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Response to the Government's White Paper, ***Security in retirement: towards a new pensions system***

Summary of Conclusions

I. ***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.

II. 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 <u>and</u> 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.

III. 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.

IV. 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.

V. 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.

VI. A detailed list of suggested issues for the Government to consider is in Appendix A.

Response to the Government's White Paper, ***Security in retirement: towards a new pensions System***, September 2006

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Introduction

1. The Pensions Policy Institute (PPI) promotes the study of pensions and other provision for retirement and old age. The PPI is unique in the study of pensions, as it is independent (no political bias or vested interest); focused and expert in the field; and takes a long-term perspective across all elements of the pension system. The PPI does not make policy recommendations, or support any one reform solution, but exists to contribute facts and analysis to help all commentators and policy decision-makers.

2. The Government published its White Paper, ***Security in retirement: towards a new pension system*** in May 2006 which set out the Government's proposals for pension reform. There are three main elements to the Government's pension reform package:
   - Proposals to extend working life.
   - State pension reform.
   - The introduction of auto-enrolment into a new system of Personal Accounts.

3. This paper provides the PPI's response to the three elements of the Government's White Paper proposals. The PPI published a detailed analysis of the Government's state pension reform proposals in July 2006[1]. The PPI has also submitted detailed written and oral evidence to the House of Commons Work and Pensions Committee[2].

4. This paper summarises the key findings from the PPI's analysis of the state pension reform proposals but, for the purposes of brevity, it does not include the full details of all of the analysis undertaken. For further details of the PPI's analysis of the White Paper state pension reforms please see the separate paper published in July 2006, ***An evaluation of the White Paper state pension reform proposals***.

[1] PPI (2006) ***An evaluation of the White Paper state pension reform proposals***, available on the PPI's website: www.pensionspolicyinstitute.org.uk

[2] House of Commons Work and Pensions Committee (2006) ***Pension Reform*** Volume 2 pages EV 1, EV 389, EV 402 and EV 405

5. This consultation response is structured as follows:

   Section 1 comments on the Government's proposals for extending working life;

   Section 2 analyses the extent to which the Government's proposed state pension reforms alleviate the problems in the state pension system identified in previous PPI research;

   Section 3 comments on the proposed introduction of a new system of Personal Accounts; and

   Section 4 analyses the interaction between the proposed state pension reforms and Personal Accounts and sets out alternative policy options that the Government could consider.

6. Specific suggestions that the Government may wish to consider are identified by a shaded text box in the main body of the response. For ease of reference they are also listed at the end of this response in Appendix A.

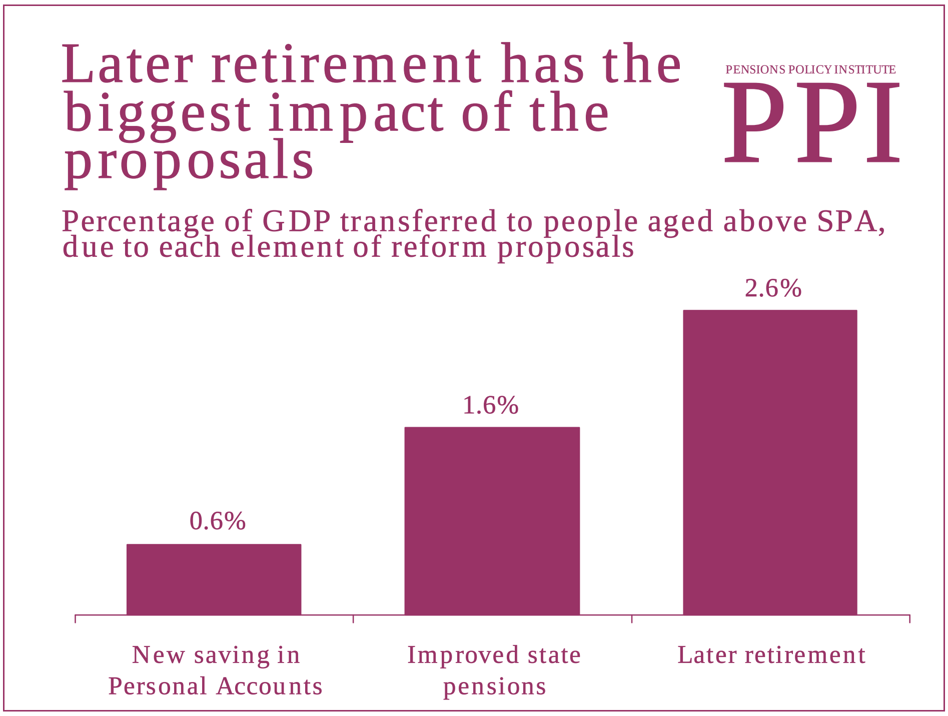
Section 1: Extending Working Life

1.1 This section highlights that:

- Extending working life 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 White Paper proposals to increase the SPA appear reasonable given the most recent projections of life expectancy. However, given the uncertainty surrounding projections it is important to keep these estimates under review.
- The impacts on lower socio-economic groups could be mitigated by the eligibility age for Guarantee Credit remaining lower than SPA.
- The Government must ensure that further policy measures intended to make a reality of extending working life are delivered.

1.2 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 saving (Chart 1).

Chart 1[3]



[3] Pensions Commission (2005) ***A New Pensions Settlement for the Twenty-First Century: The Second Report of the Pensions Commission,*** p289 & 299. The Government's White Paper proposals are sufficiently similar to the Pensions Commission's for the order of the elements to still apply.

1.3 In the White Paper, the Government recognises that working longer will play an important role in delivering retirement incomes in the future.

1.4 The White Paper proposes that the SPA should increase from age 65 to age 66 by 2026, 67 by 2036 and age 68 by 2046. The Government's proposed SPA increases appear reasonable, given the most recent projections of life expectancy[4].

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[5].

1.5 The intention to hold periodic reviews of life expectancy trends as set out in the White Paper[6] therefore seems sensible.

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[7].

1.6 The White Paper recognises that there is a need to educate and inform individuals and employers about their choices. Including likely life expectancy in state pension forecasts could provide useful information in this context[8].

1.7 A concern often raised about increasing state pension age is the impact on individuals from lower socio-economic groups, where life expectancy is lower than average. As the White Paper notes, keeping the Guarantee Credit age lower than SPA could help to mitigate the impact of different life expectancies for different socio-economic groups[9]. Recent PPI analysis for the TUC suggests that this would not have an excessive cost[10].

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[4] PPI (2006) ***Supplementary evidence to the House of Commons Work and Pensions Committee's inquiry into pension reform following the White Paper*** paragraph 34
[5] White Paper Paragraph 4.13. See ***PPI memo to the Pensions Commission*** March 2005 for more detail on how to make SPA increases contingent on a rolling review, page 12.
[6] White Paper page 99
[7] New Zealand and Ireland are examples of countries with legislation requiring general policy reviews at specific times. See PPI Briefing Note Number 29.
[8] The PPI suggested this in a letter to the then Pensions Minister in September 2004
[9] PPI (2006) ***Supplementary evidence to the House of Commons Work and Pensions Committee's inquiry into pension reform following the White Paper*** paragraph 11
[10] PPI research for the TUC, forthcoming in September 2006

1.8 The White Paper suggests that increasing the Guarantee Credit age from its then level of 65 be considered nearer the time of proposed SPA increases (from 2024), based on updated evidence of life expectancy trends at that time. This seems sensible.

The commitment to hold a review on the eligibility age for Guarantee Credit, say in 2020 could be written into legislation.

1.9 The Government has recognised that raising the SPA is only part of the solution to extending working lives and has proposed further measures to address the key barriers which prevent people from staying in work for longer. These measures to extend working lives include[11]:

- Enabling people greater flexibility to choose a phased approach to retirement.
- Providing improved communications and information in support of longer working.
- Working in partnership with employers to encourage them to retain older workers, and to offer them greater flexibility around retirement.
- The introduction of age discrimination legislation from October 2006.

1.10 These measures seem sensible and it is important that the Government works with other key stakeholders to ensure that they are delivered if extending working life is to become a reality.

[11] White Paper, page 139

Section 2: State pension reform

2.1 PPI research brought together 80 pensions experts from over 40 organisations to build up a picture of the possible shape of a consensus pensions solution that could work for the long term in the ***Shaping a stable pensions solution*** project[12].

2.2 The research identified four concerns with the current state pension system:

(i) It generates unequal outcomes;
(ii) It is highly complex;
(iii) It places too high an expectation on private savings; and
(iv) It is unsustainable.

2.3 The problems with the current system identified by the PPI's research are broadly similar to the Government's five tests, that the reformed pension system should promote personal responsibility; be fair; be simple; be affordable and be sustainable[13].

2.4 This section assesses the extent to which the Government's White Paper proposals alleviate each of the four concerns with the current state pension system identified by the PPI's research. It concludes that the White Paper proposals will alleviate to some extent the problems with the state pension system identified by previous PPI research, but none will be solved.

2.5 This section highlights that:

- 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 <u>and</u> 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

[12] PPI (2006) ***Shaping a Stable Pension Solution***
[13] White Paper, page 15

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. (See paragraphs 2.38 – 2.40)

Unequal outcomes

2.6 The first problem identified with the current system is that it generates ***unequal outcomes***. There are unequal outcomes between men and women, between workers and carers and between high and low earners.

2.7 Under the current system, 30% of women currently reaching state pension age qualify for the full Basic State Pension (BSP) compared to 85% of men[14]. Carers of adult or disabled dependants only receive credit towards their state pension if they care for more than 35 hours a week. High earners accrue more from the earnings-related State Second Pension (S2P) than lower earners.

2.8 The Government has recognised these concerns and in the White Paper proposes a number of reforms to the state pension system including:

- A reduction in the number of qualifying years of National Insurance contributions or credits needed to be eligible for a full BSP to 30 years and some broadening of the eligibility criteria for the carers' credit,
- The restoration of the earnings-link for the BSP but not for S2P, and
- Reforms to S2P that mean that it will eventually become flat-rate.

2.9 The reduction of the number of qualifying years for the BSP will help to equalise outcomes between men and women. It will enable more women to accrue rights to a state pension in their own right, although this will take some time to come into effect. By 2025 the Government estimates that 90% of women reaching state pension age will be entitled to a full BSP in their own right compared to 30% now.

2.10 Carers will also benefit from the change to 30 years as well as the proposals to broaden the eligibility criteria for the carers' credit. The introduction of a weekly rather than annual credit will help those who care for less than a full year. These are improvements on the

[14] White Paper, paragraph 3.109

current system and will help to equalise outcomes between carers and workers.

2.11 The restoration of the earnings-link for the BSP will help to prevent pensioners from having the value of their BSP income eroded relative to the incomes of the rest of the population. This is a positive change and will help to alleviate poverty for older pensioners, who are disproportionately affected by rising prices. But S2P is proposed to stay indexed to prices in payment, so pensioners will still see the value of their S2P fall relative to average earnings from their state pension age[15].

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.

2.12 However, where the White Paper proposals make less progress is on equalising outcomes between high earners and low earners. This is largely due to the continued retention of S2P, the earnings-related state pension, for several decades. The White Paper recognises that an earnings-related state pension is part of the problem, and proposes that S2P becomes flat-rate. However, unequal outcomes, favouring the better off, will persist for decades[16]. This is because:

- The proposals do very little to help current pensioners.
- The flattening of S2P is slow.
- Many people will have gaps in their contributions to S2P and so will receive less than the full amount of S2P.

2.13 Further, despite proposed improvements to S2P there will still be a range of outcomes from S2P. Women (who earn less, and are more likely to fall between the gaps) are still unlikely to qualify for full S2P. This is largely because, although the number of qualifying years for BSP has been reduced to 30 years, there has been no corresponding reduction in the number of years needed to qualify for full S2P. Individuals will need between 49 and 52 years of contributions to qualify for the maximum possible amount of S2P

[15] See PPI Briefing Note Number 31 ***The impact of the White Paper state pension reforms***
[16] This is shown in Table 5, page 32 of Curry and Steventon (May 2006) ***Transition Trade-offs: Options for state pension reform***, PPI. This paper modelled the Pensions Commission's proposed option for reform. More recent modelling by the PPI has confirmed that the White Paper proposal is close enough to the Pensions Commission's proposal for the conclusions from the analysis in the PPI paper to apply to the White Paper proposal.

(depending on state pension age when they retire), which implies a complete contribution history. Few women are likely to accrue a full S2P entitlement. This counteracts the Government's other efforts to reduce inequality in men and women's state pension provision.

2.14 The White Paper says that ***anyone who has been in employment or caring throughout their working life could receive £135 a week at retirement in state pensions***[17]. But because of the long transition to a flat-rate S2P, gaps in S2P coverage and the continued price indexation of S2P the majority of people will receive less than £135 a week, in today's earnings terms, from the state even by 2050[18].

2.15 So while the White Paper proposals are likely to go some way towards improving the equality of outcomes for men and women, for carers and non-carers, the problem of unequal outcomes between high and low earners will persist for decades.

2.16 The overall impact of the White Paper reforms on the income distribution of people over state pension age is likely to be small. The better-off could benefit more than the less well-off. For example, by 2050, average incomes towards the top of the income distribution are projected to be £20 a week higher under the White Paper proposals than in the continuation of the current system. Average incomes for the poorest 10% are projected to be only £5 a week higher (Table 1).

[17] White Paper, page 20
[18] PPI (2006) ***An evaluation of the White Paper state pension reform proposals***, page 15, Box 3

Table 1[19]: Illustrative weekly total after tax income of people over SPA in 2050 by decile of the income distribution, £ per week in 2006/7 earnings terms

	Current system	White Paper
1st	110	115
3rd	140	135
Median	165	170
7th	205	210
9th	305	325

Complexity

2.17 The second problem with the state pension system is its ***complexity***. The state pension system has evolved over many years and successive Governments have changed the rules and requirements for qualification for the state pension. The result of this legacy is that the state pension system is extremely complex.

2.18 As a result of this complexity, the majority of people do not have a clear idea of how much state pension income they can expect to receive under the current system[20]. It is highly questionable whether individuals can begin to make any rational savings decisions in the face of such uncertainty.

2.19 Some of the reforms proposed in the White Paper will reduce complexity. The reduction in the number of qualifying years for the BSP means more people are likely to qualify for a full BSP which will simplify the system. The White Paper also proposes to remove the complexity of contracting-out for Defined Contribution pensions and to make some of the credits for BSP and S2P the same.

2.20 But complexity, and the resulting uncertainty that it generates, will still be a significant problem in the reformed system through:

- The retention of two different state pensions with different rules and qualification criteria.
- The continued widespread use of means-testing.

[19] PPI estimates using the Aggregate and Distributional Models. All figures have been rounded to the nearest £5. This assumes the Guarantee Credit would continue to be increased with average earnings in the absence of reform, necessary for people left claiming the benefit not to become poorer relative to the rest of society.

[20] ***Pensions and Savings Index, Survey 1*** (September 2003), by YouGov for the ABI

2.21 The White Paper proposal to retain two different state pensions with different rules and qualifying criteria is a significantly more complex policy solution than some alternative policies that have been proposed, such as a flat-rate single-tier state pension.

2.22 Under the White Paper proposals an individual's state pension income (BSP + S2P) will depend on their National Insurance contribution record, whether they have been contracted into or out of S2P and a multitude of other factors. Although state pension forecasts can help, no forecast can take account of how an individual's circumstances may change in the future. This makes it very difficult for people to have any idea how much state pension income they can expect to receive when they reach state pension age. In turn, this makes it difficult for people to decide how much private saving they should undertake for themselves or their dependants.

2.23 A further source of complexity is the continued large extent of means-testing in the system. The White Paper estimates that 33% of pensioner benefit units could be eligible for Pension Credit after the reforms, by 2050[21]. PPI analysis suggests that the actual number could turn out to be higher than this (see paragraphs 2.38 to 2.40).

2.24 Pension Credit is complicated and adds significantly to the number of parameters on which an individual's future income depends. Further, it is not certain, as its parameters can be set at short notice in a Budget rather than being set in legislation. Small changes in these parameters can make a big difference to being eligible or not in future. So continued reliance on Pension Credit means that people (and their advisors) will continue to be uncertain about the income they can expect from the state in future and about the value of saving.

2.25 Overall, 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[22]. The problem of system complexity will remain.

[21] White Paper, page 123, figure 3.v
[22] PPI analysis. Excludes Personal Accounts.

Too high expectations on private saving

2.26 The third problem of the current state pension system was that the pension system placed ***too high an expectation on private savings***.

2.27 In 1998 the Government set a long-term target to shift pension provision from 60% provided by the state and 40% provided by the private sector, to 40% state and 60% private. Previous PPI analysis has shown that, under the current system, this shift from 60:40 to 40:60 is unlikely to happen. This is because future state spending on pensions has increased due to the introduction of the Pension Credit, and the trend in pension income from private sources is not expected to increase as significantly as would be needed for this shift to occur[23]. In the White Paper the Government proposes to drop this target [24].

2.28 The White Paper proposals for state pension reform show that the Government recognises that the state will continue to be a significant provider of income in later life. However, the overall approach to pension reform has been one of finding ways to increase the level of private saving.

2.29 The White Paper suggests that adequacy of retirement income against an income target is a better measure of policy success than the proportion of state vs. private income[25]. The number of people 'undersaving'[26] to reach the target is the key measure used by Government to illustrate current problems.

2.30 The Government estimates that after the reforms, someone working or caring for 40 years can expect to retire on around 30 per cent of median earnings, or around £135 a week in today's earnings terms, before any private saving[27]. Personal Accounts are expected to top-up state pensions to provide a reasonable total 'replacement rate' for individuals, of around 45 per cent for a median earner.[28] So the Government expects one third of a median earner's retirement income to come from private saving.

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[23] PPI (2006) ***Shaping a stable pensions solution***, page 20

[24] White Paper, Annex C

[25] White Paper, Annex C

[26] For a review of the problems with undersaving analysis see O'Connell (2006) ***NPSS policy and design choices*** pages 12-13

[27] White Paper, page 108, para 3.15

[28] White Paper, page 68, paragraph 1.102

2.31 PPI analysis suggests that the majority of people will not necessarily receive the level of state pension income that the Government expects. (Paragraph 2.14)

2.32 This implies that the state system is more uncertain and will provide less of a solid foundation for the new Personal Accounts than the Government suggests. The Government continues to place a high expectation on private saving through Personal Accounts – that it can both make up for inadequacies in the state system and reduce the level of undersaving.

2.33 The Government therefore continues to have high expectations for private saving. This is consistent with the Government's emphasis on personal responsibility. But the potential over optimism around Personal Accounts is considered in detail later in this response.

Sustainability

2.34 The fourth problem with state pensions is that ***policy was widely seen as unsustainable***. This was largely because the future growth in eligibility for Pension Credit, and the widespread increase in means-testing to the majority of pensioner households that this implied, was seen as unsustainable. However, sustainability also relates to the extent to which the overall system is seen to be affordable in the long term.

Eligibility for means-tested benefits

2.35 In the White Paper the Government clarified that it never intended that a significant majority of people should be entitled to Pension Credit[29].

2.36 However, the White Paper provides no mechanism by which the intention of earnings uprating Guarantee Credit, or the uprating of the Savings Credit threshold, will be assured. Both these parameters have a significant impact on the proportion of people eligible for Pension Credit[30]. The uncertainty in what these parameters will be in future means the future value of saving now is made more uncertain than it otherwise would be.

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.

[29] White Paper Paragraph 31
[30] PPI Briefing Note Number 31 ***The impact of the White Paper state pension reforms***

2.37 The White Paper suggests that in 2010, around 45% of 'pensioner benefit units' will be eligible for Pension Credit, but that proportion will reduce to around one-third after the White Paper reforms[31]. The implication of the Government's analysis is that there will be a significant reduction in means-testing as a result of the reforms.

2.38 PPI analysis suggests that the Government may have under estimated the likely number of people eligible for Pension Credit after the White Paper reforms. This number is very uncertain because the state pension will not take everybody above the means-tested level. Therefore, eligibility for Pension Credit depends on the circumstances at the time of each individual or couple, and in particular the amounts of different types of income that they have at the time when they are eligible.

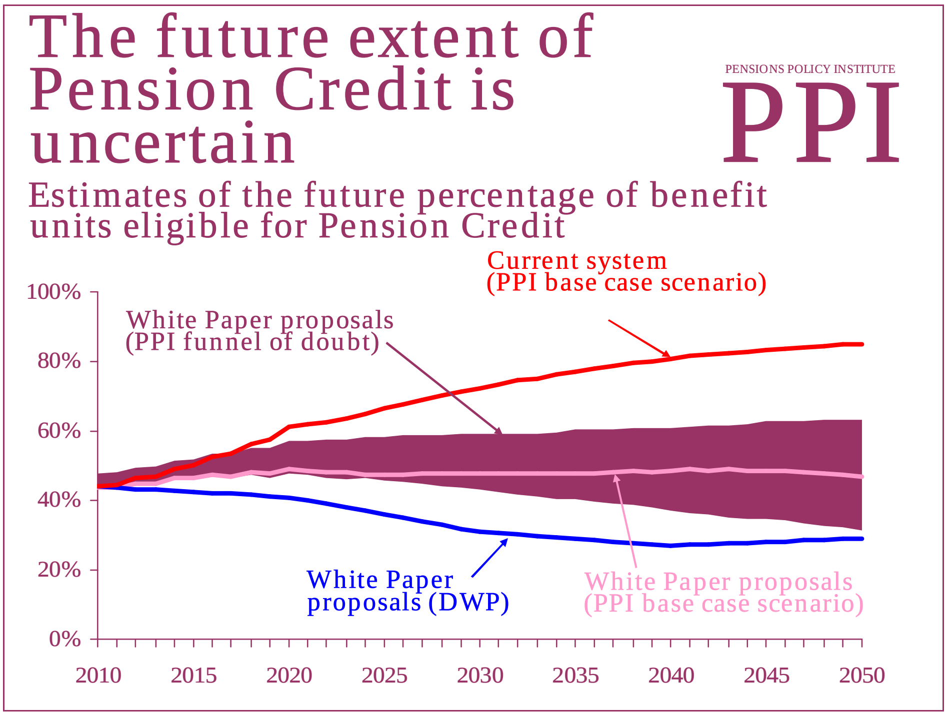
2.39 The PPI has produced a range of estimates for Pension Credit. Under a reasonable scenario for improvements to state pension coverage and private pension incomes, 45% of pensioner benefit units could be eligible for Pension Credit in 2050, which is more than the Government's estimate of one-third (see Chart 2).

2.40 The White Paper acknowledges that the number of older people eligible for Pension Credit will be uncertain, but only shows a single 'point estimate' calculated as the average of the midpoints of the ranges of outcomes from two different models used[32].

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.

[31] White Paper Figure 3.v page 123
[32] White Paper Footnote to Figure 3.v page 123

Chart 2[33]



2.41 The White Paper reforms will mean that more people will have a 100% marginal withdrawal rate on their savings (because of being eligible for Guarantee Credit but not Savings Credit) than there would have been had the existing state pension system continued. This trade-off has the advantage of fewer people eligible for Pension Credit, but the disadvantage of penalising some lower income savers more heavily than currently; where to strike the balance is a difficult policy question.

Affordability of the state pension reforms

2.42 A second aspect of sustainability relates to the affordability of the state pension system. PPI estimates of the cost of the White Paper state pension proposals are broadly similar to Government estimates[34].

2.43 The proposed abolition of contracting-out for Defined Contribution (DC) arrangements helps short-term affordability. Abolition will result in an increase in Government revenue of more than £4 billion in 2012. This has not been factored into Government projections of spending on pensions, even though the resulting

[33] PPI estimates. For further information see PPI (2006) ***An evaluation of the White Paper state pension reform proposals.***
[34] See PPI (2006) ***An evaluation of the White Paper state pension reform proposals***

higher future spending on S2P has been counted. If the increased revenue is also allowed for, there is very little immediate change in the Government's overall net fiscal position. The increased revenue from abolishing contracting-out for DC arrangements will almost exactly offset the short-term costs of state pension reform[35].

2.44 However, whether the revenue gain will be 'hypothecated' in this way is not addressed in the White Paper.

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.

2.45 The planned increase in state pension age (SPA) improves the long-term sustainability of state pensions by reflecting life expectancy improvements and reducing the overall cost of the state pension reforms. The long-term growth in the share of GDP now planned to be spent on pensions as a result of the White Paper proposals is more realistic than in previous Government projections, given the growth in the number of people over SPA[36].

[35] White Paper, page 24, Figure 9
[36] PPI Briefing Note Number 27

Section 3: Personal Accounts

3.1 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.

3.2 One way that has been suggested to try and reduce these risks to Government is to appoint a 'Delivery Authority', which:
… would be staffed by experts in financial services and administration, who would be able to take decisions on how to set up personal accounts[37].

3.3 This could help ensure that the implementation of Personal Accounts draws on experience and best practice from the private sector. However, ultimate responsibility for the policy design and practical performance of Personal Accounts would remain with the Government, even if some decisions are taken at 'arm's length'.

3.4 This part of the response highlights that:
- The success criteria for Personal Accounts are not fully defined.
- Expectations of Personal Accounts may be over optimistic.
- Uncertainty means Personal Accounts may not necessarily be good value for money for the taxpayer.
- There are significant implementation risks for Government.

Success criteria for Personal Accounts are not fully defined

3.5 The White Paper accepts that, in the long term, the state should provide a flat-rate pension and leave earnings-related provision to the private sector. This is in line with what the majority of pensions experts would view as the most appropriate roles of each sector[38].

3.6 Government intervention in the private sector with Personal Accounts goes significantly further than many pension experts suggest. This intervention aims at fairly high earnings-related retirement income (a replacement rate of around 45% for a median earner).

3.7 Despite stating that a 45% replacement rate is not a target (let alone a guarantee)[39] it may become an expectation in the absence of any other measure.

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[37] James Purnell weblog, 3 August 2006, http://www.dwp.gov.uk/pensionsreform/weblog/
[38] PPI (2006) ***Shaping a Stable Pensions Solution***
[39] Regulatory Impact Assessment Paragraph 2.45

3.8 The alternative view of many experts is that the Government should focus on delivering good flat-rate basic provision (minimum 21-25% national average earnings) and encourage / facilitate further provision without getting involved in its delivery[40].

3.9 The success of Personal Accounts could be measured by reference to an adequacy of retirement income against an income target measure, using estimates of the number of people 'undersaving'[41].

3.10 But the Government does not set a target for the reduction in the number of people 'undersaving' as a result of the proposed reforms. This means that it will be difficult to evaluate the success of Personal Accounts.

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

Expectations of Personal Accounts may be over optimistic

3.11 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.

It may not be possible to give clear generic advice on the value of saving in Personal Accounts

3.12 The remaining complexity of the state pension system and uncertainty in the extent of means-testing through Pension Credit will continue to make the value of private saving (in Personal Accounts or otherwise) uncertain. This may mean that the Financial Services Authority cannot give clear generic advice on the definite value of staying opted in to Personal Accounts. If this is the case, then opt-outs may be higher than expected[42].

3.13 The White Paper examples of saving in Personal Accounts assume that having started, people stay contributing continuously throughout a working life with a full National Insurance (NI)

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[40] See PPI (2006) ***Shaping a Stable Pensions Solution*** and O'Connell (2006) ***NPSS policy and design choices***

[41] White Paper, Annex C

[42] House of Commons Treasury Committee, ***The design of the National Pensions Savings Scheme and the role of financial services regulation Fifth Report of Session 2005-6***, Paragraphs 48-49

record[43]. This may well be over-optimistic, given the diversity of working lives. Women in particular would be likely to opt in and out of Personal Accounts. And as it takes time for the state pension system to evolve under the White Paper reform proposals, the expected value of saving will vary from generation to generation.

3.14 Although it is hard to generalise from stylised examples to the population as a whole, there are certain 'groups' of individuals who are more likely to have an uncertain value of saving in a Personal Account:

- People with interrupted NI and Personal Account contribution histories.
- People already close to state pension age (say in their 50s today).
- People who will potentially be eligible for means-tested benefits, including Pension Credit, Housing Benefit and Council Tax Benefit.

3.15 Interrupted NI and Personal Account contributions mean that individuals are more likely to have:

- Lower state pension income, and so be more likely to be eligible for Pension Credit.
- Less income from Personal Accounts, more of which replaces Pension Credit.

3.16 In some circumstances saving in a Personal Account may not increase income in retirement at all. People:

- Already close to state pension age (for example in their 50s in 2012) who do not benefit much from S2P changes, and for whom Pension Credit is relatively high compared to state pension; or
- With a long time spent not qualifying or S2P, such as the self-employed;

are most at risk of seeing no value at all from saving in a Personal Account.

3.17 People who are eligible for Pension Credit, Housing Benefit and Council Tax Benefit after state pension age are likely to see income from these benefits replaced by, rather than supplementing, income from Personal Accounts.

[43] White Paper, page 61, Annex E; Regulatory Impact Assessment page 53

3.18 As well as the increase in overall income that comes from saving in a Personal Account, there are a range of other considerations to determine whether or not an individual would be 'better off' saving:

- Is saving affordable? Particularly for low income groups, 4% of income diverted from consumption to saving could have an appreciable impact on living standards today.
- Are other forms of saving more suitable than Personal Accounts? For example, does the individual (or family) have debts to repay, or should they use a product that gives them access to savings in case of emergencies?

3.19 These factors mean it is therefore difficult to identify even broad groups of individuals who would definitely be 'better off' saving in a Personal Account.

3.20 This does not necessarily mean that individuals should not be auto-enrolled. But it illustrates that some people who are auto-enrolled will not necessarily be 'better off' having done so, or perceive that they are better off.

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.

3.21 The White Paper does not say much about how the Government plans to give information about Personal Accounts to individuals and help them make their choices in Personal Accounts – initial and ongoing - and other related financial decisions. If Government introduced a national auto-enrolment savings scheme without providing a good free source of independent generic advice on a wide range of lifetime financial decisions[44], the impact of Personal Accounts may be limited and / or the risk of mis-buying increased.

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.

[44] 'Advice' probably describes it best but can be confused with regulated 'best advice' which is not what most commentators envisage for an independent source of generic advice. It should be more than just information, and help people make their own decisions, stopping short of telling people what to do.

Factors not addressed by auto-enrolment may prevent pension saving

3.22 The White Paper gives the reasons why people do not save as they 'should' as the complexity of incentives to save, inertia and the cost of providing pensions, and the reforms are designed to combat these problems[45].

3.23 But it ignores other reasons why people do not save, for example: lack of money, preference for spending more or paying down debt, lack of trust in pensions or investments, preference for non-pension savings vehicles. For example, one survey showed 54% of non-savers do not save because they have ***no spare money***; the next reason was the ***risk of poor returns*** at 18%[46]. Given the multiplicity of reasons, auto-enrolment is likely to help, but it may not be the 'silver bullet' that solves the perceived problem.

Personal Accounts may have an adverse impact on existing pension saving

3.24 Any intervention by Government into the savings, capital and labour markets risks distorting those markets. Previous interventions (by previous and current Governments) either did not meet expectations (stakeholder pensions) or had to be wound back (SERPS). Parts of the White Paper focus on rolling back regulation from previous interventions (contracting-out, Guaranteed Minimum Pensions (GMPs)) while a chapter is dedicated to introducing a state/private vehicle which will necessitate new regulation.

3.25 The risk of future practical difficulties is compounded by the requirement, in either of the two proposed Personal Account models, for new large-scale system development[47].

3.26 These risks should be set in the context that Personal Accounts are expected to be a small part of the overall retirement savings sector. Government estimates are that even at maturity, the stock of assets in Personal Accounts will be less than 1/10th of the total sector assets[48]. This is because Personal Accounts are aimed at one group – those without current private pension provision.

[45] White Paper 1.32-1.45

[46] ABI (2005) ***The State of the Nation's Saving*** 2005 pages 12 to 16. See also Mayhew (2003) ***Pensions 2002: Public attitudes to pensions and saving for retirement***, DWP Research Report no. 193, Tables 2.25 and 2.26 which also suggests there are numerous reasons why individuals do not save.

[47] White Paper Paragraphs 1.55-1.56; Figures 1.vi and 1.vii

[48] Regulatory Impact Assessment Paragraph 2.111

3.27 Evidence as to how employers will react to auto-enrolment and the compulsory contribution is mixed. The White Paper suggests that very few employers will reduce existing pension contributions or close existing arrangements[49]. However, other research suggests that almost a third of employers would consider reducing existing pension contributions under the Personal Account system[50].

There is a need for further analysis into the possible impact of Personal Accounts on existing pension provision.

As a result expectations of Personal Accounts may be over optimistic

3.28 The White Paper suggests a central estimate of 6.7m employees out of 10.8m eligible to be automatically enrolled into Personal Accounts will stay opted in: an implied opt-in rate of 62%[51].

3.29 As the White Paper recognises, the only evidence of the impact of auto-enrolment on take-up rates is in employer-based schemes where the employer has voluntarily decided to introduce auto-enrolment. But many employees will not receive any encouragement to stay in Personal Accounts from their employer. It may not be possible to provide generic advice on the value of saving in Personal Accounts. Other barriers to saving will remain.

3.30 The opt-in rate could therefore be lower than 60%. The White Paper suggests a lower bound of 50%, but this may still turn out to be optimistic. There is no evidence from any other national auto-enrolment scheme in operation, but the New Zealand Government suggests 25% of eligible employees will stay in the planned KiwiSaver[52].

3.31 The level of opt-out and the amount of levelling down are both uncertain. The PPI has modelled the outcomes of a range of different scenarios for Personal Accounts, varying the level of opt-out and a specific scenario showing the potential impact of levelling down[53].

[49] White Paper pages 71-72
[50] AXA (2006) ***The UK workplace: engaging employees and employers in Benefits, Pensions Financial Capability and Health*** page 25
[51] Regulatory Impact Assessment Figure 2.i page 49
[52] O'Connell (2006). ***NPSS policy and design choices*** Note that KiwiSaver will operate auto-enrolment similarly to Personal Accounts, but there is no compulsory employer contribution and less tax incentive than in Personal Accounts. But the value from saving is more certain, as there is no risk of being caught in means-testing.
[53] See PPI (2006) ***An evaluation of the White Paper state pension reform proposals*** for further details

3.32 These scenarios suggest that the total stock of UK private pension assets in 2050 could vary by up to 10% depending on the level of opt-out from Personal Accounts, or the extent of levelling down (Table 2).

Table 2[54]: Total stock of private pension funds, including Personal Accounts in 2050, in £ billion, 2006/7 earnings terms and as a % of GDP

	Base scenario (33% opt-out, no levelling down)	High opt-out scenario (75% opt-out)	Low opt-out scenario (20% opt-out)	Levelling down scenario
Total stock of private pension funds	£1,800 bn (125% GDP)	£1,600 bn (115% GDP)	£1,900 bn (135% GDP)	£1,600 bn (115% GDP)
% change from base scenario	-	- 10%	+5%	-10%

Uncertainty means Personal Accounts may not necessarily be good value for the taxpayer

3.33 One of the criteria suggested for analysing the options for Personal Accounts design is ***value for money for the taxpayer***[55]. There are two aspects to this:

- The cost of tax foregone in reliefs on corporation tax, employee income tax and NI contributions as a result of additional saving, expected to amount to £1.2 – 3 billion a year[56]; and,
- The IT, administration, marketing and regulatory costs that are paid by the taxpayer rather than recouped through Personal Account fees.

[54] PPI estimates. The scenarios used are described in detail on pages 6 and 32 of PPI (July 2006) ***An evaluation of the White Paper state pension proposals***. The base scenario is similar to that assumed by the Government in the White Paper, and results in Personal Accounts forming approximately 10% of the stock of private pension assets in 2050, in line with Government estimates (White Paper Regulatory Impact Assessment, Para 2.111). The Levelling down scenario assumes employers reduce their contributions to existing schemes and all DB schemes close by 2035 being replaced by DC schemes at today's average contribution rates.
[55] White Paper paragraph 1.71
[56] Regulatory Impact Assessment Appendix E page 169

3.34 Whether there is value for money from tax reliefs is a significant issue not addressed in the White Paper, which assumed the current pension saving tax relief policy would follow through into Personal Accounts (it would not be desirable to have two different tax relief systems running alongside each other). The Pensions Commission suggested that reforming the current system is too difficult, although recognised the widely-held view that it is highly regressive, costly and ineffective.

3.35 Discussions between the PPI and practitioners suggest that reform would be possible.

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.

3.36 The White Paper quotes the Pensions Commission's estimate of £500m set-up cost, but offered no further analysis. It gave no details on how the cost would be split between the taxpayer and Personal Account fees[57]. Given this large uncertain cost to the taxpayer, and previous bad experiences with Government-run IT projects, the plans for the design and build of Personal Accounts would have to be very carefully scrutinised, costed and compared to alternatives.

3.37 The White Paper briefly refers to the investment risk a saver will run from Personal Accounts[58]. The fact that the Government is planning to organise, regulate and encourage Personal Accounts has been confused with a Government guarantee of outcomes in some reporting of the proposals. Future Governments may face calls for compensation if there is a major problem with the outcomes from Personal Accounts.

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.

[57] Regulatory Impact Assessment Paragraphs 2.123-2.127. In addition, it estimates costs to employers (excluding contributions) could be £230m set up and £90m p.a., White Paper Paragraph 1.125

[58] White Paper Paragraph 1.75

Model Choice

3.38 As to how a choice should be made between the alternative models proposed:

- A seemingly important difference between the different models of Personal Accounts illustrated in the White Paper is the level of charges. While having a low charge would, all other things being equal undoubtedly give a better pension income than a high charge, the difference between a charge of 0.3% and, say 0.6% is not so large that it should be the critical factor in the final design for Personal Accounts. The impacts of investment returns and the employer contribution, and the potential impact of Pension Credit, could be more significant for pension income from a Personal Account than the impact of a very low, rather than low, charge[59].
- One crucial policy difference between the two models of Personal Accounts presented in the White Paper is how much choice the individual should be offered. Does the Government want people to undertake more pension saving <u>and</u> to have a better understanding of how to approach investment (more consistent with the 'brand choice' model) or does it just want more people putting money into pension savings without necessarily engaging with the process (more consistent with the Pensions Commission model)?

It would be helpful if the Government confirmed its policy intentions on promoting personal responsibility.

Given the risks and uncertainties inherent in the policy choice underpinning both models of Personal Accounts in the White Paper, more <u>policy</u> analysis of the rationale for and alternative models of an auto-enrolment savings scheme seems necessary before detailed <u>product design</u> is undertaken.

[59] PPI (2006) Briefing Note Number 33

Section 4: Interaction of the White Paper State Pension Reforms and Personal Accounts and alternative policy options

4.1 The introduction of Personal Accounts has been proposed to overcome the perceived problem of 'undersaving'. Personal Accounts are expected to top up state pensions to provide a reasonable total 'replacement rate' for individuals, of around 45% for a median earner.

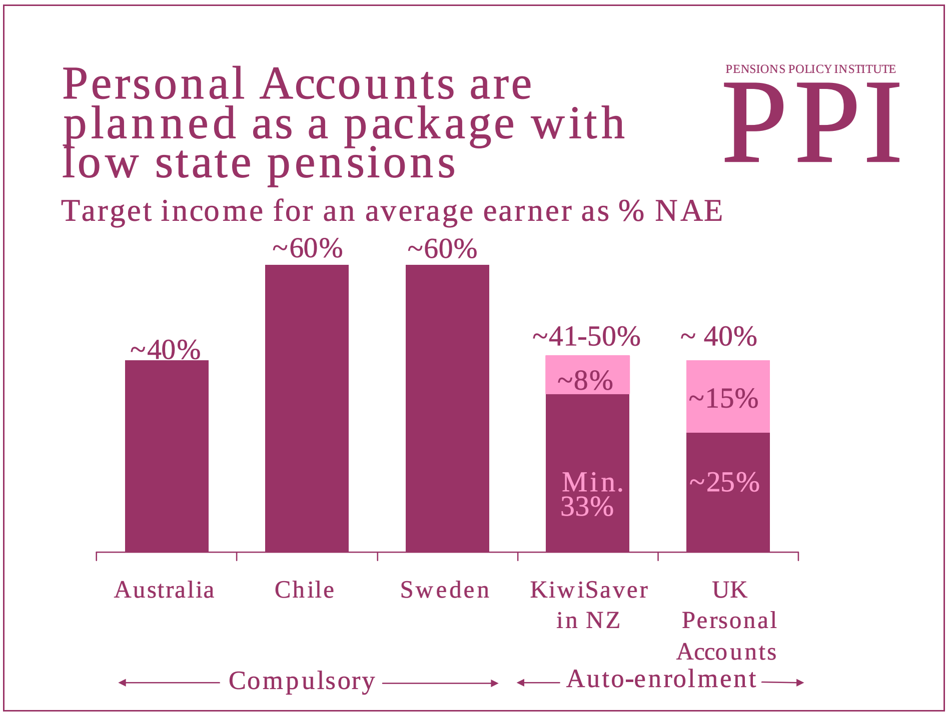
4.2 This is on top of a state pension system with two stated objectives :
- To tackle pensioner poverty.
- Provide a foundation for retirement income for all.

4.3 But the White Paper state pension proposals do not provide a certain foundation for retirement income, because:
- State pension income remains low even for those who contribute for 40 years (£135 a week, ~25% of National Average Earnings, at state pension age).
- Many people will not get as much as £135 a week from the state, even at state pension age (Paragraph 2.14).
- Eligibility for Pension Credit will remain at uncertain, but high, levels (Paragraph 2.38).

4.4 The White Paper proposals mean that the nature of Government intervention in retirement income policy would be different from that in other countries which have introduced either auto-enrolment or fully compulsory national savings schemes (Chart 3).

4.5 In countries which have introduced compulsory private savings, everyone should be taken above and beyond adequacy to a specified replacement rate: to around 40% of National Average Earnings (NAE) in Australia or around 60% of NAE in Sweden or Chile. Individuals in these countries are required to dedicate a significant proportion of their income to saving, rather than to current spending.

Chart 3[60]



4.6 An alternative policy is to guarantee adequacy through the state pension, with no reference to earnings replacement. New Zealand is a fairly generous example of this approach. Its state pension, which has wide political consensus, is set at a minimum of 33% of NAE. Nearly everyone gets this or more. Only 5% or so are eligible for means-tested benefits. Compulsion (in this case through taxes) does not extend as far as the previous countries considered. The Government allows individual choice about savings vs. spending at lower levels, but not so low as to threaten adequacy. The only other proposed national auto-enrolment scheme - KiwiSaver – will allow opt-out, but those choosing to opt out will still be sure of being able to 'get by' on the state pension. No target for retirement incomes above adequacy is set.

4.7 The UK's White Paper proposals take a very different approach. Compulsion does not extend very far, and does not guarantee adequacy. There is a low and uncertain level of state pension that may reach 25% of NAE for some people at state pension age. But PPI analysis has shown that the majority of people will receive less state pension than this and the private pension saving on top is

[60] Updated from O'Connell (2006) ***NPSS policy design and choices*** page 20, allowing for the different start date for Personal Accounts, and other policy differences between the White Paper and Pensions Commission proposals

voluntary (through auto-enrolment) so that cannot ensure adequacy either.

4.8 Personal Accounts would therefore have to make up for inadequacies in state provision as well as aiming to provide an income replacement.

The White Paper does not include full evaluation of alternative state pension reform models

4.9 Neither the White Paper nor the Pensions Commission explored any alternatives for different balances between state and private provision, any different types of intervention into private savings markets (other than to rule out compulsion) or different policies in which auto-enrolment could be effective with less risk. The two options considered for Personal Accounts in the White Paper are different delivery methods.

4.10 But many alternatives are possible:

- With a better and more certain state pension foundation, there is less policy rationale for Personal Accounts. The private sector may then be able to operate better than today without the need for Government intervention through auto-enrolment.
- If the idea of a national auto-enrolment savings scheme is still preferred to less interventionist measures, it could be introduced as a less prescriptive product on top of a firmer state foundation, for example with more discretion about contribution levels, and who pays them, with early withdrawal options and without the need to annuitise.

4.11 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. In particular, there is a need to:

- Understand more fully the impact of state pension reform, especially the distributional impact and the implications for Pension Credit.
- Compare the advantages and disadvantages of the White Paper proposals for state pension reform with those of other reform options.
- In particular consider reforms to state pensions to provide a simpler and more secure foundation for an auto-enrolment scheme that could be less prescriptive than the White Paper proposal.

4.12 The PPI has modelled in detail five alternative state pension reform policy options:[61]

1. The current system
2. The White Paper proposals
3. A long transition to a single pension
4. A medium transition to a single pension
5. A short transition to a single pension

4.13 The single pension options 3, 4 and 5 are used as they result in a simpler pension system than the White Paper proposals, are closer to the consensus solution suggested by pension experts and the broad construct for state pension reform proposed by the Pensions Commission, and are feasible to implement.

4.14 In all of the single pension options:

- The single pension is set at the level of the Guarantee Credit (£114 a week for a single person, 21% of NAE, £87 a week for each partner in a couple, 16% of NAE), is uprated in line with average earnings, and is near-universal (either through residency or an improved contribution system).
- Savings Credit is gradually reduced during the time of transition and is then removed completely.
- State pension age increases as in the White Paper proposals. Contracting-out for Defined Benefit (DB) and DC arrangements abolished from 2010.
- All BSP and S2P accrued before the system changes are paid in full.

4.15 The analysis shows that transitions to a simple single pension system can:

- Be achieved at lower cost than the White Paper reforms. The short transition would have broadly the same net cost to Government as the White Paper proposals over the next 50 years (Table 3).
- Have a better (more progressive) distributional outcome than the White Paper reforms (Table 4).
- Reduce reliance on means-testing further than the White Paper reforms (Table 5).

[61] See PPI (2006) ***An evaluation of the White Paper state pension reform proposals*** page 5 for a full description of these proposals

Table 3[62]: Projected change in Government finances from alternative reform options, compared to projected state expenditure on pensions under the current pensions system

	Projected spending under the current system	Extra cost on top of the current system			
		White Paper	Long transition to a single pension	Medium transition to single pension	Short transition to a single pension
2012	5.4%	-0.2%	-1.1%	-0.4%	0.0%
2020	5.2%	0.0%	-1.0%	0.1%	0.1%
2030	5.9%	0.1%	-1.0%	1.0%	0.2%
2040	6.3%	0.1%	-1.0%	0.8%	0.2%
2050	6.3%	0.1%	-0.6%	0.5%	-0.1%

Table 4[63]: Illustrative weekly total after tax income of people over SPA in 2012, 2030 and 2050 by decile of the income distribution, £ per week in 2006/7 earnings terms

			Single pension options		
	Current system	White Paper	Long transition	Medium transition	Short transition
2012					
1st	105	105	105	105	125
3rd	130	125	125	130	140
Median	160	155	155	160	175
7th	205	205	205	205	210
9th	300	300	300	305	310
2030					
1st	110	115	110	130	120
3rd	140	140	135	165	140
Median	175	180	175	200	175
7th	220	230	220	245	215
9th	370	390	375	405	360

[62] PPI estimates using the Aggregate and Distributional Models, first shown in PPI (2006) ***An evaluation of the White Paper state pension proposals***. See Steventon (2005) ***What will pensions cost in future*** for a technical description of the models. The figures show the additional spend on pensions and the additional revenue collected in National Insurance arising from the abolition of contracting- out (for DC schemes only in the White Paper proposals, or all schemes in the single pension options) assuming no other changes in public spending or National Insurance contribution rates. See the separate PPI modelling paper accompanying PPI (2006) for a comparison with Government estimates of the current system and White Paper proposals.

[63] PPI estimates using the Aggregate and Distributional Models, including the introduction of Personal Accounts, from PPI (2006) ***An evaluation of the White Paper state pension proposals.*** See PPI (2006) Chapter 4 for details of the base case scenario for Personal Accounts. All figures have been rounded to the nearest £5.

	Current system	White Paper	Single pension options Long transition	Medium transition	Short transition
2050					
1st	110	115	115	130	120
3rd	140	135	140	155	135
Median	165	170	175	185	165
7th	205	210	210	220	200
9th	305	325	320	330	300

Table 5[64]: PPI estimates of the projected proportion of pensioner benefit units eligible for Pension Credit and number eligible in millions

	Current system	White Paper	Single pension options Long transition	Medium transition	Short transition
2012	45% - 55%	45% - 50%	45%	45%	10%
2020	60% - 70%	50% - 55%	50%	40%	10%
2030	70% - 80%	45% - 60%	50%	5%	10%
2040	75% - 85%	35% - 60%	40%	5%	10%
2050	80% - 90%	30% - 65%	25%	5%	10%
2012	4.0 – 5.0	4.0 - 4.5	4.5	4.5	0.5
2020	5.0 - 6.0	4.0 - 5.0	4.5	3.5	1.0
2030	7.5 - 8.5	4.5 - 6.0	5.0	0.5	1.0
2040	8.5 – 10.0	4.0 - 6.5	4.0	0.5	1.0
2050	9.0 – 10.5	3.0 - 6.5	2.5	0.5	1.0

[64] PPI estimates using the Aggregate and Distributional Models from PPI (2006) ***An evaluation of the White Paper state pension reform proposals***. See Steventon (2005) ***What will pensions cost in future*** for a technical description of the models. See PPI (2006) ***An evaluation of the White Paper state pension reform proposals*** for details of the assumptions used to generate the ranges. Figures are based on the central scenario for Personal Accounts. A pensioner benefit unit is a single or a couple who can apply for Pension Credit. Percentage figures are rounded to the nearest 5% while figures in millions are rounded to the nearest 0.5 million. Figures for the medium transition are lower than in the short transition as state pension income is higher, but this affect is accentuated in later years by the rounding convention used. In the short transition, Savings Credit that is in payment when the reforms are introduced would be protected. The amount in payment is assumed to be paid for life, increasing with prices. The number receiving this protection is not shown in the chart because it would no longer be a means-tested amount. Around 25% of pensioner benefit units would receive the protection in 2010, reducing to around 5% by 2030. See Curry and Steventon (2006) ***Transition Trade-offs: Options for state pension reform*** Appendix 2 for further details.

4.16 The more certain state pension income produced by a simple single pension system, with less reliance on Pension Credit, would mean that voluntary saving would not need to overcome inadequacy in the state pension system.

4.17 An auto-enrolment system of Personal Accounts would therefore be a voluntary option for providing an income replacement. So there could be more scope or a smaller, less prescriptive system of Personal Accounts, with less risk of poor outcomes for individuals and the Government.

4.18 This is not to say that a simple single pension system should be preferred to the White Paper reforms. There are a number of other implications to consider, such as[65]:

- What are the trade-offs involved in using the alternative transition time periods and mechanisms: who wins and who loses?
- What are the specific issues arising from individuals in couples receiving less state pension than single individuals in single pension options?
- What would be the impact on existing pension schemes of abolishing contracting-out?

4.19 Previous PPI analysis has examined some of these issues, and we would be very happy to work alongside Government officials to help provide an evidence–based evaluation of these issues.

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.

4.20 The White Paper proposals for state pension reform start the transition to a flat-rate state pension system, albeit retaining two separate state pensions. However, the streamlining of some of the qualifying criteria of BSP and S2P means that it would be easier in future to merge the two into a single-tier. The relative advantages and disadvantages of moving to a simple single pension system may become clearer once contracting-out has been abolished and S2P has flattened further.

Legislation should set a date, say 2015, for a review to examine the feasibility of merging BSP and S2P.

[65] These were the issues raised by James Purnell MP at a PPI seminar, 21 July 2006

Appendix A: 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)

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)

p. 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)

Interaction between state pension 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)