What could the Coalition Government mean for pensions policy?

Table 1: Coalition Government policies - pensions and older people

Policy area	Current Coalition Government policy
State pension	Will guarantee from April 2011 that pensions will be raised by the higher of earnings inflation, price inflation or 2.5%.
State Pension Age	Will hold a review to set the date at which the state pension age starts to rise to 66, although it will not be sooner than 2016 for men and 2020 for women.
Public sector pensions	Will establish an independent commission to review the long term affordability of public sector pensions, while protecting accrued rights. Will consult with the Independent Parliamentary Standards Authority on how to move away from the final-salary pension system for MPs.
Default Retirement Age	Will phase out the Default Retirement age.
Long-term care	Will establish a commission on long-term care, to consider a range of ideas, including voluntary insurance to cover residential care costs, and a partnership scheme as set out in the 'National Care Service' proposal.

Introduction

The general election of May 2010 resulted in a Coalition Government formed by the Conservative and Liberal Democrat parties. Both parties made pre-election manifesto promises relating to pensions and older people, and the Coalition Government has now produced a Coalition Agreement, specifying which policies they have agreed to take forward.[1]

This Briefing Note summarises Coalition Government policies on pensions and older people, and highlights what impact the new Coalition may have on pensions policy and provision for retirement.

State Pension

Before the election, the three main parties committed to re-indexing the Basic State Pension (BSP) to earnings, however there was no consensus on when re-indexation would begin. The Coalition Government has now committed that from 2011 the BSP will rise yearly by the higher of earnings inflation, price inflation or 2.5%.[2]

This policy is more beneficial to pensioners than simply indexing BSP to earnings would be. In years of poor economic growth, prices may rise more quickly than earnings, or neither prices nor earnings could grow. This policy ensures that BSP will be raised by a minimum of 2.5% every year and that future income from the BSP should not fall relative to the nation's income. However, income from the State Second Pension is still indexed to prices, and may rise more slowly than the BSP.

It was announced in the Coalition Agreement that a review will be held to set the date at which the State Pension Age (SPA) starts to rise to 66, although it will not be sooner than 2016 for men and 2020 for women.

However it was revealed in the detail of the Queen's Speech in May 2010, that the Coalition Government will review both the current timetable of initial SPA rises from 65 to 66 as well as the two later increases currently scheduled at ten-year intervals, in order to ensure the future affordability of the state pension.[3] The Coalition Government review will re-examine the timetable and make recommendations regarding the timetable of SPA rises.

PPI modelling shows that if the Government were to raise the SPA from 65 to 66 in 2016 for men and 2020 for women, there could be a reduction in total state spending on pensions by £2bn per year in 2017 rising to £3.5bn per year in 2022.[4] However, bringing SPA rises forward could negatively impact people with shorter life expectancy and people closer to retirement who may have difficulty adjusting to an increase in SPA at relatively short notice.

Public sector pensions

Reforms are currently taking place to public sector pensions including raising the normal pension age from 60 to 65 for new scheme joiners (and existing members of Local Author-

Table 2: Coalition Government policies – private pensions

Policy area	Current Coalition Government policy
Occupational pensions	Will simplify the rules and regulations relating to pensions to help reinvigorate occupational pensions, encouraging companies to offer high-quality pensions to all employees.
Auto-enrolment	Will work with business and the industry to support auto enrolment.
Early access to pension savings	Will explore the potential to give people greater flexibility in accessing part of their personal pension fund early.
Accessing private pension income	End the rules requiring compulsory annuitisation by age 75 – not yet specified what policy will be put in its place.

ity schemes) reducing employer contributions and accrual rates, and building cost-capping and cost-sharing into schemes. The Coalition Government has pledged to establish an independent commission to review the long term affordability of public sector pensions (while protecting accrued rights) and will consult on how to move away from the MP's final-salary pension scheme.

The PPI is currently undertaking some research, funded by the Nuffield Foundation, looking at the implications of a number of potential reforms for public sector pensions. The research will look at the reform's potential implications for public sector workers and for the affordability and sustainability of the schemes.[5]

Policies on Older People

The Coalition Government has pledged to phase out the Default Retirement Age, which means employers will no longer be allowed to terminate employment contracts when employees reach age 65.

The Coalition Government has also pledged to establish a commission on long-term care, to consider a range of ideas, including voluntary insurance to cover residential care costs, and a partnership scheme as set out in the National Care Service proposals.[6]

The Coalition Government has not yet commented on whether they will restrict tax relief on pension contributions any further than current legislation allows, although before the election the Liberal Democrats pledged to restrict tax relief on all pension contributions to the basic rate.

Private Pensions

Before the election, all three main parties expressed interest in exploring risk-sharing options for private sector pensions, though the Coalition Government has not yet stated its intentions in this area. However, the Coalition Government has pledged to *'simplify the rules and regulations relating to pensions to help reinvigorate occupational pensions, encouraging companies to offer high-quality pensions to all employees.'*

Auto-enrolment and NEST (National Employment Savings Trust)

Under current legislation employers are required to auto-enrol eligible employees into pension saving (and pay minimum employer contributions). In addition a new low-cost national pension saving scheme, the NEST scheme, is due to be introduced in 2012.

The Coalition Government has pledged to work with business and industry to support auto-enrolment into work-place pension saving.

However, before the election both the Conservatives and the Liberal Democrats had concerns about the potential for the NEST scheme to motivate employers to

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downgrade the standard of pension they offer employees or to level down contributions in to private pensions to the minimum level of 3% for employers.

The Coalition Government is committed to the principle of automatically enrolling people. However the Pensions Minister stated at a recent press briefing that the Government will review the specific way in which auto-enrolment is done. He said that the Government will look at *"whether the scope [of automatic enrolment] is right and whether the delivery mechanism [for NEST] is right."*[7]

Access to private pension savings

Under current legislation, people are not allowed to access private pension savings before age 55, after which people can take 25% of their pension savings tax-free and must use the remainder to buy an annuity by the age of 75.

The Coalition Government has committed to lifting the requirement to annuitise by age 75, which could have the potential to give some people greater flexibility in taking retirement income, especially those with larger saving pots, though the effect of the change won't be clear until it is decided what policy will be put in its place.

Any changes the Government makes to the way people are allowed to access their private pension saving in retirement will need to take into account that many people depend on their pension savings to help provide them with a decent level of income throughout their retirement. The Coalition Government will also be interested in ensuring that any new policies ensure that they do not lose out on tax revenue and that people are not able to spend all of their pension savings early on in retirement only to depend on means-tested state benefits for support.

The Coalition Government has also committed to exploring the possibility of giving people access to part of their pension savings before the age of 55. The Coalition Government has not specified what type of early access policy they may be interested in, however before the election the Liberal Democrats pledged to allow people early access to their 25% tax-free lump sum and the Conservatives pledged to explore international options for early access.

Allowing people early access to pension savings could encourage more people to save in private pensions and to contribute at higher levels. However, allowing people early access could also reduce the level of income people receive from their private pensions in retirement.[8]

Conclusions

The Coalition Government has covered a lot of ground in their first few weeks in office and have made some important announcements on pensions policy, such as the decision to index BSP to the higher of earnings, prices or 2.5% in 2011 and to support the introduction of auto-enrolment into private pensions.

However, the Coalition Government's impact on pensions policy will be clearer once the results of the review on SPA changes and the commissions on public sector pensions and long-term care are announced and once any announcements are made regarding NEST, auto-enrolment and tax-relief on pension contributions.

As a result of the new Coalition Government we might expect some people to see greater freedoms and flexibilities in future around accessing pension wealth both in the run up to and during retirement.

[1] *HM Government (2010) The Coalition: our programme for government www.direct.gov.uk*
[2] Unless specified otherwise all Coalition Government policy pledges referred to in this Briefing Note are sourced from *HM Government (2010) The Coalition: our programme for government*
[3] www.number10.gov.uk/queens-speech/2010/05/queens-speech-pensions-and-savings-bill-50610
[4] PPI modelling, see BN 53 for more information
[5] See forthcoming PPI work in 2010
[6] careandsupport.direct.gov.uk
[7] Steve Webb, Financial Times (28 May 2010) *Pension plans for lower paid staff in review*
[8] see PPI (2008) *Would allowing early access to pension savings increase retirement incomes?* For analysis of the implications of allowing early access to pension savings

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