Pensions News arising from Labour Party Conference

The past week has been exceptionally interesting for pensions and there have been significant signs of a major shift in policy, particularly on State pensions. The Labour party conference speeches and fringe meetings have signalled a possible re-think on the future of means testing, which would be exceptionally good news at last.

Having been at the conference, I will try to provide a brief round-up of the important news relating to pensions policy.

Labour Party conference round-up:

Prime Minister's speech: Tony Blair announced that the Government is considering a radical change to pensions for the third term, if Labour is re-elected after the next General Election. He did not make clear exactly what he had in mind, but referred to having 'the Basic State Pension' as a central plank of policy, a reduction in means testing and better incentives to save. "We will design a pension system that has the basic state pension at its core, gives special help to the poorest and provides incentives to save for hard-working families whatever their wealth or income." ***Comment: This speech was taken as very significant, since the Prime Minister signalled he is engaging in the issue of pensions, which has previously been left almost exclusively to the Chancellor of the Exchequer. It is my view that Alan Milburn has been brought in to try to push through a more radical agenda on issues such as pensions, by standing up to the Treasury and insisting that the direction of policy needs to be changed. The mention of new incentives to save and the implication that such incentives will not favour those who are better off, is an enormously welcome sign that real change may be under way. New incentives are essential, if people are to be encouraged to save and tax relief merely gives the highest incentives to those who need them least, which is the wrong way round!***

Alan Johnson's speech: The new Secretary of State for Work and Pensions reaffirmed that there are no plans to increase the State pension age and called on employers and workers to stop burying their heads in the sand and start putting more money into pensions. He also indicated that part of the Government's strategy will focus on getting more of those aged 50-65 back to work, rather than forcing those over 65 to stay in employment. He indicated an increased role for trade unions in pensions and announced a £3million fund to help train trade union officials to be able to advise their members on pensions. ***Comment: It is clear that Alan Johnson would like to help the unions to recover some of their lost standing in the labour force and they see taking ownership of the pensions issue as a major potential way of increasing their popularity. Aiming to increase labour force participation of those age 50+ is an excellent policy aim and the UK is well ahead of other countries on this essential part of tackling the problems of an ageing population.***

Malcolm Wicks' speech: At various fringe meetings, the Pensions Minister outlined his vision of pensions policy. He suggested that he does not necessarily believe there is a pensions crisis, but that 'workers are in crisis about their pensions'! He outlined the Government's commitment to the voluntarist approach, part of which includes improving pensions literacy, informed choice and sending out combined pension forecasts. He also reiterated Alan Johnson's comments that he does not see a case for raising the State Pension Age at the moment and that the DWP will focus on helping more of those over age 50, who are currently not working, to get back into the labour force. The Government has set up the Pensions Commission, under Adair Turner, to examine whether voluntarism in pensions will work and its first report, due on 12th October, will be an analytical study of trends. He explained the problems for policymakers, who need to strike a balance between providing good income levels for older people and targeting on those most in need, when trying to spend scarce resources most effectively. He explained that women have been particularly helped by the Pensions Credit (of the 3 million people receiving Pension Credit, over 2 million are women). However, he also, for the first time, mentioned that he believed Pension Credit was a short – to medium-term policy. This is the first time any Government Minister has hinted at the unsustainability of Pension Credit! At the moment, figures show that it is costing over £4 per week, to pay Pension Credit to each claimant. ***Comment: The remarks that Pension Credit may not be a long term part of pensions policy are welcome indeed. This means tested benefit, while being very helpful for today's pensioners, is dreadful for tomorrow's retirees. It is one of the major reasons cited by individuals, employers and financial advisers, for putting people off contributing to pensions. It is a huge disincentive to future pensions.***

Baroness Hollis' speech: Baroness Hollis is the Government's spokesperson for pensions in the House of Lords and she gave a detailed outline of Government thinking on pension reforms. I will outline this in detail, as I think it is extremely relevant to the pension reform debate and she gave excellent insights into Government attitudes.

a. Raising Basic State Pension (BSP). She suggested that the problem with those who recommend simply raising the BSP to bring it up to an affordable level, is that it will not help the problem of older women pensioners in poverty. Only 14% of women have a full BSP in their own right, so that any rise in BSP may just pass women by, except for those who can benefit via their husbands. ***Comment: This is an important point. For younger women, this is not such a problem, since they are more likely to have been working, but it will take another 20 years or more before women's entitlement to BSP rises closer to male levels.***

b. Universal Citizen's Pension. She suggested that the Government has looked at this approach and believed that the problems of women's pensions would be addressed by this, the costs might be affordable, but that any phasing in during a transition period would pose enormous problems. Her main concerns about this proposal were that it would have very negative implications for the contributory principles on which the National Insurance system is based, with people's contributions during their working life no longer counting towards State pension and also how to decide who would be covered by this 'citizen's' pension. Would there be a residency test, how long would this be etc? ***Comment: The Government has already compromised the contributory principle somewhat, by the changes it made when it moved from SERPS (State Earnings Related Pension) to S2P (State Second Pension). This second, earnings-related, tier of State pension was changed by the Labour Government, and now allows women to stay at home to earn 'credits' for years out of the labour force (this is called 'Home Responsibilities Protection – HRP'). S2P gives higher pensions to those on lower earnings, even though they do not contribute***

more, so the link between contributions and pensions has already been significantly weakened.

c. Paying higher universal pension from age 75 or 80, rather than 65. *(This is my favoured option!)* She acknowledged that this would be affordable and would help women and the poorest pensioners, by taking them above the poverty line and abolishing the means test. She suggested that this could be connected to life events, such as widowhood, for people to qualify, rather than age, but was concerned about paying too much income to wealthier pensioners. She cited figures showing that the distribution of income for older pensioners (those over age 75) is still very wide, with the gap between the bottom 20% and top 20% being around £200 per week. This gap is similar to that for younger pensioners, although the median income for pensioners under age 75 is £20 a week higher than for those over age 75. Her thoughts were that paying everyone over age 75 a much higher state pension would suffer from paying 'too much' to some people who did not need it. ***Comment: I think this reform is the most workable and sensible and it is the one which I have recommended. I would pay the equivalent of the poverty line level for Minimum Income Guarantee and Pension Credit (£105 per week for single pensioners) to everyone over age 75. I would fund this by ending contracting out and using the £11 billion of money saved by not paying contracting out rebates, to fund higher pensions today.***

d. Pension credit. She claimed that Pension credit 'rewards saving' and should be compared with the situation before the Government introduced this policy, which was that pensioners lost their private pensions £ for £, if they claimed means tested benefits, whereas now they might 'only' lose 40p in the £. She claimed that Pension Credit may not 'incentivise' saving, but it does reward saving. She suggested that the Government cannot get rid of Pension Credit until women's pensions are higher and closer to male levels. ***Comment: My view is that Pension Credit does not reward saving at all, it merely penalises saving less than the previous system. Private pension income is still reduced by at least 40p in the £ under the Pension Credit calculation, which is hardly a reward! Baroness Hollis admitted that, for many people, including hundreds of thousands of women pensioners, if they do not have a full BSP, then they will still lose part of their pension savings £ for £, even under Pension Credit.***

e. <u>Encouragement for employers to contribute to pensions.</u> She mentioned that the current Pensions Bill will contain measures to encourage membership of employer pension schemes. In particular, the idea of requiring employers, who do not contribute at least 3% of salary to a pension, to pay for financial advice for their workers, to help them plan pensions. Also the idea of auto-enrolment, to ask employers to automatically enrol their workers in the company pension scheme, so they have to actively 'opt out', rather than requiring them (as now) to have to actively 'opt in'. This would build on a degree of inertia and pilot studies suggest that take up of company pensions goes from under 50% to over 90% in firms which adopt auto-enrolment. ***Comment: The idea of requiring employers to pay for financial advice is interesting, and would be excellent, providing the advisers chosen are good. As regards auto-enrolment, this idea has had major successes in pilot studies, but is likely to be more problematic for smaller and medium size employers, who do not***

always want to provide pensions for their workforce any more. There is clear evidence emerging that companies are no longer convinced that providing pensions for their employees is necessarily money well spent. Research from the Pensions Institute has suggested that finance directors of small businesses see pensions now as a 'company cost' not a 'company benefit' and are trying to discourage workers from joining, so as to save the contributions.

Adair Turner's speech: At various fringe meetings, Adair Turner alluded to his forthcoming initial report by the Pensions Commission, which will outline the current situation for pensions in the UK. He commented on the appalling lack of statistics, which has hampered his investigations and criticised the Office of National Statistics (ONS) which has consistently overestimated pension savings, primarily by double counting pensions when individuals transfer money from one provider to another. He also focussed on the problems with Government Actuary Department's longevity forecasts, which have consistently underestimated life expectancy. He said: "We are seeing a very major increase in life expectancy and it has accelerated. That has huge implications for pension provision, public and private." He said there were four basic options -- allow the number of poor pensioners to grow, raise taxes, increase private saving, or increase the average retirement age, or perhaps some combination of all of these will occur. His report will not make policy recommendations, but will discuss policy possibilities in light of the data and implications of current trends. ***Comment: Many commentators are expecting a radical report to be released on 12th October. This is unlikely, but the Report is likely to show that our current pension system is facing huge potential problems in future, particularly in light of the fact that Government figures have been underestimating the length of time pensions will need to be paid for and overestimating the amounts of money that has been put into pensions in the past. This obviously makes the scale of the challenges facing future pensions even greater than previously thought.***