RETIREMENT PENSIONS IN THE UNITED KINGDOM

UNITED KINGDOM

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An introductory note on pensions and social security

Since 1945, the UK state has been the dominant provider of social services and social security. We have a Welfare State.[1] While private provision continues alongside that of the state, the state has relatively little financial assistance to those who seek to make private provision for themselves. Until recently, there was no tax relief for private medical insurance. Private education fees are still not tax deductible. Savings for contingencies such as unemployment or sickness are taxed at the same rate as other "unearned income". The position of pensions is, therefore, somewhat of an anomaly. Tax relief was provided to those taking out life assurance contracts when income tax was first introduced in 1799. It was extended to contributions to occupational pension schemes in 1921. Alongside this fiscal assistance to those making private provision for the contingency of old age, there has been direct government encouragement for employees to make private provision instead of relying on the state. When the first state contributory pension scheme was introduced in 1925,[2]
members of occupational schemes whose benefits were equal or superior to those in the state scheme, were excused from contributing to the state scheme. Fiscal and social security subsidies for private retirement provision have continued up to the present.[3] The nature and extent of government assistance to those making private provision for retirement continues to be significantly greater than the assistance provided to those making private provision for education, health, or unemployment.

The state's social security system consists of a means tested minimum income level (Income support) funded by taxation, and a series of contributory benefits paid when individuals are unable to work due to sickness, incapacity or unemployment. Until recently, the state pension was also conditional upon the individual retiring from employment, but can now be claimed from the state pension age (65 for men, 60 for women, equalising at 65 for both sexes from 2020) while still working.

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The General Aspects of the United Kingdom's Pension System

Retirement provision in the United Kingdom has, since the start of this century, comprised of a mixture of systems: funded and unfunded, private and public, collective and individual. What has changed over this period is the relative importance of each of these different forms of provision.

The flat rate state retirement pension or basic state pension (described below) is earned through making compulsory national insurance contributions (a social security tax) for most of one's working life. It is unfunded, with current pensions being financed from the contributions of today's workers. As such, it might be thought to represent the principal of solidarity: a contract between generations. However, the principal of solidarity is limited by the low level of benefits. By maintaining the basic pension at a level just below the official poverty level, one restricts the contract between generations. For those who fail to make additional provision for themselves, the state retirement pension adds nothing to the means tested pension available to all citizens of the UK. The element of solidarity is limited to, and subsumed within, this wider commitment by workers not to allow their fellow citizens to fall below an official poverty line. The contributory (or insurance) basis of this benefit is also suspect. The wide provisions for crediting non-working persons with notional national insurance contributions (see below) undermines any claim that this is a contributory benefit.

For those who make voluntary additional provision, the state retirement pension represents a foundation from which to build a level of pension that takes one out of poverty in old age. These additional schemes can be public and unfunded, or private and funded. They can be collective or individual. The greatest amount of this voluntary additional provision, both in terms of the number of workers and the value of their pension rights, takes the form of occupational pension schemes. However, while the coverage of these schemes grew during the first part of this century, it peaked at 53% of the workforce in 1967[4], and has dropped back since to 47%[5]. These schemes are concentrated on the better paid, more stable sections of the workforce. A residuum of lower paid, less secure workers have continued to entirely on state pensions, as have those sectors of the population who do not participate in the workforce. Since the end of the 1950's, pension reform has focussed on the need to make additional pension provision for those individuals who do not belong to occupational pension schemes.

In tackling the provision of additional pensions, the government has relied on an element of compulsion: since 1961 workers have been required to make some additional provision when their income reaches a stipulated level. Within this additional level of pension provision, the state has provided a default scheme: workers accrue rights under an state unfunded earnings related pension scheme if they not within appropriate private, funded arrangements. Until 1988, only occupational schemes could provide alternative benefits to the earnings related state pension. Such occupational schemes had to offer a stipulated level of replacement income. Individual pension schemes were mainly confined to the self-employed, who were ineligible to contribute towards, or receive, the state earnings related pension. In 1988, the value of the state earnings related pension was reduced, and the requirements for private schemes offering substitute benefits were relaxed. This has resulted in millions of workers taking out individual pension schemes as alternatives to the state earnings related pension.

In December 1998, the current Government issued a new set of reform proposals.[6] The declared aim of these proposals is to alter the balance of public and private provision from its current ratio of 60:40 to one of 40:60.[7] This represents a drop in public provision expressed as a percentage of GDP from 5.4% to 4.5%.[8] This is to be secured by further reducing the level of benefits represented by the state retirement pension, and increasing the extent to which workers are encouraged to make private funded provision. The government ruled out making private pension provision compulsory.

Classification and description of the national pension schemes.

The flat rate state retirement pension (the basic state pension) is a public scheme which generates virtually universal entitlement to a flat rate pension. The next level of pension has always operated as a scheme that combines, in parallel, a public and a mixed scheme. From 1961 until 1978, the second tier scheme was known as the Graduated Pension Scheme. Under this scheme a worker earned unindexed replacement income. The scheme failed to account for the effects of inflation. In 1978 the State Earnings Related Pension Scheme ("SERPS") was introduced. This offered workers benefits calculated by reference to their indexed average earnings. Both SERPS and the Graduate Pension Scheme allowed workers who belonged to occupational pension schemes to opt out of the second level of state pension. Funded occupational pension schemes offering equivalent earnings related benefits would receive a subsidy in the form of a reduction in the amount of national insurance contributions paid by both employees and employers. The provision of such alternatives to the state scheme is known as "contracting out", and the reduction in national insurance contributions is called "the contracted out rebate". As well as paying lower national insurance contributions, these second tier Occupational schemes also enjoyed tax relief on the contributions, and on investment returns.

Since 1988, the government has relaxed the conditions that must be met by schemes offered as alternatives to SERPS. These no longer need to offer a stipulated level of replacement income. Instead, they need merely undertake to invest the contracted out rebate and pay an eventual annuity with whatever sum is produced through such accumulated rebates and investment returns. This change meant that contracting out was no longer restricted to defined benefit schemes, but could also be undertaken by defined contribution (or money purchase) schemes.

While money purchase schemes can be provided as occupational schemes through employers, they can also be taken out by individuals, when they are known as personal pension schemes. Personal pensions are provided by Insurance companies, banks and building societies. Before 1988, the number of personal pension schemes taken out by employees was relatively small, although they were used widely by the self-employed, for whom they were the only form of pension provision other than the state retirement pension (or ordinary savings). Employees were discouraged by the fact that personal pension schemes were not available as alternatives to SERPS; by the Inland Revenue's refusal to allow any employee to take out a personal pension who was eligible to belong to their employer's occupational pension scheme; and by the employer's ability to make compulsory membership of an occupational pension scheme a term in the contract of employment. With the removal of these obstacles in 1988, the number of personal pensions rose dramatically.[9]

Workers can move between these different arrangements. If they chose not to belong to their employer's occupational pension scheme, or take out a personal pension scheme, they will be in SERPS. If they move from an occupational pension scheme to a personal pension scheme, they may also request that a capital payment in lieu of their occupational scheme benefits be paid to the personal pension provider. The same option is also available when workers change jobs and join a new occupational pension scheme.

The benefits paid to an individual are not limited to those paid for by the contracted out rebate. Employers and employees can make additional contributions to produce higher benefits. The maximum level of benefits is fixed by the Inland Revenue.
In the case of defined benefit schemes, the maximum benefit payable is two thirds of a worker's final salary. In the case of money purchase schemes, there is no ceiling on the amount of benefits that may be paid, although the Inland Revenue will limit the total contributions paid by and on behalf of an individual in each year. The limit is age related, starting at 17.5% and rising to 40% of annual income, with a ceiling on the income against which contributions may be levied.[10]

The latest reform proposals[11] are to abolish SERPS in favour of a new Second State Pension, and limit its availability to those on low to moderate incomes. Above this level, individuals will be expected to provide entirely for themselves, either through occupational schemes, or a new type of money purchase arrangement called a Stakeholder pension. While all persons who opt-out of the second level of state pension will continue to receive a contracted-out rebate, the amount of this rebate is to be concentrated on lower income earners. In the long term, the Second State Pension is intended to be a flat rate benefit that will provide a high level of replacement income for the low paid. Moderate and higher earners will be expected to rely on stakeholder pensions. The proposals are complicated by transitional arrangements designed to ensure that moderate and higher earners are not made worse off by the abolition of SERPS.

The declared aim of this reform to reduce dependence on unfunded state pensions, and to reduce the number of pensions who come to rely on means tested social security benefits. The new stakeholder pensions are intended to overcome the weaknesses of personal pensions, especially the high costs incurred in the marketing and administration of individual pension schemes. If Stakeholder Pensions have lower costs, then more workers can be expected to use them as alternatives to state pensions, and the benefits eventually paid are more likely to keep them above the poverty line. The Second State Pension promises higher benefits than SERPS to the current generation of low paid workers, but its effect on the whole population has to be seen in the context of the treatment of the flat rate State Retirement Pension. This benefit has, since 1978, been indexed by reference to prices instead of earnings, with the consequence that its value as a percentage of average earnings has fallen steadily. By continuing with this policy, the government will allow it to fall to only 7% of average earnings by the middle of the 21st century.[12] The reforms may result in the current generation of workers being less dependent on means tested social security benefits in their retirement (though many more will postpone this situation than will avoid it altogether). But failing to earnings index the state retirement pension will increase the number of current pensioners who will become dependent on means tested benefits.

State Pensions

The basic state pension

The basic state pension is a pay as you go benefit paid for through the national insurance contributions of the working population. Entitlement is based on the individual's record of paying national insurance contributions. It is paid from April 1999 at the rate of £66.75 per week to single persons, and £106.70 for couples. To receive a full pension, men must have paid National Insurance Contributions for 44 qualifying years, and women for 39 years, although by 2020, when the state pension age will be equalised at 65, both men and women will need the same number of qualifying years. The contributions are levied as a fixed percentage of earnings up to a stipulated amount, roughly equal to the current single person's pension, known as the Lower Earnings limit. At present, men can draw this pension from age 65, and women from age 60, although from 2020, both will draw this pension at aged 65. National Insurance contributions in respect of this pension are credited to persons who do not work, such as the unemployed and those entitled to invalidity benefit. There are also special provisions for those who leave employment for prolonged periods to rear children or nurse relatives (mostly women). Such persons can earn their full entitlement over a reduced number of years. However, to get a full pension such people still have to work for at least 20 years, or half their working life where this is longer. Currently, some 86% of men and 49% of women qualify for the full pension.[13] The low figure for women is due to the failure to apply retrospectively the special provision for carers, introduced in 1978. By the 21st century, virtually all of those retiring will be entitled to the basic state pension. Given the widespread use of credits, which undermines the contribution principle, it has been argued that the pension should be paid universally, and based on citizenship.[14]

State Earnings Related Pension Scheme - SERPS

This pension was introduced in 1978. The declared aim was to reduce the dependence of pensioners (particularly women) on means tested social security benefits.[15] When introduced, the scheme offered full pensions, calculated as 25% of earnings between an upper and lower band, after 20 years. The lower earnings limit is fixed by reference to the state basic pension, and was £66 per week from April 1999. The upper earnings limit is an amount equal to about seven and a half times the lower earnings limit, currently £500 per week. The earnings on which contributions were paid were recorded, and indexed to earnings inflation. Women could earn pensions through their own contributions, and inherit their husband's pensions if they were over 50 when he died (but were limited to whichever was the larger pension). On its introduction, the combination of the basic state pension and SERPS was expected to eventually produce an average pensioner's income that was five-sixths of the average wage.[16]A worker who earned the average wage for 20 years, and retired without dependants on state benefits alone, would enjoy a indexed pension of 44% of his earnings.[17]A married man in this position could expect a state pension of 59% of earnings.[18]

Since 1988, the level of SERPS has been drastically reduced. The accrual rate is now 20% of relevant earnings. The 20 year rule has been abolished, and pensions are based on average indexed lifetime earnings within the upper and lower limits. Carers who look after relatives or carers on a full-time basis, can have years spent out of the workforce discounted for the purpose of calculating this average. (Home Responsibility credits). The Home Responsibility Credit fails to protect women who work part-time for low earnings. The level of survivors benefits has been reduced to half of the deceased's SERPS pension. Women have also suffered from the equalisation of the state pension age at 65 from 2020, requiring them to work on another 5 years.[19] If these additional years are periods of no or low paid employment, they will depress the eventual pension.

A little below half the working population has typically received the equivalent of a SERPS pension through a mixture of private and public provision.[20] In return for a reduction in the national insurance contribution rate paid by employee and employer (currently an average of 4.6% of relevant earnings) contracted-out occupational pension schemes could offer a Guaranteed Minimum Pension (GMP). This was a benefit similar to SERPS, but without the advantage of the 20 years rule or the generous survivors benefits. It cannot be paid until the worker reaches the state pension age of 60 for women, and 65 for men. They were originally not indexed in payment, but from 1988 they have been required to be indexed in payment by price inflation up to a maximum of 3% per annum.[21] SERPS accrued on the more generous basis described above, and was fully indexed after retirement by reference to price inflation. While SERPS pensions were more generous that the GMP, the worker could not lose through this system of contracting-out. Whenever the SERPS entitlement was larger than the GMP, the State made up the difference.

Until 1997 (when GMP's were abolished) the contracted-out rebate had to be set at a level that met the cost of producing the GMP, including the administrative costs. The rebate was calculated on a flat rate basis, which represented a more generous subsidy to some schemes than others. Being calculated at a flat rate, it provided more assistance to meet the cost of providing GMPs to younger workers (where it could be invested for more years before payment) than older ones. This creates a problem of adverse selection, with workers being contracted-out while they are young, and returned to SERPS when they are older.[22] It also meant that, to ensure a given population was contracted out, the government had to fix a rebate that met the costs of the **marginal** scheme within that population, leaving the remaining schemes to make a profit. As a state investment to reduce the future cost of state pensions, the system of contracting-out involved expensive overheads. 0.2% of all contributions to occupational pension schemes is spent on administration. In the case of personal pension schemes, the figures rise dramatically. The start up costs of personal pensions absorb 8% of contribution income, while the annual costs amount to 0.9% plus a flat fee of around £2.50 per month.[23] In order to encourage individuals to take out personal pensions, the government has paid a higher rate of national insurance rebate than that paid to employers in respect of the members of occupational pension schemes . From 1988 to 1992 it was 2% higher, and from 1993 (for workers aged over 30) 1% higher.

Reforms since the mid-80's have not only reduced the level of SERPS, they have also depressed the protections afforded to workers who are contracted-out of SERPS. Since 1988, money purchase occupational and personal pension schemes have been able to receive the contracted-out rebate.[24] These schemes are not required to provide GMPs. Instead, they must ring-fence the money represented by the contracted-out rebate and the investment returns thereon. Such ring-fenced monies are known as "Protected-Rights". They must be used at retirement to purchase an annuity. While the worker could never suffer by being contracted-out into a scheme paying a GMP, the same is not true of schemes offering protected rights. The worker is treated on retirement as if his protected rights were equal to a GMP. In 1997, the government removed the additional security enjoyed by members of contracted-out defined benefit schemes, by abolishing the GMP altogether. This was justified by reference to the difficulties of meeting the EU legal requirement for equal GMPs for men and women. Since 1997, contracted-out defined benefit schemes have to provide benefits at a level that ensures that most of their workers will receive better benefits than SERPS[25] but, with the abolition of the GMP, this is no longer guaranteed. The major risk to defined benefit scheme members resulting from the abolition of the GMP is the effect of inflation. Contracted-out defined benefit schemes must index the accrued pension rights of pensioners and ex-employees by reference to price inflation up to a maximum of 5% pa. SERPS remains fully indexed (by earnings inflation up to retirement and prices thereafter). The greater inflation proofing provided by SERPS creates a risk that contracting-out will depress an employee's pension.

If the latest reforms are implemented, SERPS will be abolished from 2002, though accrued entitlements to SERPS, Protected Rights and GMPs will continue to be paid well into the next century.

<u>Minimum Income in Retirement</u>

Means tested benefits provide a minimum standard of living in retirement. These may take the form of income supplements, or reductions in public sector charges (public housing rents and local taxes). Pensioners are entitled to a Minimum Income Guarantee, which from April 1999 will be £75.00 a week for single pensioners, and £116.60 for pensioner couples. Pensioners over 75 and under 80 receive a higher guaranteed level of income (£2.30 for a single pensioner), and those who are disabled or over 80 receive a yet higher income guarantee (an extra £7.25). The government intends to raise the level of this minimum guarantee, by linking the income guaranteed to earnings inflation. But this will only occur when resources allow. The rest of those in poverty (including families with children) will continue to have their means tested benefits (Income Support) increased in line with price inflation. On its introduction in April 1999, the £116.60 Minimum Income Guarantee paid to a pensioner couple was £4.95 more than the Income Support paid to a couple below pension age. If the government meets its promise to index the Minimum Income Guarantee by reference to earnings inflation, this gap will steadily increase. However, the use of means tested benefits suffers from the relatively low take up rate amongst pensioners. An estimated 67-79% of eligible pensioner fail to claim means tested benefits (compared with a take up rate of between 83 and 87% of non-pensioners). [26]

Income guarantees do not produce a minimum standard of living, unless housing costs are taken into account. The few pensioners who have outstanding mortgages, can have the interest paid through income support. Those who rent accommodation, receive assistance through another means tested benefit: Housing Benefit. Local taxes are based on the value of one's property, not the individual or household income. Low earners, including pensioners, can qualify for a reduction in these local taxes, known as Council Tax benefit. Approximately one third of the pensioner population are in receipt of these various means tested benefits.[27] About 1.7 million pensioners have their incomes topped up by Income Support, another 1.3 million get help with council tax, and almost 1 million are assisted with their housing costs.[28]

<u>Financing State Pensions</u>

State pensions are financed through the national insurance contributions. It is a pay as you go scheme, with today's state pensions, and all other contributory social security benefits, being paid from current contributions. Current expenditure on pensions is £35,602 million.[29] The current rates of national insurance contributions are 12.2% for employers and 10% for employees, (reducing to 9.4% and 8.2% respectively where the employee belongs to a contracted-out pension scheme).[30] The contributions and benefits of the national insurance scheme have never had an actuarial relationship to each other, making any the use of the term "insurance" somewhat misleading. The contributions received and the benefits paid in each year are supposed to balance, but this can be achieved by payment to, or receipts from, the government's general revenue account. In recent years contributions have exceeded benefits, and national insurance monies have increased the funds available for general government expenditure.

Concern over the cost of state pensions has, since 1984, created pressure for reform. At that time, the government forecast that the national insurance contributions would have to increase by 7.4% by the year 2050, if SERPS continued in its original form, and retirement pensions were indexed to earnings inflation.[31] This was based on demographic forecasts of the rise in the ratio of pensioners to workers, from 3:2 (1985) to 6:1 (2035).[32] Similar increases in national insurance contribution rates had occurred in the past.[33] And projected rises in GDP over the next forty years cast doubt on claims that the state pensions scheme was unaffordable.[34] However, SERPS was cut back 1985 in the manner described above. These cuts reduced the cost of SERPS by 50%.[35] Further cuts in 1995, the most important of which was the increase in the state pension age for women, cut the cost of SERPS by a further 50%.[36]

Occupational Pension Schemes[37]

Coverage

The government set an early and generous example of pension provision when, in 1834, civil servants were provided with pensions of two-thirds of salary after working for 45 years.[38] By 1900, about 5% of the workforce belonged to occupational pension schemes, concentrated in the public sector, and the largest private employers, such as railway companies.[39]Tax relief was introduced for funded pension schemes in 1921.[40] At that time only 15% of scheme members paid tax.[41]by the beginning of the second world war, membership had risen to 13% of the workforce. With the rise in taxation that followed (the basic rate of income tax rose to 50% during the war, and most workers became liable to pay it) membership grew. As more of the workforce came to pay income tax with the rise in taxation during and after the war, the benefits of occupational scheme membership rose. Membership grew to 33% by 1956[42]By 1963 membership has risen to 48% of the working population.[43]In 1967, membership peaked at 53%.[44]Subsequent surveys, from 1971 onwards, showed that the period of growth in membership had come to an end, and that there was even a small decline. By 1987, scheme membership had fallen back to 49% of those employed.[45]The government's 1991 survey showed membership as 47.5% of the working population.[46]

A breakdown of scheme membership (see tables in appendix A) reveals that there is a higher coverage in the public sector than the private. Within the private sector membership is concentrated within large employers. Male workers are better represented than female ones, and full timers have a far higher membership than part-timers. This information points to the problem facing any government seeking to increase private pension provision through occupational scheme membership: the need to encourage a large number of small firms to offer such schemes, and for all schemes to extend membership to part-timers and to reduce barriers to female membership.

Benefits offered (See tables in appendix A)

The majority of members of occupational pension schemes accrue benefits calculated by reference to their final salary (the salary paid at the time when they leave the scheme due to retirement or change of employment). Each year of membership a member accrues a fraction of this salary, with the most common fraction being 1/60th for each year of membership. Thus, after 40 years of membership, a worker would retire on 2/3rds of final salary. Schemes typically offer pensions to surviving spouses of half the pension paid to the member. At retirement, the member can forgo pension equivalent to up to one and a half years salary in exchange for a lump sum, which is tax free. Schemes normally pay pensions at the state pension age. Earlier retirement is usually possible, although terms vary. Retirement due to illness or disability typically operates as a form of disability insurance, as not only will the worker enjoy a pension paid early, but he will be credited with extra years of service. Outside of ill health situations, schemes will usually reduce a pension paid before normal retirement date. The Inland Revenue stipulates the actuarial factors that may be used when making this calculation. A scheme's rules will often provide for there to be no reduction in pension for early retirement where the retirement is the result of a redundancy. Such provisions allow occupational pension schemes to be used to assist an employer to re-structure its workforce. Schemes commonly offer a form of life insurance cover, with worker's families receiving some multiple of their salary on the event of a death in service.

The role of Government

Before 1921, the state did not influence occupational pension scheme provision except through its own example in providing pensions to its civil servants. Thereafter, it influenced the structure of occupational pension schemes more directly, through the provision of tax relief, and the conditions placed upon the receipt of that relief.[47] Up to 1947 conditions were minimal, the principal condition being that occupational schemes take the form of a trust, and the employer's contributions to that trust should be irrecoverable.[48] The legacy of this condition is that almost all UK occupational pension schemes take the form of a trust. Given the freedom of employers to dictate the terms of their trusts, this did not represent a significant restriction, although it did prevent the pension fund from being seized by an employer's creditors if the employer became insolvent. The Finance Act 1947 reflected a concern that pension provision could be used as a form of tax avoidance. Conditions were introduced regarding maximum pensions and rates of accrual. Over time this has grown to a complicated revenue code of maximum benefits governing accrual, total pension, the actuarial tables used to commute pensions, the earliest date for retirement, ill health benefits, winding up provisions etc.[49]

By contrast with its interest in restricting the maximum benefits payable, the state's interest in providing protection to employees is of more recent origin. By the 1970's, the design of scheme benefits (which penalised workers who changed jobs prior to retirement) was perceived to create inefficiencies in the labour market. The government responded in 1973 with statutory preservation requirements.[50] These required schemes to offer a deferred benefit to workers who left a scheme after more than 5 years (now reduced to 2[51]) on terms no less favourable than the terms available for those who remained. Concerns over the rights of those changing jobs have continued.[52]In 1985 the legislation introduced a right for employees to transfer pension rights to a new pension provider on change of jobs, and a requirement for schemes to index deferred pensions (up to the lower of price inflation or 5%).[53] Social security policies began to affect the structure of scheme benefits from 1978 onwards. Only defined benefit schemes could receive the contracted-out rebate and pay GMPs. This encouraged employers to move from money purchase to defined benefit schemes. Within contracted-out schemes, employees for the first time enjoyed a statutory minimum pension: the GMP. In order to monitor the state investment in occupational schemes represented by the contracted-out rebate, the government introduced the Occupational Pensions Board. This body did not restrict itself to overseeing contracting-out, and produced periodic reports on many aspects of occupational pensions schemes design and administration. Its reports led to statutory requirements for disclosure of information to members in 1985,[54]and equal access for men and women in 1975.[55]

The 1990's saw two further waves of regulatory provisions. The first, in response to another Occupational Pensions Board report,[56]introduced minimum indexation for all pensions in payment,[57]an obligation for employers to fund the deficits of insolvent defined benefit schemes,[58]restrictions on investment with the employer,[59] better protection for schemes when employer's became insolvent[60] and a new Pension Ombudsman to investigate maladministration and to enforce members' rights.[61] The second wave came in response to a major pension scandal, involving the appropriation of £420 million of occupational pension scheme assets by Robert Maxwell, the chairman of a major group of public companies.[62]This led to the Pensions Act 1995. This Act introduces a whole new regulatory framework,[63] providing for statutory minimum funding[64] (see below), the constitution of trustee boards[65], a new regulatory body with power to fine, prosecute and suspend scheme trustees and administrators[66]. It ensures the independence of scheme advisors,[67] provides for the scheduling of contributions,[68] introduces compensation for the appropriation of scheme assets.[69]and prevents retrospective loss of members' benefits through scheme amendments.[70]This Act also introduced a requirement to provide equal treatment for men and women in all aspects of occupational pension scheme provision.[71]This last provision was not a response to the Maxwell scandal. It implemented the European Court decision in Barber v Guardian Royal Exchange.[72]

Funding

Within the public sector, there are unfunded occupational pension schemes, the most important of which is that for the civil service. The pensions of public corporations are funded, as are those of the local government workers.[73]With the exception of a few pension schemes aimed at the most high paid executives, all private occupational pension schemes are funded.

Occupational schemes are funded through contributions from employers and employees, and investment returns on the scheme's investments. The contributions and investment returns are increased in value as a result of tax reliefs. No tax is paid on contributions, or on investment returns, whether income or capital gains. Tax is paid on pensioners periodic payments, but treated as if it were a salary. On retirement, a pensioner may also receive a lump sum, which is tax free. The value of these tax reliefs is estimated by the Government at £8,500 million.[74]

In order to receive tax reliefs, an occupational scheme has to be funded by the employer, it cannot be funded by employees alone. Employees contributions are not always required, and those schemes which do not provide for them are called "non-contributory schemes." Where employees are required to make contributions, these are always a fixed percentage of salary, most commonly 5%. In a money purchase scheme, the employer will covenant to pay a fixed contribution of pay. With defined benefit schemes, employers covenant to pay the "balance of cost" of promised benefits. This is a covenant to pay such sums as the actuary estimates are necessary to match the scheme assets with its liabilities. The wide range of actuarial methods and assumptions that may be chosen by the actuary exposes scheme funding to manipulation and possible insolvency. [75] A scheme may be valued as having a surplus over assets over liabilities, and the employer be recommended to pay zero contributions[76], and yet be insolvent if it was to be immediately wound up.

Since 1996, there have been statutory provisions to compensate members who lose benefits through no fault of their own.[77] But compensation is only paid when loses arise through the theft or fraudulent use of scheme assets. Members remain at risk when the losses arise through an employer's failure to pay contributions. To meet this risk, the Pensions Act 1995 requires the scheme trustees to stipulate a schedule of contributions.[78] If these contributions are more than one month late, the regulator (Occupational Pensions

Regulatory Authority, known as "OPRA") must be notified. OPRA has power to fine employers who make late payments, and trustees who fail to inform it when contributions are overdue.

With contracted-out money purchase schemes, the minimum contribution is the fixed contribution stipulated in the scheme rules. In a contracted-out money purchase scheme this must not be less than the contracted-out rebate. The money must be invested, and the value of the assets and the investment returns allocated to notional individual member accounts. On retirement, the amount in an individuals' account must be used to purchase an annuity.

In defined benefit schemes, the level of employer's contribution is determined by the scheme's actuary. Before 1997, the minimum level of funding in a contracted-out pension defined benefit pension scheme was determined by the need to secure the GMP. The scheme actuary had to provide a periodic certificate confirming that the scheme's assets could secure the GMP's. From 1999 onwards, scheme actuaries must state whether their scheme complies with the new Minimum Funding Requirement ("MFR") introduced under the Pensions Act 1995.[79]. The Act and regulations stipulate that an actuarial valuation has to take place every three years. This valuation is used to identify the level of contributions necessary to maintain the MFR over the next 5 years. Thereafter, the actuary must prepare an annual certificate confirming whether the MFR target is still being met. If the scheme is funded below 100% but above 90%, schemes have 5 years to reach MFR. If a scheme valuation show assets below 90% of MFR, it must reach 90% within a year. The MFR does not ensure that the scheme will be able to fund the benefits promised. It is calculated by reference to a standardised portfolio of gilts and equities, the proportion of each depending on the relative number of current and retired scheme members. If a scheme were to be wound up, and had to secure its benefits by the purchase of annuities from an insurance company, the cost would be much higher than the MFR. The MFR also provides the basis for the debt payable by the employer if scheme winds up and is insolvent. A deficit below MFR becomes an unsecured debt of the employer. However, as the employers of most insolvent pension schemes are also insolvent, this debt is unlikely to be enforceable.

Defined benefit schemes are funded on the assumption that the promised pensions will be paid, when due, direct from scheme assets. There are no individual accounts and, outside of a winding up, no requirement to purchase annuities. If a scheme winds up insolvent, benefits have to be reduced to the level which can be afforded with the assets available. There is a statutory provision dictating the priority given to the different kinds of benefits.[80]

Maximum funding levels are stipulated by statute.[81] Schemes which exceed these levels must make provision to reduce funding levels (through benefit increases, contribution reductions or refunds) within 6 months, or face a partial loss of tax relief.

Administration of Occupational Pension Schemes

Private sector employers who establish occupational pensions schemes use the legal form of a trust. This has the advantage that the assets will be owned by the schemes' trustees, and not the employing company, and so are not available to creditors in the event of the employer's insolvency. The use of a trust is also a condition of tax relief. Some public sector schemes do not use a trust, but the Courts still treat those responsible for the investment and custody of statutory scheme assets as trustees.[82]Until 1973, Trust law was considered convenient to employers, both because they could appoint the scheme trustees, and subject to inland revenue requirements, draft the scheme rules as they saw fit.[83]Since the 70's (see Role of Government above) this "freedom of trust" has been steadily eroded.

Subject to any exclusions contained in the scheme rules, the general law of trusts offers a set of implied terms that are quite appropriate to pension schemes. Trustees must act in the best interests of the scheme's beneficiaries, avoid conflicts of interest, and invest the assets of the scheme in a manner that is likely to achieve the best financial return, while being prudent as to the risks.[84] The power to appoint trustees is usually retained by the employer, who may chose to be the scheme trustee, or appoint a wholly owned subsidiary to act as a corporate trustee. Trustees are not the representatives of those who appoint them, and cannot be mandated by them, but must act independently. If the law of trusts operated in accordance with these legal principles, it should make no difference who appointed the trustees. However, there is a general acceptance that the employer's power to appoint the trustees can be abused by the appointment of persons who put the interests of the employer before that of the scheme beneficiaries. The Pension Act 1995 contains provisions which reduce the employer's control over the trustees. Employees now have the right to insist on appointing up to one third of the scheme's trustees.[85] The employer can no longer choose the trustees' advisers.[86] And the power of amendment can no longer be exercised in a manner which adversely affects the members' benefits without the trustees' consent.[87]

Personal Pensions

Introduction

Individual pension schemes had little relevance to the employed population before 1988, though they were used widely by the self-employed. Full tax relief on contributions was introduced in 1956, but this relief was only available for self-employed persons, or employees who were ineligible to join occupational pension schemes. Individual pension schemes could not be used to contract out of SERPS, or its predecessor (introduced in 1959) the Graduated Pension scheme. In its review of Social Security in 1985, the government expressed a desire "to ensure that the conditions are created whereby individual pension provision can expand."[88] From 1988, individuals who took out personal pensions were given tax relief even if they were eligible to belong to an occupational scheme, (although they could not actually belong to both at the same time).[89]These personal pension schemes could be used to contract-out of SERPS and receive the contracted-out rebate.[90]Employers could no longer make membership of their occupational pension schemes a condition of employment.[91]

The high costs of administering personal pensions (particularly those of selling) make them a poor investment for low paid workers, or those who change jobs frequently. Nevertheless, with the assistance of a higher rate of national insurance rebate, 5.6 million were taken out between 1988 and 1994.[92] The cost to government of this form of contracting-out was enormous, estimated at £10.5 billion in respect of the personal pensions taken out from 1988 to 1994.[93] With the benefit of these subsidies, the majority of those who left SERPS to take out personal pensions have been as well, or better off as a result. By contrast, the freedom of occupational pensions scheme members to choose personal pensions has proved a complete disaster.[94] As personal pensions are not funded by employers (see below), the benefits which they can provide are unlikely to match those provided by an occupational scheme. Despite this, between 1988 and 1994 salesmen persuaded up large numbers of occupational pension scheme members to leave (or fail to join) their employer's occupational pension scheme and instead take out a personal pension. As investment salesmen are legally obliged to offer "best advice" to their customers, this should not have happened. The scandal of widespread mis-selling of personal pensions has led to an enforced review of 2.4 million PP sales with a view to identifying loss and offering compensation.[95] This review and the compensation payable is expected to cost between £8 and £11 billion.[96]

The Government's latest set of reform proposals continues to look to individual pension plans as a means to privatise and pre-fund the pensions of workers who are not members of occupational pension schemes. The reform is also an attempt to learn from the problems of 1988-94, and find a form of individual pension with low administration costs that will not be mis-sold.

Benefits

Personal pensions are savings schemes whereby the accumulated contributions and investment returns are used, at retirement, to purchase an annuity for the policy holder. The annuity will be taxed on receipt as earned income. Where a personal pension is used for contracting out, an sum that is equivalent to the contracting-out rebate is paid by the state to the pension provider. These state contributions, and the investment returns they produce, are called protected rights. On retirement, protected rights must be used to purchase an annuity for a surviving spouse as well as for the policyholder, and the spouse's pension must be half that of the member. Protected rights cannot be used to purchase a pension before the member reaches state pension age. With a personal pension that is not contracted-out, or with that part of a contracted-out scheme other than the protected rights, there is greater flexibility. In such cases, an annuity may be taken at any age from 50 to 75, [97] there is no need to provide dependants' benefits, and a quarter of the fund may taken as a tax free lump sum instead of an annuity. As with occupational schemes, the maximum value of this lump sum is now limited to £150,000.

Being in the nature of a savings scheme, most personal pension schemes provide for a return of money to the policy holder's family if he/she should die before the annuity is purchased. At a minimum, the family will receive a return of contributions (but not the contracted-out rebate) without interest. More usually, the family will receive the whole of the accumulated fund (but not any protected rights). Early on in the life of such a scheme, a return of contributions or fund provides little security for a worker's family. Schemes can provide for life insurance, but this is an optional extra. Part of the mis-selling scandal (see above) has been a consequence of occupational pension scheme members transferring to schemes offering single life annuities and no life insurance cover. Dependants who would have been provided for within the occupational scheme have found themselves without benefits.

The range and kind of benefits that may be offered (disability, dependency, survivorship etc) is the same as for occupational pension schemes. The major difference is that the size of these benefits is not determined as a ratio of salary, but by reference to the value of the accumulated fund. Instead of limiting the value of the pension, the inland revenue control the value of the contributions. These operate along a sliding scale according the age. A worker up to 35 years of age may contribute 17% of income per year, rising to 40% for a worker aged 60. The earnings to which these percentages are applied are subject to a ceiling**,** currently £87,600. [98]If the employer contributes, the total contribution must not exceed these levels.

Funding

Employers are not required to contribute to personal pension schemes, and most chose not to. They are most likely to contribute to a personal pension scheme where they have encouraged their workforce to take out personal pensions with a particular pension provider (a cheap substitute for an occupational scheme). These collective arrangements are called "group personal pension schemes", although each policy holder still has an individual contract with the pension provider. Where a personal pension is used to contract-out, the minimum contribution will be the contracted-out rebate. Otherwise there is no minimum. The fact that most employers do not contribute to these schemes, plus the high administration costs, makes them poor value in comparison to belonging to an occupational pension scheme. While the pension must take the form of an annuity, the fund can be invested though a wide range of conventional investment devices: deposit accounts, with profits insurance policies, managed funds, or unit trusts. They can be taken out with a bank, buildings society, or insurance company. The value of the fund will depend on the record of contributions and the performance of the investments, less the cost of administration and marketing.

Flexibility

The advantages of personal pension are linked to the restrictions of occupational pension schemes. If an occupational pension scheme does not provide for pensions to be paid before age 50, a transfer to a personal pension can side-step this limitation. More controversially, a change to a personal pension may improve a worker's pension at the expense of his dependants, by exchanging an occupational pension scheme that takes care of them for a personal pension scheme that does not. Most of these advantages relate to deferred pensions - the pensions left with a scheme after a worker changes jobs. A worker cannot be prudently advised to take out a personal pension instead of joining, or continuing to belong to, his current employer's occupational pension scheme. Since occupational pension schemes provide benefits funded by employers as well as employees, the benefits earned from an occupational scheme are likely to be worth more than those earned through a personal pension funded by the employees contributions alone. If the employee wishes to earn higher benefits from making additional contributions, these can be made to the occupational pension scheme (which must then pay the worker extra benefits in exchange for these "additional voluntary contributions").

Personal pensions suffer from inflexibility due to the large start up costs (particularly commissions paid to salesmen) associated with marketing them to individuals. The schemes are sold on the assumption that an individual will continue to contribute to them for the rest of his/her working life, and the high initial costs will average out to a lower figure over this period. However, various events may interrupt this pattern of contribution. If workers become pregnant, fall ill, or become unemployed, they may not be able to maintain the contributions. If this causes the policy to lapse within 2 years of its commencement, all of the contributions will be absorbed by initial costs.[99] As an alternative to allowing the policy to lapse, it may simply be suspended, with no further contributions being made until the worker can again afford them. In these circumstances, the start up costs will be spread over the remaining term, and absorbed from the interest earned on the accumulated fund. However, this option only makes sense if the investment returns on the accumulated fund will exceed the amortised start up costs and the periodic administrative costs. If the policy is only a few years old, there will be a small fund and little investment return. Similar problems arise if a worker with a personal pension become eligible to join an occupational scheme. He can not belong to both schemes at the same time. The personal pension scheme will have to lapse, or be suspended during the period of his new employment.[100] To conclude, while personal pension schemes are sold as a remedy for the inflexibility of occupational pension schemes, their charging structure makes them very inflexible as a form of retirement savings.

The new reforms - Second State pensions and Stakeholder Pensions.

In December 1998, the current Labour government issued its proposals for pension reform in a document entitled, "A new Contract for Welfare: Partnership in Pensions."[101] The document states the intention to abolish SERPS and replace it with a new Second State Pension, and at the same time encourage as many of the population as possible to provide for their own retirement through privately funded pension schemes.

Those who have not already made private provision will be encouraged to take out a new private funded "Stakeholder Pension." The government found that 97% of employees earning over £20,000 per year already make private retirement provision. Their proposals for new Stakeholder Pensions are therefore aimed at those earning between £9000 and £20,000 per year. These Stakeholder Pensions are to be more accessible and flexible than existing personal pension schemes, and sold to workers who are not currently members of occupational pension schemes.

Although Stakeholder Pensions can be personal or occupational pension schemes, the bulk of them are expected to be personal pension schemes. The government has declined to make occupational pension provision compulsory, and does not wish to increase the level of subsidy paid to employers. The government wants to promote low cost personal pension schemes as an alternative to a progressively less attractive state pension scheme for those workers who do not belong to an occupational pension scheme. The first part of this policy requires them to persuade the pensions industry to jettison many of the practices that have made personal pensions too inflexible and expensive for moderate income earners. The government wishes employees to have the opportunity of taking out personal pensions that have low administration costs, and do not penalise workers who need to terminate or suspend payments to them.

The second part of the government's policy is a combination of incentives and deterrents. The government intends the Second State Pension to become a flat rate benefit. While the benefit will be flat rate, the contributions will continue to be earnings related. Whilst it will represent a generous benefit for those on no, or low (below £9,000 pa) earnings, it will not be attractive to those on higher earnings. As such, it will provide employees on moderate to high incomes with an clear incentive to forgo the Second State Pension and rely instead on private pensions.

The proposal is complicated by the difficulties of achieving transition. Workers are not expected to change to the new Stakeholder arrangements at once. There is therefore to be a period in which the Second State Pension continues to offer earnings related benefits to those who do not contract-out. By the end of 5 years, the government expects to have persuaded sufficient numbers of workers to enter into stakeholder arrangements to begin to allow those with moderate and high incomes to suffer a progressively higher penalty for failing to take the contracted-out option. At this point, everyone earning more that the equivalent of £9000 per annum will be better off in a Stakeholder pension.

As well as providing economic reasons for the individual worker to contract out of the Second State Pension, the government wishes to convey the general ideological message that an individual of moderate income should not look to the state for a comfortable standard of living in retirement. As well as eventually making the Second State Pension flat rate, it also intends to allow the flat rate basic state pension to erode in value, by continuing to increase it only in line with price inflation. As stated above, it will deteriorate to 7% of average earnings by 2050.

In defence of these reforms, one should note that the assistance given to those on the lowest incomes is intended to be higher under the Second State Pension than under the current version of SERPS. Those earning under between £3000 and £9000 per year will receive a replacement income from the Second State Pension of 40%, twice that provided by SERPS. Those who are unable to earn £9000 per year due to family responsibilities, illness or disabilities will be credited with Second State Pension benefits as if they were earning this amount. The accrual rate for earning between £9,000 and £18,500 is 10% (to claw back the 40% enjoyed on their earnings up to £9000). Earnings over £18,500 accrue a pension of 20%. The use of these different rates of accrual ensures that none of those earning above £18,500 will be worse off under the new arrangements than SERPS. In the long term, once the Second State Pension becomes flat rate, everyone earning over the equivalent of £14,500 will be worse off from accruing a Second State Pension instead of a stakeholder pension.[102]

As well as increasing pension provision by low to moderate earners, the government wishes to help the current poorest pensioners. This is to be achieved through the new minimum income guarantee (introduced April 1999 - described above). Basically, this represents a change in the basis of entitlement for the means tested benefits paid to pensioners. The government has made a loose commitment to index this benefit to earnings instead of prices (when this is affordable), thus allowing the poorest pensioners to participate in the rising standard of living of the working population. By increasing the level of means tested benefits for pensioners, while leaving income support to be indexed to prices, the government will steadily increase the support given to the poorest pensioners. On its introduction in April 1999, the minimum income guarantee for a single pensioner was set at £75, while the income support paid to other categories of single person was only £71.95. The new higher level of means tested benefit paid to pensioners will, in short to medium term, increase the numbers entitled to means tested benefits.

The proposals face two enormous challenges. The first is to persuade the pensions industry that it is profitable for them to provide low cost pensions to low earners with interrupted contributions. The government clearly hopes that a small number of companies will undertake this business on the basis that large numbers and consequent economies of scale, will make it profitable. The second challenge is their stated intention that all those who save for retirement, whether through the Second State Pension, or Stakeholder pensions, will see their thrift rewarded by a standard of living in excess of the minimum income guarantee. Otherwise pre-funded pensions will simply reduce the state burden for means tested benefits, without improving the position of the individual pensioner.

Providing low cost pensions

The government intends to stipulate the maximum charges that can be imposed by Stakeholder Pension providers, and to ensure that those who cease contributing due to, for example, change of job or unemployment, do not suffer poor returns in consequence of administrative charges. It order to ensure that these restrictions do not make the sale of stakeholder pensions unattractive to pension providers, it seeks to reduce the administrative and marketing costs involved. As well as offering a large number of contracts to those institutions willing to accept them, the government hopes to reduce costs by making the marketing of this type of personal pension simpler. It will encourage the use of standard forms of scheme, which will allow for easier comparison between different types of pension provision (state, occupational or personal) and the use of simple tax rules. Such standardisation of terms is expected to reduce the need for individual financial advice. The government also proposes to compel those employers who do not provide an occupational pension scheme to provide Stakeholder Pension providers with workplace access to their employees. The employer will also be required to collect the contributions of any employee who enters into a Stakeholder Pension. The government also proposes to introduce the equivalent of a trustee board into stakeholder pension schemes. They hope that a board such as this, with a duty to act in the best interests of the contributors, will be able to act as a collective purchaser of Stakeholder Pensions services. In an extreme case, a trustee board who felt that the pension provider was not providing value for money would move the investments of the contributors to another pension provider.

While these measures are sensible reforms, it is unclear why it is necessary to introduce them as part of a new pension scheme. All personal pension and defined contribution occupational schemes could benefit from these reforms. It is also questionable whether the financial circumstances of those who do not have private pension provision warrants the introduction of this new pension scheme. Only 11% of those earning between £9000 and £18,500 pa have no private pension, and research indicates that the majority of these are young workers with little or no savings and unstable earnings.[103] Even with lower costs, the new Stakeholder Pensions may not significantly increase the retirement provision of these workers.

The relationship between the new pensions and means tested benefits

While the government estimates show that the new pensions will make individuals ineligible for means tested benefits on their retirement, the position changes if one tracks pensions after retirement. Stakeholder pensions are only required to be indexed in retirement up to 5%, and the Second State Pension is increased after retirement only by reference to price inflation. By contrast to these two forms of pension, the Minimum Income Guarantee is supposed to become indexed to earnings. Pensioners who start their retirement with a Stakeholder or Second State Pension which is above the level of the Guarantee will gradually fall below it. For example, a person who retired on a Second State Pension in 2050 after enjoying earnings of £9000 throughout their working life would become eligible for the Guaranteed Minimum Pension in 2060, when they were 75 (assuming earnings increase by 1½% pa more than prices).[104]

Conclusion

Retirement provision in the UK has, since the introduction of state pensions, always been a mixture of private and public provision. This is not by itself unusual. However, the peculiar feature of the UK system has been the system of contracting-out: a system whereby the state pays private schemes to provide pre-funded alternatives to a state pension. The commitment to this system of contracting-out continues, although its terms have changed, and will continue so to do.

In order to increase the percentage of the workforce who covered by private pensions, the government has had to make more forms of private pension available to them. This has been expensive for government, and has exposed workers to higher levels of risk. Higher subsidies have had to be paid to the providers of personal pension scheme than to occupational schemes, in order to compensate for the higher administrative charges they generate. Defined contribution schemes (whether individual or occupational) place the investment risk with the employee. With contracted-out defined benefit schemes, it had been shared between the employer and the state.

The burden of subsidising alternatives to defined benefit schemes, and the willingness to expose the members of such alternative schemes to investment and inflation risks, has led government to re-examine its requirements for defined benefits schemes. The state's guarantee to a worker of being no worse off as a result of contracting-out has been removed from defined benefit schemes. With the risk of loss placed on the worker instead of the state, the government has been prepared to simplify the system of contracting-out, no longer requiring each scheme to identify and secure the individual worker's alternative to the state pension (the GMP).

The current reform proposals do not impose new burdens on occupational pension schemes. Nor do they seek to increase the subsidy paid to personal pension providers. Further reductions in the value of the state pension (for moderate and high earners) is intended to provide an incentive for workers have no private provision to take out personal pensions. At the same time, the administrative costs of such pensions is to be reduced through measures intended to provide economies of scale. It remains to be seen whether these latest measures will overcome the long standing failure of private pension providers to extend their coverage to workers with irregular earnings and unstable employment patterns. This will not simply be a question of reducing administrative costs. Government pension policy also creates ideological messages. The public are being educated into not expecting contributory state pensions to provide an adequate level of retirement income. However, they are also being told that state benefits will do little to assist those who take out private pensions to climb above the official poverty level, and that the value of the means tested benefits paid to the retired population is to rise steadily. In the face of these messages, the enormous difficulties in making individual pension provision cheap and accessible, and the government's continued reluctance to make private pension provision compulsory, these reform proposals are unlikely to achieve the government's target for reducing the burden of public pension provision.[105]

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[1] See R Lowe *The Welfare State in Britain since 1945* 2ed. (MacMillan 1999).

[2] The Widows' Orphans and Old Age Contributory Pensions Act 1925.

[3] From 1947 to 1961 employees were not allowed to offer their private pension schemes as alternatives to state provision.

[4] Government Actuary *Occupational Pension Schemes: Third Survey* (HMSO, 1968).

[5] Government Actuary *Occupational Pension Schemes: Ninth Annual Survey* (1994, HMSO).

[6] *A New Contract for Welfare: Partnership In Pensions* Cmnd 4179 (HMSO 1998)

[7] *Ibid*, chapter one, para. 41.

[8] *Ibid*.

[9] In the period from 1988 to 1994, 5.6 million individuals contracted -out of SERPS into personal pensions. In the same period, the total number of personal pensions taken out totalled 20 million. The last figure includes individual who took out more than one policy during this period. See "UK Pensions Market, Facts, Figures and Trends", ABI Insurance Trends, July 1997, p.3.

[10]. Currently £87,600. See Retirement Benefit Schemes (Indexation of Earnings Cap) Order 1998 (SI. 1998 No. 758.

[11] *A New Contract for Welfare: Partnership In Pensions* Cmnd 4179 (HMSO 1998)

[1212] *Pensions Bill 1994: Report by the Government Actuary on the Financial Implications of the National Insurance Fund*, Cmnd 2714 (HMSO 1994) para 23.

[13] *A New Contract for Welfare: Partnership In Pensions* Cmnd 4179 (HMSO 1998), Chapter Two para.14.

[14] Paul Johnson & Gary Stears, "Should the basic state pension be a contributory benefit?" 17 Fiscal Studies (1996) 105.

[15] *Better Pensions*, Cmnd 5713 (HMSO 1974) paras 1,2.

[16] *Better Pensions* ibid, para 86.

[17] Ibid, Page 3, table A, para 8.

[18] Ibid.

[19] Pensions Act 1995, s126, Schedule 4.

[20] For example, in 1979 around half the working population belonged to occupational pension schemes, and just over 3/4s of the members of such schemes were contracted-out of SERPS. See *Occupational pension schemes, 6th Survey by the Government Actuary* (HMSO 1979)., pages 4-5. At that date, one could only contracted-out into a n occupational pension scheme. Since 1988, the membership of occupational pension schemes has fallen. However, as employees have been allowed to contract-out of SERPS into personal pension schemes, the total percentage of the workforce who enjoy a private alternative to SERPS has risen.

[21] Social Security Act 1986, s9.

[22] Since 1997 the government has reduced the element of adverse selection (but only in respect of money purchase occupational schemes and personal pension schemes) by providing a contracted-out rebate that is age related.

[23] These figures come from the Government Actuary. See *Occupational and Personal Pension Schemes: Review of Contracting-Out* Cm 3221 (London HMSO 1996). For analysis of the rate of return on the government's investment in contracting-out, see Hemming & Kay, "The Cost of the State Earnings Related Pension Scheme" 92 The Economic Journal (1982) 300**.**

[24] In the case of personal pensions, this is enjoyed not through a reduction in national insurance contributions, but by an annual lump sum of equivalent value being paid by the government to the personal pension provider.

[25] They have to meet the standard of a reference scheme. See Pensions Act 1995, s136.

[26] Department of Social Security Income Related Benefits: Estimates of Take-Up in 1996/97 (DSS 1998).

[27] Family Resources Survey, 1996-97.

[28] A new contract for welfare: partnership in pensions Cmnd 4179 (HMSO 1998), chapter two, para 28.

[29] Figures provided by the Department of Social Security at http://www.dss.gov.uk/hq/index.htm.

[30] *Financial Report and Budget Statement 1999: Budget Measures*, Table 1.4; HC298 (1999 HMSO). (See Http://www.Hm-treasury.gov.uk/budget/1999/fsbr/29807.htm).

[31] "Population and Pension Costs: Note by Government Actuary's Department", Annex B to "Social Security Expenditure: Past Growth and Projected Future Growth," Reform of Social Security Background Papers, Cmnd 9519 (HMSO 1985).

[32] Reform of Social Security, Cmnd 9517, vol. 1, para 5.4 (HMSO 1985).

[33] In the 35 years from 1950 to 1985, the national insurance rate attributable to pensions rose 7.5 percentage points, from 5 to 12.5, *New Society* June 14 1985 p407.

[34] Nobles, "Pensions: The New Legal Framework" 49 Modern Law Review (1986) 42 at 44.

[35] See *Social Security Bill 1986, Report by the Government Actuary on the Financial Effects of the Bill on the National Insurance Fund*, Cmnd 9711, table 1, (HMSO 1986).

[36] See Nobles, "Pensions Act 1995", 59 Modern Law Review (1996) 241 at 243 to 250.

[37] For a full statement of the history, structure, and problems of UK occupational pension schemes see *Pension Law Reform:The Report of the Pension Law Review Committee* ("the Goode Report") CM 2342 (HMSO 1993).

[38] Superannuation Funds Act 1834.

[39] See Hannah, Investing Retirement: The Development of Occupational Pension Schemes in Britain (Cambridge University Press 1986), page 21.

[40] Finance Act 1921.

[41] Hannah, supra note 39 page 20.

[42] Government Actuary, *Occupational Schemes: A survey*, (HMSO, 1958).

[43] Government Actuary *Occupational Pension Schemes: A New Survey.* (HMSO, 1966).

[44] Government Actuary *Occupational Pension Schemes: Third Survey* (HMSO, 1968).

[45] Government Actuary *Occupational Pension Schemes: Eight Annual Survey* (1991, HMSO).

[46] Government Actuary *Occupational Pension Schemes: Ninth Annual Survey* (1994, HMSO).

[47] Finance Act 1921, s32.

[48] Report of the Royal Commission on Income Tax, Cmd. 615 (HMSO 1920), para 319.

[49] See *Inland Revenue Practice Notes.* IR12.

[50] Social Security Act 1973, s63.

[51] Social Security Act 1985, s1.

[52] Occupational Pensions Board, *Improved Protection for the Occupational Pension Rights and Expectations of Early Leavers* Cmnd 8271 (HMSO , 1982).

[53] Social Security Act 1985, s2, Pensions Act 9(as amended by the Social Security Act 1990) required this indexing for all deferred pensions. Pensions Act 1995, s51-54, 162-163, requires pensions accrued after 1995 to be indexed in payment up to this level.

[54] *Solvency, Disclosure of Information and Members' Participation in Occupational Pension Schemes* Cmnd 8649 (HMSO 1982), Social Security Act 1985, schedule 2.

[55] *Equal Status for Man and Women in Occupational Pension Schemes* Cmnd 6599 HMSO 1976, Social Security & Pensions Act 1975,s53.

[56] *Protecting Pensions: Safeguarding Benefits in a Changing Environment* CM 573 (HMSO, 1989); see Nobles, Occupational Pensions and the Social Security Act 1990" 19 Industrial Law Journal (1990) 255.

[57] Social Security Act 1990, s11.

[58] Ibid, schedule 4, para 2.

[59] Ibid, para 3.

[60] Ibid, para 1 (Independent trustees).

[61] Ibid, schedule 3.

[62] For an account, see Social Security Select Committee, Second Report, *The Operation of Pension Funds*, HC 61-II 1991/2.

[63] The Act was mainly based on the recommendations of the Goode Committee, supra note 37. For an excellent discussion of its major provisions, see Freshfields, *The Guide to the Pensions Act 1995* (Tolley 1995).

[64] Pensions Act 1995, s56-61; Occupational Pension Schemes (Minimum Funding Requirement and Actuarial Valuation) Regulations (SI 1996 No. 1536).

[65] Ibid, s16-21, provides for member appointed trustees.

[66] Ibid, s1-15: setting out the powers of the Occupational Pensions Regulatory Authority.

[67] Ibid s47.

[68] Ibid s58.

[69] Ibid, s83-86.

[70] Ibid s67.

[71] Ibid s62-66.

[72] (C-262/88) [1990] E.C.R. I-1889.

[73] The teachers' scheme is an anomaly. It fixes employer and employee contributions on an actuarial basis by reference to a notional investment fund, whilst current pensions are paid for out of current revenue.

[74] *Financial Report and Budget Statement 1999: Budget Measures,* Appendix 1C, Table 1C.1; HC298 (1999 HMSO). (See Http://www.Hm-treasury.gov.uk/budget/1999/fsbr/29807.htm).

[75] See Nobles, *Pensions Employment and the Law* (Oxford University Press 1993, chapter 6; the Goode report, supra note 37, chapter 4.4.

[76] The Inland Revenue's requirement for employer contributions is waived when such a recommendation is made.

[77] Pensions Act 1995, s78-86.

[78] Sections 58-59.

[79] Section 56-61.

[80] Pensions Act 1995, s73.

[81] Income and Corporation Taxes Act 1988, schedule 22.

[82] Martin v City of Edinburgh District Council [1988] Scots Law Times 329.

[83] See Hannah, supra note 39, page 19.

[84] See Nobles, supra note 75, chapter 3.

[85] Known as member-nominated trustees, Pensions Act 1995, s16-21.

[86] Ibid, s47.

[87] Ibid s67.

[88] *Reform of Social Security* supra note 32, at para 1.15.

[89] Finance (No.2) Act 1987.

[90] Social Security Act 1986 and regulations.

[91] Ibid, s15.

[92] "UK Pensions Market, Facts, Figures and Trends", ABI Insurance Trends, July 1997, p.3

[93] DSS, *Annual Statistics* 1994.

[94] J. Black and Richard Nobles" Personal Pensions Mis-selling The Causes and Lessons of Regulatory Failure" 61. Modern Law Review (1998) 789.

[95] Treasury Select Committee, Ninth Report, *The Mis-Selling of Personal Pensions* HC (1997-8) 712-I. para 27, Appendix II, Supplementary note by the Financial Services Authority.

[96] Ibid, Ninth Report, para 25.

[97] The Inland Revenues requirements are set out in s630-653 if the Income and Corporation Taxes Act 1988, and the Inland Revenue Guidance Note IR 76.

[98]. See Retirement Benefit Schemes (Indexation of Earnings Cap) Order 1998 (SI. 1998 No. 758.

[99] The government estimates that around one third of the people who buy personal pensions cease contributing within 3 years. *Pensions in Partnership* supra note 28, chapter 7, para 6.

[100] Of the personal pensions sold in 1993, 30% had lapsed by 1996. See Personal Investment Authority, *Third Survey of the Persistency of Life and Pensions Policies*, (London PIA); and Disney and Johnson, "The United Kingdom: a

working system of minimum pensions?" in H. Seibert (ed.) *Redesigning Social Security*, Institut fur Weltwirtschaft an der Universitat Kiel; Tubingen: Mohr Siebeck.

[101] Cmnd 4179 (HMSO 1998).

[102] Disney et al. *Partnership In Pensions: An Assessment* (Institute of Fiscal Studies 1999) page 26.

[103] Ibid, page 38.

[104] Ibid, page 31.

[105] From 60% to 40% of total pension costs in the next century. See *Pensions in Partnership: A New Contract for Welfare,* supra note, 28, para. 41.