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Pensions ‘Privatisation’ in Britain. Two Decades Reviewed

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Pensions “Privatisation” in Britain.

Two Decades Reviewed

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First draft – please do not quote

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1 Introduction

It appears that the United Kingdom has been quite successful with a political agenda that many countries have adopted later on: the privatisation of pension provision. At the beginning of the 1980s both state and non-state actors had their roles as providers of old age pensions, the state's role being rather weak by European standards. Still, the Thatcher government set out to widen the scope of occupational and individual private pension provision further while containing the future costs of state pensions. When the New Labour government took office, it abolished the previous State Earnings-Related Pension Scheme (SERPS) for a new State Second Pension that offers better value for employees on low earnings. The state scheme will become less generous for its remaining members, who are expected to contract out, taking advantage of the new stakeholder pensions.

If one takes a closer look however, it becomes apparent that things are not quite that simple. State and private pensions in Britain interact in many ways. To find the appropriate regulatory framework for private pensions and to achieve a sustainable public/private mix in pension provision remains high on the political agenda (Bonoli and Palier 2000: 173).

These aims trigger further state intervention. There never really was a clear-cut boundary between the public and the private spheres during the past 20 years of British pension policy. But the distinction of the two is even more blurred today. Drawing on recent theoretical approaches highlighting changes in the social production of welfare (especially the growth of "welfare markets" and the rise of the "regulatory welfare state"), I will compare the public/private mix of the UK pension system of the early 1980s with the present setting and analyse to what extent these measures may be characterised as "privatisation" in this context. I will argue that whilst the term is quite appropriate regarding some aspects of the process (e.g. lower state benefits, new private actors, more choice for individuals) it seems less so for others: "Private" pensions are subsidised and heavily regulated by the state. Insufficient "private" provision and means tested state benefits are linked in multiple ways.

Empirically my analysis draws partly on 31 expert interviews I conducted with decision makers, experts and influential actors in the field of old-age security in the UK in 2004/5.² In the first part of this paper I will sketch out the UK pension landscape of the early 1980s (2). Then I will illustrate the changes that led to the current arrangement (3) which is outlined afterwards (4). This provides the background for the assessment of whether the term “privatization” aptly describes these changes (5). I will finally delineate the problems inherent in the British pension policy approach (6) before I close with some concluding remarks (7).

2 The British Pension Landscape of the early 1980s

The foundations of the post-war British pension system were laid when the 1946 National Insurance Act introduced a Basic State Pension (BSP) which since remained largely unchanged. It is financed by National Insurance contributions (NICs) made by employees and their employers and by the self-employed. While contributions are earnings-related, the BSP is flat-rate. The level of the Basic Pension is dependent on contributions only in respect to the length of the contribution period, but not on the amount of contributions paid. A full Basic Pension is available after paying contributions for 44 years (men) or 39 years (women).³ For those with shorter contribution histories the Basic Pension is reduced accordingly, with the minimum of a quarter of the full amount available after 9 years of contribution (men: 14 years). A full BSP equalled 20 per cent of average earnings in 1977/78. Until 1980 the BSP was updated in line with average earnings or retail price inflation, whichever was the greater. Afterwards it was only raised in line with retail price inflation which meant that it lost value in relative terms. The low level of benefits meant that even a full BSP was below the level of means tested Income Support.

² The interviewees were Members of Parliament with a special interest in pensions or policy advisers, they worked for government departments (DWP, Treasury, GAD), regulatory bodies (OPRA, OPB, FSA), or for pension providers or in diverse organisations (NAPF, CBI, ABI, TUC, the Pensions Management Institute – PMI, the Society of Pension Consultants – SPC, the Investment Management Institute – IMA, the Association of Pension Lawyers – APL, Which?, PPI, The Association of Corporate Trustees – TACT, Age Concern, National Pensioners Convention - NPC, the Actuarial Profession, and the Association of Consulting Actuaries – ACA). Still, the views they expressed in the interviews did not necessarily represent those officially held by their organizations.

³ When the pension age for women will be raised to 65 between 2010 and 2020, the number of years necessary for a full BSP will be increased accordingly.

On top of the BSP the 1975 Social Security Pensions Act introduced the State Earnings Related Pension Scheme (SERPS). Entitlements towards SERPS could only be build up by employees and only on 'band earnings' between the Lower Earnings Limit (LEL) and the Upper Earnings Limit (UEL). These 'reckonable earnings' were revalued in line with the rise of average earnings in the whole economy until retirement. A full SERPS pension originally provided a quarter of an individual's average revalued reckonable earnings. In order to make SERPS mature more rapidly, benefits were based on the best 20 years of earnings since its introduction in 1978. After retirement SERPS was to be indexed to prices. SERPS benefits were available from State Pension Age, i.e. age 60 for women and 65 for men.

The UK has a strong tradition of occupational pension provision. The pension plans are usually set up as trusts by the employer. So the scheme's assets are independent of the sponsoring company, which has to make up for possible deficits. Employers could make membership in their pension scheme a condition of employment. The schemes were overseen by the Occupational Pensions Board (OPB) set up by the Social Security Act 1973. The board members were representatives of employers and employees and of the actuarial profession. The OPB also served as an advisory body on pensions policy for the government (see Bonoli 2000: 61).

Occupational pension arrangements were tax benefited. Pension contributions up to a limit set by the Inland Revenue (IR) were tax free. Capital gains of pension funds were tax free, provided the funding level did not exceed the IR limit of 105 per cent of the Projected Benefit Obligation.⁴ Fund surpluses above these limits had to be reduced within five years by means of increased benefits or reduced contributions (so-called contribution holidays) to sustain the tax approved status. Pension benefits were taxable but a part of them could be taken as a tax free lump sum. Additionally, pensioners enjoyed higher tax allowances and were likely to be in a lower tax band.

⁴ The limits in respect to the Projected Benefit Obligation set for tax purposes must not be confused with the much lower Minimum Funding Requirement (MFR) introduced by the 1995 Pensions Act (see below).

When the SERPS predecessor Graduate Pension⁵ was introduced, those employees who were members of an occupational pension scheme could contract out of the state scheme and remain in their occupational arrangements instead. This was intended to maintain strong occupational provision. But membership of these plans tended to be skewed towards male white-collar employees in larger enterprises and in the public sector. The state scheme was thought of as a fall-back for those without access to occupational schemes.

Under SERPS the established contracting out option continued, provided these schemes offered a so-called Guaranteed Minimum Pension (GMP), that is, benefits at least broadly equivalent to SERPS. Hence, only salary related schemes (i.e. working on a defined benefit basis) could contract out. Contracting out resulted in a National Insurance contribution rebate, representing the SERPS entitlements given up. Thus the function of SERPS in the British Pension Landscape was threefold. It provided an earnings related pension for its members and it established a minimum standard for the contracted out arrangements. The third function appears to be the most astonishing: Even though someone might have contracted out, s/he would still be entitled to her/his SERPS pension minus GMP from the state scheme. “[T]he GMP refers to the occupational scheme’s obligation, but not to the employee’s entitlement. Whether contracted in or out, an employee is statutorily entitled to the amount that would have been payable under contracted-in provision” (O’Higgins 1986: 138). Unlike SERRPS, the GMP did not have the best 20 years rule. The indexation of earnings during working life was less complete under GMP than under SERPS, particularly for those changing jobs frequently. Survivor’s benefits were less generously calculated. Finally, there was no requirement for an indexation of the GMP after retirement. So the state scheme actually provided price indexation for contracted out occupational schemes (O’Higgins 1986: 138). “This leads to the curious result that those who opt for private occupational provision by contracting out may still receive the majority of their second tier pension from the state” (O’Higgins 1986: 140).

⁵ The Graduated Pension was negligible, because its value eroded to high inflation. There was no indexation of benefits before 1975 (O’Higgins 1986: 112).

Thus Whiteside concludes: “The state not only permitted contracting out, but underwrote the viability of the schemes that chose to do so – a move that extended public liability in an unprecedented fashion” (Whiteside 2003: 31).

O’Higgins regards the arrangement that prevailed into the early 1980s as a bad deal for the state. “The 1975 settlement of the shape of the British pension package can therefore be characterized as a structure of subsidized competition: the state created a structure within which private provision could compete with state provision on more-than-equal terms. [...] The state [...] undertook to pay for guarantees which the private sector (because of factors like uncertainty, timescale, etc.) felt unable to provide for” (O’Higgins 1986: 139).

Walker (2001) looks upon the arrangements more favourably. Her focus is not on the provider side and the public expenditure caused by the interaction of private and public, but on the consumer. “[T]he original SERPS framework provided a genuine partnership between the state and occupational pension schemes in which the state promoted good quality schemes and protected the position of those contracted out” (Walker 2001: 131).

O’Higgins (1986) concludes in his analysis that “the label ‘private provision’ is a misnomer because it conceals a complex mix of public and private finance.” (O’Higgins 1986: 140f.). One could not possibly argue with that assessment. But still the regulatory framework of private occupational pensions was relatively weak, and there was a clear commitment by the state how much it was willing to provide. Over the next two decades both features of the arrangement were about to change. Both the state promise and the regulatory framework were to change frequently. Whereas the former was often to be reduced the latter would tend to densify. The complexity of the public/private interaction was to become impenetrable. I will now turn to the changes that have occurred.

3 Two Decades of Pension Reform

3.1 Increasing the scope of private provision, part I : The 1985/86 reforms

The Conservative Thatcher government was very concerned about the future cost of SERPS introduced by its Labour predecessor. In a policy Green Paper entitled "Reform of Social Security" it proposed to abolish SERPS in favour of "a system in which everybody is able to contribute either to an occupational pension scheme or to a personal pension" (DSS 1985a: 24). The government made clear that they wanted more than *just* to cut back the state scheme: "The government accept the need to tackle the open-ended commitments of SERPS. *But we do not believe it would be right to respond on a purely negative basis by simply ending or restricting SERPS without putting anything in its place.*" (DSS 1985b: 5; my italics).

The original plans to put an end to SERPS faced opposition by some organizations such as Age Concern, the Trade Union Congress (TUC), the Labour Party and, perhaps more surprisingly, by the Confederation of British Industry (CBI), the National Association of Pension Funds (NAPF) and even the Treasury (Bonoli 2000: 71ff.). Consequently the government aimed in its White Paper (DSS 1985c) merely at containing the future costs of SERPS and at widening the scope of contracting out, but it left the scheme in existence.

The changes to SERPS were to be phased in over a transitional period until 2010. The best 20 years rule was eradicated. SERPS was now to be calculated based on lifetime earnings. The level of SERPS was reduced from 25 per cent to 20 per cent of revalued reckonable earnings. SERPS rights inherited by widows and widowers were reduced from the full to the half amount of the member's pension. Contracted out occupational pension funds now had to inflation-proof GMPs up to 3 per cent, thus reducing the amount of SERPS benefits payable to those who contracted out (see DSS 1985c: 4)

In order to expand the scope of private provision, contracting out was extended to occupational money purchase schemes (i.e. working on a defined contribution basis). Since these schemes did not promise a defined level of benefits, the GMP was not applicable as a contracting out criteria. Instead, a minimum contribution at the level

of the contracting out rebate was prescribed as a condition for leaving the state scheme. The pension fund had to be used to buy an annuity at retirement. That part of the pension pot that was generated by the National Insurance rebate was called “protected rights” and had to be used to buy an unisex annuity⁶. While salary related schemes meant an open-ended liability for the employers, money purchase schemes allowed them to know their responsibility. It was expected that this would foster the set-up of industry-wide schemes and encourage smaller employers to offer occupational pensions.

Personal pensions, purchased on an individual level on a defined contribution basis, were also established. They were a further way to contract out of SERPS in order to allow them “to compete fairly with the state and occupational schemes” (DSS 1985c: 15). Again, at least the contracting out rebate had to be paid in. Pension scheme members were given the right to pay additional voluntary contributions (AVCs) in order to boost their pension entitlements. Personal pensions were thought to improve individual choice and the portability of pension rights for job changers. It was now no longer possible for employers to make membership in their occupational pension funds a condition of employment. Besides insurance companies, banks and other financial bodies were as well enabled to offer personal pension arrangements. In addition to the contracting out rebate there was also tax relief on contributions towards a personal pension.

In its ambition to improve the portability of pension rights, the 1986 Pension Act built on the reforms of the 1985 Social Security Act that had established that pension rights of early leavers had to be increased in line with prices up to 5 per cent. Everyone leaving a scheme had the right to a transfer value representing his deferred pension rights which s/he could put in a new scheme, a single premium annuity or a personal pension,⁷ and schemes were required to disclose relevant information to their members (DSS 1985c: 5).

⁶ Usually, annuity rates for men are more favourably than those for women due to the differences in life expectancy.

⁷ Before that it was estimated that only 5 per cent of job changers had their pension entitlements transferred to the new employer. 75 per cent only retrieved their own contributions (i.e. without the em-

Private provision was to be encouraged by means of financial incentives. “Employers setting up new schemes and individuals setting up their own new personal pension for the first time will be given an additional national insurance rebate for a five year period. This will amount to 2 per cent over and above the standard rate” (DSS 1985c: 5).

The 1985 White Paper stresses the importance of investor protection for personal pensions. “The importance of adequate investor protection is central to encouraging more occupational and personal pensions. People have a right to know that the savings on which their income in retirement will depend are properly safeguarded” (DSS 1985c: 17). Particularly, a new financial services legislation “should protect the public against overselling by the use of misleading projections of returns.” (DSS 1985c: 17).

In order to protect the money locked away in personal pensions the schemes had to be approved by the OPB. “The Board’s main concern will be that people holding personal pensions will be properly protected, while ensuring that the rules are as simple and flexible as possible. They will be responsible for seeing that personal pensions comply with government regulations, meet appropriate investment standards and offer compensation in the event of negligence, fraud or theft” (DSS 1985c: 17).

3.2 The 1995 Reforms – Securing the pension promise

The promotion of private pensions by the Thatcher government had in some ways been surprisingly successful. About ten years after the 1986 reforms roughly one-half of the employees who were members of SERPS in 1985 had left the scheme. 68 per cent of employees were contracted out, and only 17 per cent remained in SERPS⁸ (Budd and Campbell 1998: 100). Originally, the Department of Social Security (DSS) had assumed that about half a million people would take out personal pensions, but as early as by the end of April 1990 four million had been sold (Budd and Campbell

ployers part or any interest). The remainder were entitled to a deferred pension. In this case future wage increases were not taken into account when calculating entitlements (Bonoli 2000: 64).

⁸ The remainder were neither members of SERPS nor of a contracted out arrangement mainly due to an income below the Lower Earnings Limit (Budd and Campbell 1998: 100).

1998: 110). Due to the incentives granted, the unpredicted demand for personal pension was quite costly for the government.

The extra 2 per cent rebate – some have called it a bribe – made it particularly advantageous for young people to contract out of SERPS and to contract back in at a later date. This was due to an effect called back-loading of benefits: Compared to the defined contribution personal pensions, benefits under SERPS accrue more heavily in later years. Since there was no rule to prevent contracting back in, special age-related rebates have been offered since 1993 to discourage these tendencies. All in all, it was estimated that instead of saving money the net costs for government over the first ten years of the existence of personal pensions were about £10 billion (Blake 2003: 335).

Tempted by the additional 2 per cent incentive and/or ill-advised by salespeople some hundreds of thousands people who had better remained in the state scheme because of low income or discontinuous careers opted for a personal pension. Additionally, between 1988 and 1993 about half a million members of occupational schemes moved to personal pensions.⁹ As many as 90 per cent of these were given inappropriate advice. Although often staying with the same employer they moved to a personal pension towards which the employer did not contribute and which took a significant part of the transfer value in commission and administrative charges (Blake 2003: 334). These proceedings came to be known as the mis-selling of personal pensions. Blake quotes the example of a miner who transferred to a personal pension in 1989, five years prior to his retirement. Instead of a lump sum of £5,125 and a pension of £1,791 from his former occupational pension he received only £ 2,576 as a lump sum and a monthly pension of £734 from his new scheme (Blake 2003: 334).

The safeguards proposed in the 1995 White Paper proved to be insufficient in another incident too, even though this one did not relate particularly to the 1985/86 reforms. The event is connected to the name of Robert Maxwell, the media tycoon. When Maxwell's body was found in November 1991 in the waters near the Canary Islands it soon became clear that he had misappropriated money from the occupational pension funds of his companies, such as the Mirror Group, in an attempt to

restore the solvency of other companies under his control, boost share prices and keep his diverse businesses running. As the investigation of the Department for Trade and Industry noted “Mr Robert Maxwell had always regarded the pension funds as his” and “ran his companies and the pension funds as if they were one” (DTI 2001: Summary). After Maxwell’s mysterious death the pension funds were found to be severely underfunded and their members were at risk of losing what was promised to them.

The incident regarding the Mirror Group pension scheme caused a public outcry and severe concerns about the governance of pension schemes and the security of pension money. In due course the Pension Law Review Committee, chaired by Roy Goode, was given the task of reviewing the legal framework of private pension provision. In its report it pointed out that the law should seek to protect the “pension promise”, i.e. the “reasonable expectations” that accrued rights are protected and benefits will be provided according to the scheme’s rules and legal requirements (Pension Law Review Committee 1993: 10). The Committee proposed the set-up of a pensions regulator, better protection of rights accrued in the past, member participation on the trustee board, better and clearer information to members, minimum solvency requirements and a compensation scheme to cover scheme deficits arising from fraud, theft or misappropriation. The proposals of the Committee became part of the 1995 Pensions Act.

The Act set up the Occupational Pensions Regulatory Authority (OPRA) to replace and take over the responsibilities of the OPB except the advisory role. OPRA was given extensive powers, e.g. to remove and appoint pension scheme trustees under certain conditions, to wind-up or modify schemes under specific circumstances and to impose penalties for misconduct. OPRA also had far-reaching investigative powers, such as to require trustees, managers or professional advisers of a scheme or the sponsoring employer to produce any scheme-related document, to enter premises where scheme members are employed, scheme related-documents are kept or the

⁹ The extra rebate was only available to former SERPS members in order not to encourage members of occupational schemes to leave their employers plans (Bonoli 2000: 79).

scheme administration is carried out and to question any person on those premises (Blake 2003: 342).

A minimum funding requirement (MFR) was also introduced by the 1995 Pensions Act, intended to make sure that the assets of a scheme at least match its liabilities. If the scheme was running with an underprovision of up to 10 per cent the shortfall would have to be made good within five years. A serious underprovision below the level of 90 per cent MFR would have to be restored to the 90 per cent level within three years time (Blake 2003: 345f.).

Scheme members were given the right to nominate at least one trustee (at least two in larger schemes with more than 100 members) who cannot be removed by the employer without the consent of all other trustees (Blake 2003: 344).

A Pension Compensation Board was established to provide compensation if a scheme's assets were reduced by an illegal act and if the employer is insolvent. Payments were limited to 90 per cent of the loss or the amount necessary to restore the scheme to 90 per cent of the MFR.

The 1995 Pensions Act went beyond the proposals of the Goode Committee. The obligation for personal pension holders to buy an annuity at retirement was relaxed with the 1995 Finance Act. It was now possible to postpone annuitisation until the age of 75. In the meantime part of the pension pot could be accessed by means of income drawdown.

Again, measures were taken to reduce the cost and thus limit the generosity of SERPS, by changing the formula for the calculation of benefits. The method of revaluation of earnings under SERPS was modified, in order to prevent earnings below the LEL to generate entitlements (for details see Budd and Campbell 1998: 111). Additionally, following a rule of the European Court of Justice the pension age of men and women was equalised. The state retirement age for women was subsequently raised to 65, gradually phased in over a period between 2010 and 2020.

The GMP was abolished in favour of a reference scheme test. This finally put an end to the (partial) inflation-proofing of occupational pension schemes by SERPS. At the

same time occupational funds were now required to provide a limited price indexation of benefits up to 5 per cent per year.

3.3 Increasing the scope of private provision, part II: The New Labour reforms

The Labour Party was strongly opposed to the Conservative pensions policy of the 1980s and 1990s, particularly to the attempt to abolish SERPS. However, at the time they eventually came to power they followed the route of their predecessors in many respects. When the New Labour government took office in 1997, their major reforms of the pension system were the replacement of SERPS by a State Second Pension (S2P), the introduction of Stakeholder Pensions (a kind of no-frills personal pension aimed at moderate earners) and the implementation of a means tested Minimum Income Guarantee, soon replaced by the more sophisticated Pensions Credit. They also strengthened the regulation of financial services by establishing a single Financial Services Authority (FSA).

The overall aim was to direct state pensions primarily to those in greatest need and to expand private provision for all others. “Those who are able, should save what they can for their retirement. The Government should support those who cannot save and regulate the pension system effectively. The private sector should provide affordable and secure second pensions” (DSS 1998: 3).

The replacement of SERPS by the S2P had two intentions: to improve benefits for low earners and – in the long run – to make S2P unattractive to anyone earning above roughly £9,000 annually. In order to do so the accrual rates were raised for everyone earning between a Lower Earnings Threshold (LET) and an Upper Earnings Threshold (UET) set at £9,000 and £18,500 respectively,¹⁰ in a way that benefited those on lowest earnings most. Everyone earning between the LEL and the LET was deemed as earning as much as the LET. So unlike SERPS, which only had a single accrual rate, S2P had different accrual rates on (future) band earnings. In line with the higher benefits of S2P that would be given up, contracting out rebates were to be increased for persons in the respective income band.

¹⁰ 1998 figures. The earnings thresholds were to be increased in line with earnings. The UEL roughly equals average earnings.

In the long run it is intended to turn S2P into a flat rate benefit at the level envisaged for people earning at the LET. But, up to now no measures have been taken to implement that last step. After all, New Labour (almost) succeeded in doing what even the Conservatives did not dare: putting an end to state earnings related pensions in Britain.

Those who are still members of the S2P but earn above the LET were expected to contract out into a private pension, particularly opting for the stakeholder pensions introduced in 2001. These are, basically, a form of personal pensions which have to fulfil some minimum standards. Charges are capped at 1 per cent¹¹ of the fund, there are no penalties for starting or stopping contribution, the scheme has to accept contribution payments as little of as £20 and employers with more than five employees who do not offer an occupational scheme or contribute towards a group personal pension have to designate a stakeholder scheme and enable their employees to make contributions directly from their pay (Emmerson 2003: 174). Since stakeholder pensions have to comply to a given set of standards, they can be sold under a simplified advice regime.

In the long run the government expected their measures to lead to a situation where about 60 per cent of pensioner income would be derived from private sources and only 40 per cent from the state, thus reversing the current public/private mix (DSS 1998: 8, 31f, 103).

The introduction of S2P and stakeholder schemes did nothing to alleviate the situation of those pensioners currently entitled to means tested Income Support. Instead of raising the BSP across the board,¹² the New Labour government introduced a Minimum Income Guarantee (MIG) to improve the income for those on lowest means. The MIG was set at £75 per week for a single pensioner and £116.60 for a couple¹³. That meant the MIG was set well above a full BSP of £67.50 for a single person at that time. The MIG was to be increased in line with earnings while, on the other

¹¹ From April 2005 the price cap over the first 10 years is 1.5 per cent. As Wynn (2001) suggests there may well be additional charges that are not capped.

¹² Still, in 2001 and 2002 there had been increases to the BSP above inflation.

¹³ 1999/2000 figures

hand, BSP was only inflation indexed. Thus, the gap between the two is going to grow wider over the long term. The advantage was that the income of the poorest pensioners could be raised at a substantially lower cost than with an increased BSP which would have benefited better off pensioners as well. MIG is means tested and has to be claimed. Consequently there is a gap between the number of pensioners entitled and of those actually claiming (see Blake 2004: 29).

Introduced in 1999, MIG was reformed in October 2003 by the introduction of the Pensions Credit. One part of it, called Guarantee Credit, replaces MIG while the other part, called Savings Credit, aims to ensure that people with modest provision for retirement are better off than those without. The MIG/Guarantee Credit is available from state pension age but the Savings Credit can only be claimed from age 65.

“For every £1 of income received that is above the level of the full BSP but below the level of the Guarantee Credit, the Savings Credit pays an additional benefit of 60p. The credit is then ‘tapered down’ for additional income above the Guaranteed Credit level” (PPI 2005: 3f). Unlike the MIG, which in effect had a withdrawal rate of 100 per cent on savings in excess of MIG, the Pension Credit’s withdrawal rate is only 40 per cent. It has to be noted though, that all pensioners without a full BSP, aged below 65 or receiving other means tested benefits (e.g. housing benefit, council tax benefit) still face a withdrawal of up to 100 per cent.

The New Labour government also tightened the supervision of pension provision. In 1997 a Financial Services Authority (FSA) was created and given far reaching responsibilities by the 2000 Financial Services and Market Act. Subsequently the FSA took over the responsibilities of a wide range of regulatory bodies in the financial services industry. The FSA’s objectives are the maintenance of confidence in the financial system, the promotion of public understanding of the financial system, the securing of the appropriate degree of protection for consumers and the reduction of financial crime (FSA 2005). Still, the regulation of the governance of occupational pension schemes remained within the realm of OPRA. There is a shared responsibility for stakeholder schemes. Whereas OPRA is concerned with their governance, the FSA

regulates the marketing of and advice on stakeholder pensions and authorises and supervises the fund managing firms.

3.4 The 2004 Pensions Act – The protection of pension rights

In recent years there have been growing concerns about companies becoming insolvent and leaving behind an occupational pension scheme insufficiently funded to meet its liabilities. This happened even to schemes funded by more than 100 per cent MFR. The consequences became even more severe due to the statutory winding up priority order that gave pensioner's benefits, including future increases, priority over the entitlements of active members, so the remaining assets were unevenly distributed among the scheme members. Many employees close to retirement found that after decades of contributions the pension they had expected virtually disappeared.

The government reacted and introduced a new Pension Protection Fund (PPF). The PPF is going to compensate for scheme underfunding in the event of employer insolvency, so every member will still receive the bulk of her/his entitlements in the event of employer insolvency. For those above the scheme's normal retirement age or still in receipt of benefits the compensation level will be 100 per cent, for the remainder of scheme members it is set at 90 per cent up to an overall benefit cap. The scheme is funded by a mainly risk-based levy charged on all eligible schemes. The PPF will also take over the responsibilities of the PCB (see PPF 2005, DWP n.d. b).

For schemes wound up due to employer insolvency before 6 April 2005 when the PPF became operational, the 2004 Pensions Act established a Financial Assistance Scheme (FAS) funded by £400 million of public money over 20 years. The benefits available under the FAS will be capped at £12,000. (DWP n.d. a)

The 2004 Pensions Act also intended a simplification of the regulatory framework. OPRA was replaced with a new Pensions Regulator (PR), following proposals of the Pickering Report on the simplification of private pension provision (Pickering 2002). The report pointed out, that OPRA had to focus on detailed compliance, but was limited in its ability to exercise its judgements, to advice pension scheme professionals or to comment on the ambiguities within the regulatory framework (Pickering 2002:

8). The PR was therefore set up to work with a proactive, risk based approach to impose lighter touch regulation on well run schemes.

The 2004 Finance Act saw a radical simplification of the tax arrangements for pensions. A plethora of eight different tax regimes on pensions savings was turned into a single regime. Instead of age related annual contribution limits a single lifetime limit of £1.5m and an annual limit were introduced on tax free pension contributions.

4 The Current British Pension System

As the previous remarks point out, the current state of the British pension system is characterised by an intense public-private interplay, high complexity and widespread confusion.

“To encourage the purchase of personal savings and pension products, government has extended official controls over marketing, sales, and customer relations, raising the administrative costs of an increasingly complex system and stimulating legal debates over whom (if anyone) should compensate for market failure. [...] The failure to clarify who is precisely responsible for what – the complete confusion of pension finance and pension governance – distinguishes the British system ...” (Clark and Whiteside 2003: 13).

Moreover, pensions have been bad news over the last two decades. Incidents such as the Maxwell pension fraud, the mis-selling of personal pensions, insolvent companies with insufficiently funded pension funds or improper governance of the life-insurer Equitable Life resulted in a severe decline in consumer confidence. Fuelled by media exaggeration these things had contagious effects on pension provision overall (see Casey 2003). Measures like the PPF require some time to restore consumer confidence.

Particular problems arise for low to moderate earners. As Emmerson (2003) points out, the majority of those within the target group for stakeholder pensions (i.e. earning in between the LET and the UET) already had a form of private provision before. Furthermore employees within the target group are more likely to work for smaller employers who do not have to designate a scheme (Emmerson 2003: 184). So there is

quite a debate about the virtues of this new pension vehicle. There are ubiquitous claims that stakeholder pensions did not work out and most stakeholder schemes were “empty boxes”.

Stakeholder is not working. The vast majority of stakeholder schemes have nobody in them. [...] What the government said was [...], companies with more than five employees which do not at present provide a pension scheme for members have to nominate a stakeholder provider. They have to say ‘the Legal & General is our stakeholder provider’. But that’s all they have to do. Eighty per cent of all the nominated schemes have no members in them. No members (expert interview 1.1).

I think certainly amongst the target group, take up has been... . A number of organisations have suggested that take up could be higher (expert interview 1.7).

At least some schemes seem to be running successfully. An example is the B&CE stakeholder scheme, an industry-wide plan in the construction industry with 285,000 members (CBI 2004: 24-26). But there seems to be a lack of coordination between state and non-state arrangements. Those who think themselves likely to receive the Pensions Credit later in life may come to the conclusion that they will not be much better off in the future saving today. Surely, most people will not engage in detailed calculations. But if they like to buy a pension product the salesperson will probably advise them not to do so because the adviser fears later accusations of mis-selling.

One of the difficulties for the intermediaries trying to sell private pension provision is that at moment we’ve got a government offering... , it seems to be moving towards means tested benefits in retirement. So if you don’t know what the level of those is going to be the great fear of the financial advisors and the apprehensive individuals they advise is for the relatively low paid if you save during your career and end up simply earning a private pension and losing state means tested benefit, what have you gained? (expert interview 1.3)

People with unstable employment patterns and frequent spells of unemployment are often unable to lock away money in a pension and would be better advised to save in a more liquid product (Emmerson 2003: 184).

Since occupational pension funds in the UK invested large parts of their money in equities the stock market boom of the 1990s allowed employers to maintain rather generous pension schemes at virtually no cost, that is they could take extensive contribution holidays. After the stock market crash in 2000 there have been growing concerns about the funding of occupational pensions. Additionally, increasing longevity, the growing regulatory burden and the obligation to improve benefits as a precondition for contracting out over the years made the provision of defined benefit occupa-

tional pensions more expensive for the employer. This development was described quite often in the expert interviews.

[T]he sort of pensions that have been built up are very, very expensive and the cost and the volatility of that cost is now appearing in their company accounts in a way it never used to. The new accounting standards are making all of that transparent and finance directors have had some nasty shocks. They had no idea what all this would cost! They certainly know now and they're thinking "Why are we? Why, you know, as part of our strategic planning and our workforce planning, why are we putting 25 per cent of payroll costs into pensions?" (expert interview 1.2)

So the end of the stock market boom led to the acceleration of a long-term trend of employers replacing defined benefit with defined contribution arrangements and reducing contributions, with the result of occupational pension arrangements becoming less generous and more risky for the employee (see Pensions Commission 2004: 79-125). This trend is accompanied by another. Occupational pensions are changed into contracted in arrangements, intended only to top-up state provision. On the employers' side contracting back in the state S2P marks a step towards a new mode of risk sharing between employers and government in respect of future pension liabilities.¹⁴ In some respect this represents a new "partnership in pensions", but clearly not the kind of partnership the government had in mind.

According to estimates by the consulting company Watson Wyatt, 522,000 people contracted back from contracted out arrangements into S2P in tax year 2002/2003. Among these, 319,000 people did so as a result of the replacement of salary related schemes with money purchase arrangements. The remaining 203,000 people chose to switch back from having their contracted out rebate paid into a personal pension to membership in S2P. Against the background of low investment returns and rising life expectancy the contracting out rebate is currently set at a level too low to make contracting out worthwhile. Therefore some providers tell their customers to consider contracting back in (Knight 2004). Again, this reveals some lack of coordination between state and private provision. The level of the rebate is reviewed every five years, but investment returns might change much quicker. It has to be noted though, that in the past the rebate tended to be overgenerous. In the future the rebate is likely

¹⁴ This is exemplified in the case of the brewer Scottish & Newcastle plc in CBI (2004).

to be set at a higher level. This implies falling investment returns cause higher public costs of private provision.

5 British Pension Policy – An Example of Privatisation?

I will now assess whether the British pension policy of the last decades is aptly described as a process of privatisation.

Generally, the privatisation of pension may be pursued along different lines. It might be possible for a government simply to cut back state benefits assuming that people will turn to the market (or their employers) to acquire additional benefits (or to negotiate for them at the workplace). The rationale behind this strategy would be the neo-liberal presumption that the market knows best. Such an approach could be termed “passive privatisation”. But more often a flanking strategy of “active privatisation” is pursued by way of the creation and adaptation of appropriate markets. This might entail the establishment of product standards, the introduction of fiscal incentives or compulsion, the set-up of supervisory bodies and other means of protecting pension money from incompetent, fraudulent or negligent behaviour, the provision of information and the improvement of financial literacy; in short: the creation of a regulatory framework for private provision. Active privatisation allows for welfare ideologies way beyond neo-liberal values (see Hyde and Dixon 2002; Hyde *et al.* 2003).

With these considerations in mind, there are four possibilities to consider the appropriateness of the term “privatisation”, reflected in the following table that I will employ for my further analysis.

Privatisation		
	passive	active
appropriate	1	3
not appropriate	2	4

ad 1.) Obviously, the cut back of contributory state pension entitlements qualifies as a measure of passive privatisation. The BSP is only linked to inflation and thus state pensions lose value in relation to earnings. SERPS had been cut back several times under Conservative governments and since contribution limits were also price indexed it was due to fall in value in the long run. This is likely to continue with the successor S2P. The proposed changes into a flat rate benefit will, over the long term, reduce S2P entitlements for all but low earners.

ad 2.) On the other hand New Labour improved the conditions of S2P for lower earners and introduced the MIG and the Pensions Credit, thus raising the pension income of those most in need. So overall the elements of interpersonal redistribution within the system of state old-age benefits were strengthened at the expense of the elements of inter-temporal redistribution. There is a broad consensus among the experts that the pension market is unsuitable to cater for those on low income.

More problematic, though, is the interaction of state and private benefits. The lack of an universal non-means tested minimum pension makes it difficult for an individual to judge whether additional private provision is worthwhile. So the lack of adequate non-means tested state pensions is partly detrimental to private provision and the British pension system will leave many pensioners with insufficient incomes both from state and non-state sources. Many experts assume a higher state pension without means testing would improve the level of private provision. This contradicts the common notion that state benefits crowd out private savings for old-age.

Over time, both due to this government and other governments - let's not single out this government for criticism - the interface between state provision and private provision has become disjointed. And I think that's one of the key reasons why we are calling for a reform of the state pension system. Because private provision should be able to build upon a solid state platform where people saving privately are not dis-incentivised by the current regime (expert interview 1.7).

And so I'm not sure that more information, and expecting consumers to behave like rational economic creatures is necessarily going to solve our problems in this country and that's why I come back to a universal subsistence pension that people can live on, that lifts them out of poverty. And then people will understand that if they want any more luxuries than that, they're on their own and they've got to do something for themselves. And that is such a simple thing to understand, I think people could get their heads around that (expert interview 1.2).

ad 3.) With the introduction of personal and stakeholder pensions active measures to promote non-state pensions clearly have opened the pensions market for retail pro-

viders. Since membership of the company's occupational pension fund could no longer be a condition of employment after 1988, there was an increasing competition among different kinds of pension providers. Together with the option to contract out into a money purchase (defined contribution) occupational pension, Britons face more choice and flexibility in old-age provision than ever. But, the rising complexity of the pension system caused a situation where many people find it hard to decide what is the right thing for them to do.

ad 4.) Even though the state is no longer providing the price indexing of private pensions there still is a significant element of cost sharing between public and private in private pension provision by means of tax incentives and the contracting out rebate.

One of the most striking features of British pensions policy over the last two decades is the ever growing amount of regulation. This was both motivated fiscally – to reduce state spending on private pensions – and triggered by successive incidents of market failure: the Maxwell scandal, the mis-selling of personal pensions and the insolvency of companies with insufficiently funded pension schemes, to name the most important. This resulted in a large amount of rules concerning scheme governance, funding, information and advice and benefits. The last ten years have seen a set up of new regulatory bodies and the Pension Protection Fund. In other words: *the actions of those in charge of private pension funds – employers, trustees, fund managers, actuaries auditors and financial advisers – are to a large extent determined by rules that were set by the state in order to achieve political goals and to react to perceived shortcomings of the system.* Still, these regulations may not be sufficient to create a pension system that is likely to be understood and trusted by those expected to provide for their old-age and to generate adequate income for their future retirement.

6 Regulated Welfare Markets and Shortcomings of the UK Approach

There is an increasing awareness among social scientists that the provision of an appropriate regulatory framework for private (pension) provision forms an integral part of the welfare state. While a shift from state to market implies a changing *mode of welfare production*, state regulation might still try to achieve distributional outcomes, or *welfare goals*, that are seen as appropriate. "Typically, the *non-public* components

are not completely private, but are shaped by public regulation and fiscal welfare such that tax advantages for individuals and firms can be secured only under the condition of adherence to regulatory standards" (Hinrichs 2000: 356).

British examples are minimum standards for contributions or benefits, compulsory membership in either the S2P or a private equivalent, compulsory annuitisation of money purchase pensions in order to keep pensioners from spending their money too quickly, prescribed unisex-annuities for the protected rights part of private pensions to achieve more equality among men and women, and arrangements to compensate for market failures. The most important and most basic objective British governments pursues by regulating private pension is to make sure that citizens do engage in private provision and contributions are made at an appropriate level. This is supposed to give people a sufficient income in retirement without the need to fall back on the state.

Whereas previously the welfare state was generally seen as opposed to markets (cf. Esping-Andersen's [1990] concept of de-commodification), there is now a recognition of welfare provision by means of regulated "welfare markets" (Taylor-Gooby 1999; Nullmeier 2003) within the welfare state. "What has emerged is a public-private hybrid as officials attempt to adapt the market to secure political objectives with astoundingly restricted success" (Whiteside 2003: 32). State and market provision does not merely coexist, it is interconnected in many ways. The state tries to ensure that private provision is available, that it provides benefits in an appropriate way, and that people actually take advantage of private provision.

Despite all regulatory efforts by the state, welfare market outcomes are to a large extent outside the realm of political control and not fully calculable (Nullmeier 2003: 966). Attempts to influence the behaviour of market actors by means of regulation or incentives might still have unintended effects. Despite all state regulation, market actors will pursue their own interest. An interviewee pointed at this in connection to recent trends to contract back into the state scheme.

If a scheme is going to contract out, a lot of work has to be done and that meant fees for advisors. You are not going to get any more fees if the companies continues to contract out; you might get some fees if it contracts back in again. So I think there are two issues here. One is that the incentive to contract

out has gone down in real terms, and two, there is work to be done so it's a good idea to sell contracting back in again (expert interview 1.8).

If welfare markets should fail, people will turn to the government for protection. When it turned out that there was no member protection when companies went bust with insufficiently funded pension schemes, protesters took to the streets, demanding government compensation. One sign read "We've tried to provide for our old age, now all we've got is pension rage. No fund, no hope, no future" (see Pestridge, 2003). They pointed out that they were doing what they were asked to do by government, so they held the state liable for their misfortune.¹⁵ Thus the creation of state-regulated welfare markets, or their employment for social policy goals, leads to a politicisation of (these) markets (Nullmeier 2003: 968; Leisering forthcoming). Because market failures are often unforeseen governments can often only react after problems have occurred.

I think, overall, that pension policy has not evolved, it has tried to set up minor manoeuvres and fire-fighting from the problems of the past (expert interview 1.1).

But the problem that the regulator has is that it is set up by legislation, drawn up in a context of something very different. What we're now doing is, the Pensions Bill is being put through against the context of under-funded schemes. Whatever happens in the future, the circumstances won't be quite like that. So you will get a regulator set up in this mindset dealing with problems that are completely different, perhaps a high inflation and the impact of that, and everybody will say: 'This regulation is completely inappropriate!' And the answer will be: 'Of course it was.' But it was set up to deal with a different problem (expert interview 1.8).

On the other hand, market actors, *the providers of non-state old-age provision and the (potential) customers, may very well drop out of the (welfare) market.*¹⁶ This is even more likely when the whole setting of the welfare market depends on (incentivised voluntary arrangements. Providers will leave the market if they see the regulatory burden as too heavy, or the future costs and the risks they are expected to take as too high in relation to their profits or other benefits, such as the chance to attract employees to their companies by promising an occupational pension. The customers will turn their back to the welfare markets if they are put off by the complexity of the arrangements, or by a lack of confidence in the market, or if they assume they can find a better deal

¹⁵ Some experts argue that the government may well have a legal liability because regulators and government departments have given a false impression about the safety of final salary schemes (see Altmann 2004 and Webb 2004).

¹⁶ If the politicisation of welfare markets may be seen as a form of "voice", withdrawal would be the "exit" option.

elsewhere. This might be a state scheme, or in some cases even the prospect of a means tested benefit in old-age. The current trend to contract back into the S2P may serve as an example. Others might turn to a less regulated market like non-pension investment products or the housing market. At the same time as there is a debate about the “pension crisis” and a “savings gap”¹⁷ the property market is overheated. This is also commented on by the experts.

There is a widespread perception that a house is a good investment and a pension is a bad investment. (expert interview 3.9)

‘Pensions’ has become a negative term for many consumers in this country and people don’t have the confidence any more in pension savings. And instead they’re putting their wealth into property which is probably not a good idea because the property market in this country is quite volatile and it’s quite easy to be seduced by thinking ‘Oh well, my house is worth a hundred thousand Pounds, I don’t need to worry!’ People have no idea about how much money they’ll actually need to have a decent income in retirement! (expert interview 1.2)

Some people might not even enter the welfare market for old-age provision in the first place. The ability of people to plan ahead is affected by difficulties to imagine the future, the degree to which peoples actions are informed by what others do around them and by the amount and the of resources that people command. So those with insecure lives face difficulties to plan ahead (Rowlingson 2002). For them a voluntary regulated welfare market approach is unlikely to result in adequate pension income.

7 Conclusion

Does the British pension policy over the last to decades constitute an example of privatisation? There is no easy answer to this question. While state pensions have been cut back, private provision often remains insufficient. While the costs of National Insurance pensions could be contained, there are rising expenditures on incentives for non-state arrangements and on means tested benefits for pensioners. While the market was opened to new providers and Britons today face more choice than ever before on how to make arrangements for their retirement, private pension provision became more and more regulated and supervised by the state, often in reaction to a number of market failures and scandals. And finally, while new forms of private

¹⁷ According to the ABI (2004) “7.4 million working people are still not saving at all for retirement and further 4.8 million are saving at too low a level to provide an adequate retirement income”.

provision for moderate earners are promoted by the New Labour government, the increasing importance of means tested benefits is seen by many as a disincentive for private provision.

The British approach of shifting pension provision from state to private is a strategy to avoid public liabilities in the future, but it was pursued at substantial cost. Furthermore, the government is challenged to find an adequate framework to accommodate both state and private provision. To ensure that the market delivers pensions appropriately it has been turned into a heavily regulated and politicised welfare market. The state is held liable for market failures. The market regulation itself makes pension provision less attractive for the providers but it appears to be insufficient to create consumer confidence and a stronger demand for private pensions. Both providers and consumers drop out of the welfare market. The state not only has to find the appropriate means of market regulation, it also needs to co-ordinate the entire framework of public and private pension provision. It has to adopt a structure that ensures an adequate income for current pensioners and simultaneously makes private provision attractive for both sides of the market. For the state the boundaries between public and private vanish.

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