paper suggested that rights in all schemes should vest immediately, with the proviso that *de minimis* amounts could be transferred by the trustees to a stakeholder pension, providing members did not object.
34. In general those who supported immediate vesting did not support the transfer proposals. There were a number of concerns, not least the extra administrative burdens that would arise and the risk that these might prompt employers to introduce waiting periods, which would be a regressive step.
35. However, the Government believes it is important to enable more employees, and particularly those who change jobs frequently, to have the opportunity to start to build up a private pension when they leave an employment before their rights have vested in an occupational pension scheme. **We will therefore introduce an alternative approach under which employees who have been scheme members for at least three months but who leave during a vesting period, must be offered the choice of a refund of contributions, less tax, or a Cash Equivalent Transfer Value (CETV) which they must transfer out of the scheme to another occupational scheme or personal/stakeholder pension of their choice.** Opting for the latter will allow individuals to benefit from their employer's contribution and tax relief in order to build up their own pension savings. We have included below an illustrative case study.

Miss Jones, 29, has worked for a company for four and a half years, and has been a member of its defined benefit pension scheme for one and a half years. She now plans to leave the company.

In total, her own contributions to the scheme are valued at just over £1,000. However, the Cash Equivalent Transfer Value (CETV) is valued at almost £2,500. This is the total value of her company pension benefit to date, which is also funded by her employer.

Therefore, if she had had the option to take the CETV instead of just the value of her own contributions, she would have the whole £2,500, rather than just over £1,000, to put towards her pension.

36. As the Age Concern and Fawcett Society joint response to the Green Paper states: *"The current two year vesting period can be a major disadvantage to women who are more likely to leave a job before two years than men"*, while the Equal Opportunities Commission pointed out that: *"For some women, this may be the period in which they earn their highest incomes, prior to family formation. It is vitally important that they should have the best chance possible to start accumulating a pension at this stage in their lives."*

An opportunity to build up pension rights from each employment, where they have joined a pension scheme, will therefore have a proportionately greater impact on the overall level of women's private pension saving.

37. The measures discussed so far in this chapter will strengthen the protection offered to those who are already members of pension schemes. Respondents to the consultation were clear that this on its own was not sufficient: that is, that there is also a need to ensure that people are able to join pension schemes, and take advantage of the provision their employers offer.

Promoting pension scheme membership

38. In light of the responses, we have decided **not to allow employers to make compulsory membership of their occupational scheme a condition of employment for all new members**. The Pickering report¹ recommended that employers should be allowed to make membership of their pension scheme a condition of employment where they contribute at least 4 per cent of pensionable pay. In the Green Paper, we were clear that it should be possible for members to opt out if, for example, they were already contributing to a stakeholder scheme, in order to allow people to continue to exercise an informed choice in this area.
39. While the consultation showed some support for allowing compulsory membership with no opt-out, the majority of respondents opposed the proposal. For example, one insurer pointed out that employers currently have the option of automatically admitting members as a means of raising the take-up of scheme membership and felt that the compulsory route was unlikely to add significantly to this. As only a small minority of schemes would have taken up this option, we have focused our proposals on getting a far larger number of firms to introduce default membership, in order to achieve a bigger effect on pension saving, and preserve the individual's freedom to opt out of the scheme in the small number of cases where their circumstances make saving in an occupational pension unattractive.
40. In place of this, we believe that there may be scope for the new Pensions Regulator to issue general guidance that employers should ordinarily include employees in their pension scheme unless they actively choose to opt out of it. The Employer Task Force will be considering why employees choose not to join good quality occupational pension schemes, and for the longer term, the issue of compulsory scheme membership may be something which the Pensions Commission will wish to examine as part of its agenda.

Requirement to consult

41. Our proposal to **introduce a requirement on employers to consult before making changes to pension schemes** has been widely welcomed. The Government believes this change is central to ensuring that future challenges in pensions are addressed in partnership. The main concerns have been: that any new requirement does not hinder business flexibility to make long-term commercial decisions; that it should cover significant

¹ Alan Pickering, 2002, *A simpler way to better pensions – An independent report*.

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rather than minor changes and affected groups; and that we should recognise that there are already a range of consultation mechanisms in place. We are looking at the best means to achieve this alongside consideration of how to implement the EU Information and Consultation Directive. We plan to issue a consultation document on the implementation of the Directive during summer 2003.

Chapter 3: Making pension provision easier for employers

Chapter summary

The Government will implement a number of changes to simplify and enable greater flexibility in pension provision for employers and pension providers. In particular, we will:

- replace the Minimum Funding Requirement with **scheme-specific funding arrangements**;
- **reduce the cap on the mandatory indexation** that is required of schemes;
- **increase the flexibility for schemes** to rationalise the structure of their benefits; and
- **simplify the legislation** in other key areas – including tax and contracting-out – to make it easier to administer pension schemes.

1. In the Pensions Green Paper, we said that in order to encourage greater pension provision, we needed to strike a balance between offering simple, flexible regulation for pension providers and employers, and ensuring that pension scheme members are reassured that their money is held securely. **Chapter 2** proposed measures to bolster the protection of rights that had already been accrued. This chapter outlines proposals to increase the flexibility with which pensions can be designed and costs contained in the future. It also advances measures to simplify regulation and to make it easier for firms to provide pensions.
2. We believe that members and schemes will welcome increased flexibility – especially where it gives alternative options to closure for schemes that are under pressure. Our intention to simplify and increase flexibilities was welcomed by a wide range of respondents to the consultation, from business organisations to groups representing pensioners.
3. These proposals complement our measures on protection to give a balanced package which is intended to ensure that there is no increase to the cost of pension provision for employers as a whole. We estimate that across all schemes, depending on what employers choose to do, the impact will range from cost-neutrality to a net saving of £155 million a year.

Increased flexibility in pension design

Introduction of scheme-specific funding

4. In the Green Paper, we restated our intention to replace the Minimum Funding Requirement (MFR) with more flexible **scheme-specific funding requirements**. The MFR was a flawed approach. It distorted investment decisions for some schemes and it increased regulation and costs for sponsoring employers, without delivering the level of security which many people expected. Our proposals will allow schemes greater flexibility to match their investment strategy to the profile of their members – for example, schemes with younger members may be freed to invest more heavily in assets expected to give a higher return over the long term.
5. The detail of the planned new framework for scheme funding was developed with the assistance of a consultation panel of representatives from the pensions industry, consumer organisations, employers and trade unions. Employers and the pensions industry responding to the consultation were broadly in favour, while members and consumer groups were concerned that it could weaken protection of members' benefits, particularly in cases where the employer became insolvent. We have taken account of these concerns by developing plans to strengthen the protection offered to pension scheme members as set out in **Chapter 2**.
6. The key elements of the scheme-specific funding requirements will be that:
 - scheme trustees will be required to draw up a Statement of Funding Principles;
 - trustees will be required to obtain a full actuarial valuation of their scheme at least every three years;
 - following the valuation, the trustees will be required to put a Schedule of Contributions in place, setting out how much the employer and employee will pay into the scheme;
 - where trustees and employers cannot reach agreement on issues fundamental to the funding of the scheme, the trustees will be given, as a last resort, powers to freeze or wind up the scheme;
 - trustees will be required to send regularly updated information to scheme members each year, containing key information about the funding position of their scheme, in line with the likely requirement of the EU Occupational Pensions Directive; and
 - the scheme actuary's duty of care towards scheme members will be clarified.
7. These proposals require employers, trustees and the scheme actuary to work together to develop an appropriate funding strategy for their scheme. Providing scheme members with funding information about their scheme will raise their awareness and understanding of the funding proposals of their scheme and increase accountability. We estimate that there will be savings of around £100 million a year arising from the impact of the removal of the MFR on schemes' investment strategies.

Easing the indexation requirements

8. The Green Paper sought views on the proposal to remove the requirement that defined benefit pension schemes must increase pensions in payment in line with inflation, capped at 5 per cent each year – a provision known as Limited Price Indexation (LPI). This was one of the recommendations made by Alan Pickering¹. He pointed out that providing indexation was now consuming a high percentage of overall contributions to pension schemes, and suggested that regulation in this area might have become disproportionate and excessively prescriptive. A wide variety of responses were received. The pensions industry were largely in favour – for example, Watson Wyatt said: *“Its [LPI] continued existence is a major factor prompting the closure of defined benefit schemes ... schemes should no longer be required to provide guaranteed increases for future service.”* However, consumer organisations and trade unions stressed that it was important that the purchasing power of pensions was broadly maintained. Some responses pointed out that removing the indexation requirement entirely could reduce pensions significantly over a long retirement.
9. The Government has considered all these views carefully, and accepts that mandating some level of protection from inflation remains desirable. It believes, however, that the current level of compulsory inflation insurance is excessive. In 1995, when the legislation introducing LPI was passed, long-term expectations of inflation were significantly higher: the 5 per cent cap was only intended to provide for partial cover against inflation. But the Government’s success in reducing inflation means that mandatory indexation has effectively become full inflation cover, something which is proving disproportionately expensive for some schemes to provide.
10. **We have therefore decided that we will relax this requirement, so that schemes are required only to index pensions in payment by inflation, as measured by the September annual increase in the Retail Price Index (RPI), capped at 2.5 per cent each year.** This reflects the reality of an economic climate where inflation has been driven down to average just 2.4 per cent over the years since 1997. The change will also better align the regulation of defined benefit and defined contribution schemes – members of the latter are not generally obliged to purchase any cover against inflation at all.
11. This will ease the funding liabilities for scheme sponsors in the future, without imposing the significant effect on pensioners’ incomes that could have arisen if indexation were removed entirely. It will be up to individual schemes to decide whether to change their provision in this respect. Pensions in payment will be unaffected by this change.
12. We believe that this change could reduce funding costs for employers of between £345 million to £415 million a year. This is part of our balanced package, which will ensure that costs for employers and pension providers need not increase overall as a result of our reforms.

¹ Alan Pickering, 2002, *A simpler way to better pensions – An independent report*.

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13. We have taken care to assess the impact on women's incomes. Women's life expectancy is greater than that of men by around three years at age 65, which means that there will be a greater proportionate impact from any reduction in indexation on women's retirement incomes than on those of men. However, because the legal requirement to index is capped at 2.5 per cent, as measured by the RPI, we believe there will only be a marginal impact on the incomes of both women and men. We have concluded that it is likely to be a fairer and more reliable outcome for women as a whole to reduce compulsory indexation slightly, as part of a balanced package that also improves the security of occupational pensions.

Survivors' benefits

14. **We do not propose to make any changes to survivors' benefits.** One of the recommendations of the Pickering report was that pension schemes should not have to provide benefits for the surviving spouses of scheme members. Removing the requirement would offer schemes greater flexibility and members more choice. However, it would also have a major impact on the incomes of retired women who have traditionally relied on their husbands to provide for their retirement.
15. Some respondents have suggested that there would be advantages to making this change. The Society of Pension Consultants commented that: *"Such a relaxation would be consistent with a change to simpler, less costly, arrangements in future and would thus help to encourage private occupational provision on a contracted-out basis."* The majority, however, felt that this would not be a desirable change. The Association of Pension Lawyers said: *"We doubt that either coverage of, or contributions to, occupational pension schemes would be increased by changes to the requirements for contracted-out schemes to provide survivors' benefits"* and Age Concern and the Fawcett Society commented jointly that: *"We would strongly oppose moves to take away provisions for survivors' benefits given that these mainly benefit women who are already disadvantaged in terms of pension provision."* It was also clear from the consultation that it is unlikely that there would be any widespread abolition of survivors' benefits in existing schemes. The Government will not, therefore, pursue this simplification.

Simplifying the legislation

16. The Government has been consistently clear that simplification must lie at the heart of any strategy to encourage voluntary pension provision. The new regulatory framework we set out in **Chapter 2**, which is supported by our plans for a new Pensions Regulator, will enable us to simplify the legislation relating to scheme administration and governance. In future the level of prescription will be based on the risk to the benefits of scheme members. This will provide schemes with greater flexibility to design and manage themselves in a more efficient and effective way that better fits with the business of the sponsoring employer. The remainder of this chapter sets out some of the areas in which we intend to simplify the legislation.

Increasing flexibility to modify the structure of members' accrued rights

17. **We will amend the restriction in Section 67 of the Pensions Act 1995 which heavily restricts schemes' ability to change any member's accrued rights without the member's consent.** Schemes will be able to make such rule changes if:
- there is a power in the scheme rules to make the change;
 - the change does not involve converting defined benefit rights into defined contribution rights;
 - the trustees approve the change;
 - the total actuarial value of members' accrued rights at the point of any change is maintained;
 - pensions already in payment are not reduced; and
 - members are consulted before a change is made.
18. The Green Paper proposed a new *de minimis* provision. The general response from the industry was that this would be far too complex to operate and would not provide schemes with sufficient freedom. For example, CMS Cameron McKenna commented that: *"[The de minimis approach seems] to be more complex and potentially difficult to operate than the existing provisions in Section 67."*
19. The proposed changes, which are based on the recommendations made in the Pickering report, provide schemes with the freedom to adapt to changing circumstances, while continuing to provide security for their members. In particular, they will allow schemes to avoid escalating funding costs in the future, if the assumptions underlying the scheme change over time. They provide that the actuarial value of members' accrued rights must be maintained at the point of any change, which is an important safeguard that was widely endorsed in the responses received. Deloitte & Touche Human Capital Advisory Services commented: *"The proposal to allow trustees to replace historical benefits with alternative benefits of equal value is sensible and will allow historical benefit structures to be rationalised"*, while the Pensions Management Institute commented that: *"As a general proposition, Section 67 should incorporate a value test as envisaged in the Pickering report."*
20. In making this reform, the Government has listened carefully to the responses it has received. Our proposals give schemes the flexibility and scope they need to contain costs in the future, without jeopardising the value of accrued rights.

Greater member involvement in running occupational pension schemes

21. Consultation responses have broadly supported the proposal that **the legislation that schemes should have at least one-third member-nominated trustees (MNTs) should focus on the required outcome rather than the process.** We have decided to take forward the more radical of the two options to simplify the MNT provisions set out in the

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technical paper which accompanied the Green Paper². This provides for minimum requirements in legislation backed by guidance from the Pensions Regulator. This will ensure that all members are able to nominate some of the trustees of their pension scheme, while making it easier for schemes to meet this requirement in a manner suitable to their circumstances.

Removing the requirement on schemes to provide facilities for Additional Voluntary Contributions

22. The Pickering report proposed that **occupational schemes should be able to choose whether to offer members a facility to make Additional Voluntary Contributions (AVCs)**. We propose to simplify the tax rules to enable us to implement this. Many schemes will continue to offer AVC arrangements voluntarily but, where they do not, members will have the flexibility to make their own arrangements for additional contributions through a personal or stakeholder pension.

Streamlining the rules of contracting-out

23. We are taking steps to simplify the procedures for contracting out of the State Second Pension.
24. **We wish to simplify the administration of Guaranteed Minimum Pensions (GMPs)**, which ceased to accrue in 1997, and the anti-franking legislation that protects benefits over and above the GMP from being eroded. This work has been generally welcomed as a potentially significant simplification of the contracting-out rules. For example, the CBI said: *"[The CBI] strongly supports the principle of simplifying Guaranteed Minimum Pensions (GMPs) given that GMPs contribute to the inflexible nature of the regulation of defined benefit occupational pension schemes."* We are continuing to explore options in this area.
25. **We will also introduce a package of measures to simplify the operation of contracting-out.** These will:
- relax some restrictions on contracted-out rights forming part of the tax-free lump sum permitted under Inland Revenue rules;
 - relax some restrictions preventing contracted-out rights being paid at the same time as other benefits;
 - increase the level at which small pensions derived from contracted-out rights can be commuted;
 - remove the requirement to obtain member consent for the commutation of pension into a lump sum when their entitlement consists solely of Equivalent Pension Benefits arising from the graduated pension scheme which ceased to accrue in 1975; and

² December 2002, *Simplicity, security and choice: technical paper*.

- extend commutation on grounds of serious ill-health to contracted-out rights in Appropriate Personal Pensions. This did not form part of our Green Paper proposals, but we have listened to the comments received during the consultation exercise and will now move forward with this proposal.
26. The consultation confirmed that there was still a need for Contracted-out Mixed Benefit schemes and so the Government will not abolish these provisions.

Other simplifications

27. **The Government will also pursue other simplifications to the legislation that were welcomed by respondents to the consultation.** We plan:
- to rationalise the rules governing the way occupational schemes communicate with members;
 - to streamline the procedure for dealing with disputes between trustees, managers and scheme members or beneficiaries, which has been widely welcomed;
 - to clarify the existing jurisdiction of the Pensions Ombudsman so that cases of maladministration by an occupational or personal pension scheme fall clearly within his remit; and
 - to simplify the treatment of pensions on divorce: by abolishing safeguarded rights in order to provide greater flexibility in implementing a pension share for the former spouse and the pension scheme; and by aligning normal benefit age as the earliest age from which a pension share may be payable for all private pension arrangements. This simplification makes pension sharing on divorce more likely, and this would be of particular benefit to women.
28. The Government recognises the valuable contribution multi-employer schemes can play in providing pension savings for employees, particularly in small- and medium-sized enterprises. Our tax simplification proposals will ease the complexities associated with such schemes. We have invited the National Association of Pension Funds (NAPF) to work with the Inland Revenue to find a simple, workable solution to one final difficulty – namely, cross-subsidy between unconnected employers.
29. The role of the Employer Task Force is to assist in identifying and promoting good practice, including employer-led solutions to extend occupational and private pension provision, among small- and medium-sized as well as large employers. In addition, the Pensions Commission will also consider any specific issues that arise in relation to pension provision among smaller employers.

Chapter 4: Choice for all – planning for retirement

Chapter summary

The Government believes that people should have the choice over how and when they save, and how long they work. We are committed to opening up options for flexible retirement to enable and encourage people to extend their working lives. We want to ensure that people have sufficient information to make effective choices. The first step is to provide better information to individuals about their retirement savings.

- In 2003, members of defined contribution pensions began to receive the first Statutory Money Purchase Illustrations, and we started to issue self-employed people with state pension forecasts for the first time.
- We will build on these initiatives by seeking to **extend the provision of combined pension forecasts, introducing a retirement planner and working with employers** to help them give their employees information about pensions.
- In the coming months, we will work with our partners to build a robust and sustainable **strategy for financial planning** for the future. The Financial Services Authority will launch an extensive programme of work in summer 2003.

The second step is to give people **greater choice about flexible retirement**. We have already signalled our intention to maintain the State Pension age at 65. We propose to:

- outlaw age discrimination;
- introduce new flexibility to tax rules to promote flexible retirement;
- increase the earliest age from which a pension may be taken from age 50 to age 55; and
- **raise the normal pension age in public service pension schemes.**

1. The Government believes that individuals should be empowered to make their own decisions about their retirement and the level of income they will need. This means opening up decisions about how much and how to save, and how long to stay in work. The Pensions Green Paper made it clear that some people have not yet made sufficient provision to enjoy the income they want in retirement, and that they should either save more, or be prepared to work longer, or a combination of the two, in order to increase their income in retirement.

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2. **Chapter 2** and **Chapter 3** of this document set out how we intend to improve member protection and encourage employer provision to ensure that more people are offered appropriate, secure options for saving in pensions. This chapter sets out the action the Government is taking to allow individuals to take control of their retirement planning.

Making choices and planning for retirement

3. We recognise that the Government, the wider public sector, and voluntary and community groups have an important role to play in ensuring that key messages about the value of retirement saving are communicated to all. We will be working across government and beyond to ensure that we emphasise the importance of planning for retirement, and provide sufficient information, so that individuals are aware of the choices they can make, and where they can get information and advice to help them make those choices. The Financial Services Authority is taking forward a major programme of work to develop a national strategy for financial education, information and generic advice. We intend that the informed choice agenda will be an integral part of this developing strategy.
4. The feedback from the consultation process indicates strong support for making informed choice a reality for people. A number of important messages have come through.
 - Personalised information can raise people's awareness of their pension entitlement.
 - People need to be able to identify their needs in retirement and whether they are on track to meet them.
 - Powerful messages to encourage people to make pension provision are needed.
 - A concerted effort must be made to reach particular groups of people, especially women and black and minority ethnic people.
 - Employers should play a key role in the provision of information to, and the financial education of, their employees.
5. Respondents reported that many women view their pension as a supplement to that of their husband/partner and they are more likely to prioritise their spending on meeting immediate household needs than on saving for their retirement. Age Concern commented: *"Many of the women had not thought about pensions because they had assumed their husband would provide but now wish they had been better informed"* while the Oxford Institute of Ageing noted that: *"The Paper is right in saying that citizens in general, and women in particular, need more information on work opportunities and the structure of the pension system in order to make the choices that best suit their individual circumstances. We welcome the Paper's proposal to provide women with more information, and we urge the Government to research methods in which women can specifically be targeted."* We have taken these points into consideration in developing our proposals.

6. Many of the Government's proposals will be tailored to address the specific needs of black and minority ethnic groups, which research has shown are less likely to have pension savings. The Policy Research Institute on Ageing and Ethnicity (PRIAE) highlighted the need to communicate effectively with these groups: *"The complexity in the current system ... can often be even more complicated for ethnic minority communities ... [and as Mahesh Amin of Asian People with Disabilities Alliance notes] in particular, ethnic minority groups are unaware of the benefits that accompany contributing to a pension scheme, including tax benefits."* Effective communication with these groups is central to the success of the Government's informed choice strategy. We will build on our experience with The Pension Service, and translate this to the wider context of saving for retirement.

Personalised information

7. The response to the consultation supports our belief that one of the key elements of making informed choice a reality is the provision of personalised information, and in particular, a projection of the likely pension income someone will receive in retirement from their occupational, private or state pension. For example, the Trades Union Congress (TUC) commented: *"More personalised information, sent direct to individuals, is essential if people are to have a clearer picture of how much they will receive when they retire."*
8. Starting from April 2003, everyone who is a member of a defined contribution scheme will be receiving a Statutory Money Purchase Illustration that will indicate the likely income they will receive from their pension savings. This means that, for the first time, members will have a realistic indication of the spending power of their pension to help them make informed decisions.
9. **We will expand this initiative so that members of all types of pension schemes get information of this kind, by legislating to require defined benefit schemes to issue annual benefit statements to their members** showing the amount of pension they have already built up in their scheme as well as the likely amount they will receive when they retire. Most large defined benefit schemes are already providing this information to their members and we see this as a basic building block for pension planning and want all members to receive it.

State pension forecasts

10. **We are complementing the work of our partners on Statutory Money Purchase Illustrations and annual benefit statements by beginning to issue state pension forecasts at regular intervals.** This programme began in May 2003 with self-employed people, with a view to the service being extended across the rest of the working-age population over the next five years. This initiative has the support of many respondents. The Investment Management Association, for example, said: *"An automatic state pension forecast for everyone, whether they request it or not, would help prompt savers to plan for their future earlier."*

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Combined pension forecasts

11. A combined pension forecast adds state pension information to the forecast of an individual's current occupational or private pension scheme, and is delivered through the employer or pension provider. Currently, pension schemes are not required to provide state pension information, but many do so on a voluntary basis.
12. Feedback from the consultation exercise suggests a high level of support for the provision of combined pension forecasts, particularly from those who are already providing them. Prudential plc reports: *"[We are] now issuing combined [pension forecasts] for the majority of our personal pension policyholders ... we support improving communication in this way to consumers and have experienced a positive reaction by increased increment business as consumers recognise the gaps in their planning ... [and believe that] building best practice is a better approach than mandating their issue."*
13. There are concerns that some businesses may not have the resources to deliver combined pension forecasts. While we acknowledge that some organisations have a number of questions and concerns over the practicalities of the proposal, the Government remains convinced that combined pension forecasts have the potential to be a key motivator in encouraging people to engage in financial planning.
14. Therefore, we wish to **extend this service across the pensions industry, in the first instance by encouraging voluntary participation through concerted and targeted marketing activity.**
15. However, if the voluntary approach does not achieve the desired coverage, we will reconsider the question of whether there should be a statutory requirement on pension schemes and employers to provide this service. **We will legislate to allow us to require pension schemes to issue combined pension forecasts on a regular basis if we believe it to be necessary in the future.**

Retirement planner

16. We recognise that there is a need to do more than simply provide personalised information about people's current retirement savings; we need to give people tools to identify their retirement needs and whether they are saving enough to meet them. So, as we proposed in the Green Paper, **we will continue to develop a web-based retirement planner**, which will enable people to view their total projected pension income from both state and private sources, estimate the income they might need in retirement and calculate any savings shortfall. We expect to make the first elements of this tool available in 2004.

Working with our employer partners

17. In the Green Paper, we set out our aim to promote the provision of pensions and information in the workplace. Many respondents agree that employers have a pivotal role to play – for example, the Consumers' Association feels: *"The workplace is a particularly effective channel for providing information on pensions."*

18. Some respondents were concerned by the prospect of a statutory requirement on employers to offer access to pensions information and advice. For example, the London Chamber of Commerce commented: *“It is not appropriate that employers be placed in a position where they might be perceived as giving advice.”* However, there is clearly support for encouraging employers to do more.
19. In the Green Paper, we acknowledged that while there are many employers who recognise the important benefits for both employer and employee of good pension provision, there is also a significant minority of employers who make little or no contribution to their employees’ pensions. Therefore, we proposed a range of options for requiring employers who do not provide a pension, or, if they do, make a contribution of less than 3 per cent of salary, to offer access to a minimum level of information and advice. These options are:
 - a state pension forecast and a reminder of the stakeholder pension scheme designated by the employer;
 - a pension information pack;
 - a presentation from the designated stakeholder pension provider or other authorised retailer about pensions and saving for retirement; or
 - an interview with the designated stakeholder pension provider or other authorised retailer about pensions and saving for retirement.
20. Before compelling employers to provide access to pensions information and advice, we need to understand the most effective way of delivering such information and advice in the workplace.
21. We have therefore decided to **pursue a pilot scheme for employer-based information as suggested in the Green Paper, in order to evaluate the effectiveness of different forms of pensions information and advice in the workplace. We will seek legislative powers to allow us to apply the learning from this pilot to employers if the pilot proves successful.**
22. One of the issues to be considered in the pilot will be the extent to which requiring employers to provide better access to pensions information and advice might be of particular help to women. As the Green Paper stated, only around 30 per cent of part-time workers (the majority of whom are women) are members of employer-sponsored pension schemes – which is about half the proportion of full-time working women and men who are members of such schemes. Many of these women may not have considered their pension position or they assume they can rely on their partner’s income. We believe that better information and advice might encourage people to review their position and consider making their own provision where possible. So the learning from this pilot will also enable us to understand how to improve take-up of occupational pensions where they are offered, and promote pension scheme membership as discussed in **Chapter 2**.

Working for retirement – realising the potential of older workers

23. In the Green Paper, we put forward proposals to enable people to work until they choose to retire and to ease the transition from work to retirement. We recognise that working and saving for longer is one of the most effective ways that people can increase their retirement income. This may be of particular benefit to women, many of whom interrupt their careers at younger ages to look after children, or become carers later in life. But too many people, who are both willing to, and capable of, work, currently do not have the opportunities they need. As the *Labour Force Survey* shows, in 1979 the employment rate for those aged 50 up to State Pension age was 72.4 per cent, but by the time this Government took office in spring 1997 it had declined to 64.7 per cent. By spring 2002 it had already risen to 68.1 per cent, and the Government is committed to further action in this area.
24. The Green Paper set out a broad range of proposals to extend working lives including extra back-to-work help for jobless people aged 50 and over, reforms to incapacity benefits, and ideas for modernising the state pension system so that people get a fair deal when they choose to take their pension later than State Pension age. We will be giving further details of our plans in these areas in the future. We have already signalled our intention to maintain the State Pension age at 65.
25. The proposals seeking to extend working lives will complement the Government's existing efforts to improve the opportunities of black and minority ethnic people in the labour market. These have included Employment Zones, Action Teams for Jobs and the Department for Work and Pensions Outreach Service, which aim to engage more effectively with people from minority ethnic groups.
26. The response to the consultation supports our approach to extending working lives through increased choice and flexible opportunities to retire later. There is a consensus that people should have the right to work longer, but that this should be voluntary, not forced, summed up by the comment from The Alliance for Finance, which stated: *"It is right by voluntary means for Government to encourage increased participation in the labour market as far as older people are concerned."*

Age discrimination

27. Feedback from the consultation process indicates widespread support for ending discrimination against older workers. Many organisations representing older people would welcome change. Some employers and their representatives expressed concern that legislation might lead to an increase in actions on unfair dismissal, reduce flexibility for employers considering staff restructuring, and have a possible impact on younger workers. They were also concerned that legislation on age discrimination should not significantly increase employers' costs – ending compulsory retirement ages could impact on the existing employment practices of many employers. But the majority of organisations and individuals felt that the issue of retirement should focus on ability, not on age, and that the use of mandatory retirement ages is increasingly anachronistic. They favoured flexible approaches to retirement for the real benefits it offers employers and individuals.
28. Many organisations highlighted the benefits that would accompany more flexible approaches to retirement, through the better retention and transfer of knowledge and skills, leading to improvements in overall efficiency and productivity, and reductions in costs. A number of employers recognised that the abolition of fixed retirement ages reflected good employment practice – for example, Unilever commented that: *“The abolition of compulsory retirement ages is aligned with our business principles of a commitment to diversity and our commitment to recruit, employ and promote employees on the sole basis of qualifications and abilities needed for the work to be performed.”*
29. An underlying theme to the responses is that legislation to outlaw age discrimination in employment, although important, can only be a starting point and that cultural change will take time and cannot happen in isolation. The Equal Opportunities Commission stresses the importance of actively promoting anti-discrimination policies and suggests that: *“An effective agency will be needed to promote cultural change and positive attitudes to the employment of older people, backed by effective powers to enforce age discrimination legislation.”*
30. **There will be a further opportunity during summer 2003 to comment on the options for implementing the age discrimination legislation. In the run-up to legislation the Government, in partnership with employers and their representatives, will continue to promote the business benefits of age-positive employment practices to employers.**

Flexible retirement – occupational pension rules

31. Flexibility in retirement, allowing people to move from full-time to part-time work, can help to make the transition from work to retirement a more smooth and gradual process. Our proposals to offer employees who would like to carry on working for the same employer the opportunity to do so, while drawing on their occupational pension, were welcomed by employers, trade unions, individuals, the financial sector and representative organisations alike. Ernst and Young said: *“This would improve flexibility of working patterns and offers people the opportunity to aspire to semi, then full retirement.”* As part of this package, we will increase the earliest age from which a pension may be taken from age 50 to age 55 by 2010.

Public service pensions

32. The Government has a responsibility, in its role as a large employer, to lead the way in addressing the social and economic consequences of demographic change. Most public servants now have the option to work to age 65. In the Green Paper, we asked for views on the proposal to take this further by making the normal pension age in public service schemes 65 rather than 60.
33. Many responses welcome this change, for example the Institute of Directors strongly endorse this proposal saying: *"It would be difficult for the Government to credibly urge business to encourage working beyond 60 if the public sector was unwilling to undergo similar changes."* The local authority employers' pension committee also supports the proposal to raise the pension age to 65 both for new entrants and the future service of existing staff. The TUC and several individual trade unions oppose the change. In addition, over 100 individuals have written expressing concern about the impact on them. These are mainly public servants within their last decade before retirement who are unlikely to be affected given the timescale for the reviews and the need for transitional arrangements.
34. **The Government intends to proceed with this proposal through reviews of public service pension schemes and in consultation with employers and employer representatives.** Precise timing and details of the reform package will depend on the particular scheme but it is envisaged that by the end of 2006 all new staff will join on the new conditions. The Government has already made it clear that pension rights already accrued from past service would be fully protected. A key task for the scheme reviews will be to decide how the higher pension age will apply to the future service of existing staff and how to ensure that transitional arrangements are fair and balanced.

Chapter 5: Taking the agenda forward

Chapter summary

This document is the first step in implementing our reforms. The Government will work closely with all our partners to make sure that we maintain the momentum and energy of the consultation process.

1. This document sets out how we are going to play our part in implementing the agenda set out in the Pensions Green Paper. The announcements it contains are the first step in the process of delivering our reforms, and they will be further developed over the forthcoming months.
2. The indicative timetable at the end of this chapter sets out when we expect to be able to give further details of our proposals, subject to the parliamentary timetable.
3. The Government will work with our partners to ensure that this timetable will be delivered. The Pensions Commission, which will be examining the effectiveness of the voluntary nature of the UK pensions system, will be a major contributor to this partnership.

Pensions and women

4. The Green Paper was the first ever statement of Government policy on pensions that explicitly considered the particular needs of women, and assessed whether the UK pensions system met those needs. Pensions are particularly important for women, as 64 per cent of the pensioner population are women, and the Government recognises the importance of designing a pensions system that helps women accumulate savings for retirement.
5. The Green Paper encouraged wider thinking in this area. Most experts commented that women were more dependent than men on state pensions for their retirement income. But far fewer women build up a full National Insurance record in their own right. Many policy suggestions that emerged during the consultation proposed ways in which National Insurance cover could be extended to include more women. We will examine these and other policy suggestions.

Tax simplification and annuity reform

6. Alongside the Green Paper, the Government published the results of a major review of pensions taxation. The Financial Secretary to HM Treasury plans to give further details of our proposals later in 2003, which include the widely welcomed measures to enable people to take advantage of flexible retirement in the future.

Sandler

7. The Green Paper referred to the recommendations made by Ron Sandler in his review¹ of the medium- and long-term retail savings industry. This review had significant implications for pensions provision, but had a wider scope, covering broader questions of savings products, and the manner in which they are sold. The Government issued a further consultation paper on the simple products in February 2003, while the Financial Services Authority (FSA) has also consulted on the appropriate sales regime for these products. We expect to give further details of the outcome of these consultations, and the steps we intend to take, later in 2003.

Child Trust Fund

8. In Budget 2003, the Government announced that the Child Trust Fund will provide an initial endowment of £250 for every child at birth, rising to £500 for children from the poorest families, to be invested until the child reaches age 18. This is part of our strategy for strengthening the savings habit of future generations. We will publish full proposals for the Child Trust Fund later in summer 2003.

Reforming incapacity benefits

9. The majority of inactive people aged between 50 and State Pension age receive incapacity benefits due to ill-health or disability. Although many of these people expect to return to work, we know that many of them fail to make the move back and effectively enter early retirement. We recently set out our response to the consultation² on the reform of incapacity benefits, which outlined our proposals for a series of pilots to help recipients return to work. We have now announced locations for these pilots, of which the first tranche will start in late October 2003, with a further tranche beginning in April 2004.

1 Ron Sandler, 2002, *Medium and Long-Term Retail Savings in the UK – A Review*, HM Treasury.

2 June 2003, *Pathways to work: Helping people into employment – The Government's response and action plan*, Cm 5830, Department for Work and Pensions.

Our timetable:	
Time	Event
April 2003	<ul style="list-style-type: none"> ● Members of money purchase pension arrangements were issued with illustrations of their likely pension for the first time.
May 2003	<ul style="list-style-type: none"> ● We began to issue state pension forecasts to self-employed people.
June 2003	<ul style="list-style-type: none"> ● We are publishing draft regulations alongside this document to ensure that solvent employers who choose to wind up their schemes will meet their pension promise in full – full buy-out.
Summer 2003	<ul style="list-style-type: none"> ● We will respond to the Sandler review. Details of the revised sales regime, and product specifications, will be finalised following consultation on the Sandler recommendations. ● We will publish draft regulations to change the priority order in the case of wind-up. ● We will lay regulations on full buy-out effective from the publication date of this document. ● We will consult further on proposals for age discrimination legislation. ● We will publish full proposals for the Child Trust Fund.
Autumn 2003	<ul style="list-style-type: none"> ● We will provide further details of our plans to reform the taxation of pension schemes. ● We will lay regulations to change the priority order in the case of wind-up. ● Pilots outlined in the incapacity benefits consultation document begin.
Summer 2004	<ul style="list-style-type: none"> ● Interim report from the Pensions Commission.
Late 2004	<ul style="list-style-type: none"> ● Age discrimination legislation laid in Parliament. ● Report from the Employer Task Force.
Spring 2005	<ul style="list-style-type: none"> ● Earliest possible date for most reforms to pensions law to come into force, including amendments arising from the EU Occupational Pensions Directive. ● Possible implementation of reforms to the taxation of pension schemes, including flexible retirement.
Summer 2005	<ul style="list-style-type: none"> ● First report from the Pensions Commission.
Late 2006	<ul style="list-style-type: none"> ● Age discrimination legislation comes into force.
2010	<ul style="list-style-type: none"> ● State Pension age for men and women begins to be equalised, with parallel changes to the entitlement rules for Pension Credit and Jobseeker's Allowance. ● Minimum pension age will have been increased from age 50 to age 55 for all pension scheme members since 2005.

Annex: Summary of funding and administrative savings and costs

1. We are committed to ensuring that we strike the right balance between protecting pensioners' benefits and reducing funding pressures on businesses. This annex sets out a brief synopsis of the key savings and costs that schemes will incur as a result of our plans.

We estimate that across all schemes, depending on what employers choose to do, the impact will range from cost-neutrality to a net saving of £155 million a year.

Funding costs for defined benefit schemes

Pensions Protection Fund

2. We are committed to improving member protection, which is why we intend to introduce the Pensions Protection Fund. The extra protection the Pensions Protection Fund provides will result in additional funding costs for private sector employers offering defined benefit schemes. The costs will depend on the level of salary cap which is used to calculate any entitlement payable by the Pensions Protection Fund. If the cap were to be £40,000–£60,000, the cost might be £340 million–£375 million. However, the level of the cap will be subject to the views of the Employer Task Force and others.

Full buy-out

3. Full buy-out costs would only fall to those solvent employers who opted to wind up their schemes. We cannot calculate the exact costs of full buy-out due to data limitations. But we can estimate that the costs are likely to be in the range £50 million–£100 million. Under the new rules, we have assumed that schemes with more than £500 million in assets will not wind up, due to the limited annuities market. Also, the increased cost of voluntary wind-up will tend to discourage such wind-ups. And measures elsewhere in the package to increase flexibility for schemes to control costs should reduce the incentives and need to wind up. Our estimate also takes account of the likely effect of the proposal from the actuarial profession to update the actuarial assumptions underpinning the Minimum Funding Requirement.

Action on occupational pensions**Better protection for early leavers**

4. We estimate that our proposals to offer employees who have been scheme members for at least three months, but who leave during a vesting period, the option of a Cash Equivalent Transfer Value (CETV), could result in additional funding costs of £15 million for defined benefit schemes.

Funding savings for defined benefit schemes

5. The Government's plans give private sector defined benefit schemes the flexibility to counterbalance these additional funding costs – while at the same time ensuring that members' benefits are not unreasonably affected. Three key policies which will deliver funding savings for defined benefit schemes are set out below.

Replacement of the Minimum Funding Requirement

6. We estimate that replacing the Minimum Funding Requirement (MFR) with scheme-specific funding arrangements will result in funding savings of £100 million across all private sector defined benefit schemes. The MFR is considered to have had an impact on the demand for gilts, and its removal will therefore lead to some reversal of this trend. At present it is estimated that schemes have some £100 billion invested in gilts overall. On the assumption that 5 per cent (£5 billion) of this was switched to equities following the removal of the MFR and that an extra 2 per cent return was achieved on those assets as a result, the extra investment income would amount to £100 million.

Lowering the indexation cap

7. Recent inflation rates and the Government's commitment to retain low inflation rates over the long term, mean that the current level of indexation, capped at 5 per cent, is providing a higher level of inflation protection than that required on current trends. The Government is committed to strengthening member protection in the event of scheme wind-up. We believe that most schemes and scheme members will welcome a shift in the level of protection from where its need is less (protection against high inflation) to where its need is greater (protection in the event of scheme wind-up). If private sector defined benefit schemes covering 70–85 per cent of all members take this option up, it would result in actual aggregate savings of £345 million–£415 million¹ across all private sector defined benefit schemes, if applied to all future accruals for existing and future members.

¹ The above savings are based on the assumption of an average inflation rate of 2.5 per cent with 1.5 per cent fluctuations either way.

Funding costs for defined contribution schemes

8. We estimate there will be funding costs of around £35 million for defined contribution schemes as a result of our proposals to extend the availability of CETVs (as discussed above).

Administrative savings arising for all schemes

9. There should be administrative savings of £80 million as a result of our proposals on tax simplification.

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