

PRESS RELEASE

12 September 2006

“The state pension system remains complex and uncertain despite reforms” says Pensions Policy Institute

The Pensions Policy Institute has published its response to the Government’s White Paper, *Security in Retirement: towards a new pensions system* which set out the Government’s proposals for pension reform.

Niki Cleal, PPI Director said “The Government’s White Paper proposals will alleviate to some extent the problems with the state pension system identified by previous PPI research, but none of these problems will be solved.”

“The White Paper proposals will help to equalise outcomes from the state pensions and the Government’s proposals to increase the state pension age will improve the overall sustainability of the system.”

“But the system remains complex and the amount of state pension income that people will receive is uncertain, even after the reforms. This complexity and uncertainty means that it may be difficult to give clear generic advice about the value of saving in the new Personal Accounts.”

“Auto-enrolment into private pension provision has potential advantages which should lead to an increase in the number of people saving for their retirement. But the White Paper may set unrealistically optimistic expectations for what Personal Accounts can achieve.”

“The PPI would like to see more detailed analysis to establish whether alternative state pension reform options could provide a better foundation for Personal Accounts.”

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Notes for editors

The PPI is an independent research organisation, focused on pension provision. Its aim is to improve information and understanding about pensions (state and private) through research and analysis, discussion and publication. It does not lobby for any particular issue, but works to make the pension policy debate better informed.

A summary of conclusions from the report follows and a list of suggested issues for the Government to consider is attached to this press notice. The response can be downloaded from:
www.pensionspolicyinstitute.org.uk.

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PPI response to the Government's White Paper
Summary of conclusions

1. **Working longer** is likely to have a larger impact on future retirement income levels above state pension age (SPA) than either state pension reform or higher private saving. The Government's proposed increases in SPA appear reasonable but should be kept under regular review given the uncertainty around future trends in life expectancy.
2. The White Paper **state pension reform** proposals will alleviate to some extent the problems identified with the state pension system by previous PPI research, but none of these problems will be solved.
 - The White Paper proposals **will help to equalise outcomes** between men and women and between workers and carers – but the inequality of outcomes between high and low earners will persist for many years, largely due to the retention of the state second pension (S2P).
 - Currently there are roughly 100 parameters that define what any individual may receive from state pensions and Pension Credit. After the White Paper reforms, there will still be around 95 parameters. The problem of **complexity** in the state pension system and the uncertainty that it generates will remain.
 - The Government continues to place a **high expectation on private saving**: that it can make up for inadequacies in the state system and reduce the level of undersaving through Personal Accounts.
 - The White Paper proposals will **improve the sustainability of the state system**, with increased public expenditure offset by increases in state pension age in the long term. However, this could be undermined by uncertainty over future Pension Credit levels. PPI analysis of the White Paper reforms suggests that future eligibility for Pension Credit is uncertain, but is likely to remain at relatively high levels.

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3. Auto-enrolment into private pension provision has potential advantages which should lead to an increase in the number of people saving for their retirement. However, there are risks in both the policy and design of *Personal Accounts*. In particular, *the White Paper may set unrealistically optimistic expectations for what Personal Accounts can achieve*. This is because:
 - It may not be possible to give clear generic advice on the value of saving in Personal Accounts.
 - Factors not addressed by auto-enrolment (such as affordability) may prevent pension saving.
 - Personal Accounts may have an adverse impact on existing pension saving.
4. The White Paper reforms do not provide the certainty of a solid state pension foundation ideally required to facilitate the introduction of a system of auto-enrolment into Personal Accounts. The White Paper did not include a full evaluation of alternative state pension reform models which could provide a better state pension foundation for the introduction of Personal Accounts, or look at alternative combinations of state and private pension reform.
5. A more detailed analysis of broader reform options than that in the White Paper is essential to finding and maintaining a consensus on pension reform.

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Summary of suggested issues to consider:**Working longer**

- a. Given the inherent uncertainty around long-term trends in life expectancy, it will be important to keep the proposed increases in SPA under review. The first SPA review could be coincident with the review of the default retirement age in 2011. (Paragraph 1.4)
- b. To make sure these reviews actually happen, legislation could lay down time spans within which the Government of the day has to commission a formal, evidence-based, independent review of specified pensions policy issues or general reviews of the effectiveness of pensions' policy. (Paragraph 1.5)
- c. The commitment to hold a review on the eligibility age for Guarantee Credit, say in 2020 could be written into legislation. (Paragraph 1.5)

State pension reform

- d. In order to minimise the political risk in indexation policy, legislation should include not just the start date but the definite commitment to ongoing earnings indexation of the BSP as a minimum (not contingent on later decisions). In addition it would be helpful if the Government set out its long-term plans for indexation of S2P both as entitlement is built up and when it is in payment. (Paragraph 2.11)
- e. The uncertainty surrounding future Pension Credit levels could be minimised by setting the uprating of all Pension Credit parameters in legislation in the same way as BSP earnings indexation. (Paragraph 2.36)
- f. The Government should publish the range of outcomes from the models and assumptions used to estimate the proportion of pensioner benefit units eligible for Pension Credit in future. (Paragraph 2.40)
- g. Government should account for how the revenue gains from abolishing contracting-out for DC arrangements will be spent, in particular, confirming whether they will be spent on improving pensions rather than on other areas of Government spending or debt reduction. (Paragraph 2.44)

Personal Accounts

- h. The Government will need to address what it believes should be the target outcome of Personal Accounts, and how that can be measured. (Paragraph 3.10)

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¹ The paragraph numbers refer the PPI's response to the Government's White Paper, *Security in retirement: towards a new pensions system*. The full response is available on the PPI's website: www.pensionspolicyinstitute.org.uk.

Personal Accounts (continued)

- i. The Government should make clear whether it has considered broader factors such as possible eligibility for means-tested benefits, affordability of contributions, and the suitability of saving in Personal Accounts compared to other forms of saving in any analysis used to support generic advice. (Paragraph 3.20)
- j. Government plans for providing a good, free source of independent guidance in making the financial decisions required by the introduction of auto-enrolment need to be more detailed and costed. (Paragraph 3.21)
- k. There is a need for further analysis into the possible impact of Personal Accounts on existing pension provision. (Paragraph 3.27)
- l. A review of value for money to the taxpayer of current and alternative systems of tax incentives for pensions and other forms of savings would help address a remaining significant policy issue. (Paragraph 3.35)
- m. Government will have to make unambiguously clear in all literature what the nature of Government guarantee is in Personal Accounts and consider how acceptable it will be, and the potential future costs, if people do not fully appreciate their investment risks. (Paragraph 3.37)
- n. It would be helpful if the Government confirmed its policy intentions on promoting personal responsibility. (Paragraph 3.38)
- o. Given the risks and uncertainties inherent in the policy choice underpinning both models of Personal Accounts in the White Paper, more policy analysis of the rationale for and alternative models of an auto-enrolment savings scheme seems necessary before detailed product design is undertaken. (Paragraph 3.38)
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Interaction between state pension reform and Personal Accounts and alternative policy options

- q. Government should undertake and publish detailed evaluation of alternative state pension reform proposals to help develop consensus on future policy. This could include consideration of single-tier and two tier options under slow and fast transitions. (Paragraph 4.19)
- r. Legislation should set a date, say 2015, for a review to examine the feasibility of merging BSP and S2P. (Paragraph 4.20)