

Public Sector Pension Reform

Briefing Note
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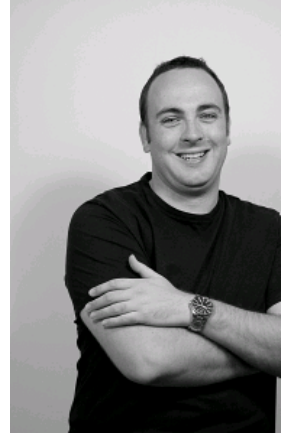
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Introduction

A major independent review of public sector pensions has recommended that people work for longer, contribute more and accept lower pension benefits in retirement.

The review was carried out by Labour peer Lord Hutton in response to the “unsustainable” rise in the cost to taxpayers of funding public sector pensions.

John Hutton’s Independent Public Service Pensions Commission made a total of 27 recommendations to government which will now be considered before policy is decided and implemented.



Within this special briefing note, we take a closer look at these recommendations and consider what they could mean for public sector employees.

As a firm of Chartered Financial Planners, we work closely with individuals to help them plan a financially secure retirement. This means establishing the required level of income in retirement and working out a strategy to create this, from pension and non-pension assets.

We hope that you find this briefing note useful and would welcome any questions you might have about this or any other retirement planning subject. You can call us on 01483 274566, email us at hello@icl-ifa.co.uk or follow us on Twitter @informedchoice.

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Background

Before looking in detail at the recommendations made within this latest report, it is important to understand the context in which they have been made.

The Independent Public Service Pension Commission was formed to conduct a fundamental structural review of public sector pension provision. It was asked to make recommendations to the Chancellor on making pension arrangements both sustainable and affordable in the long term.

The Commission also had to consider fairness to the public service workforce and taxpayer. This fairness had to be consistent with the financial challenges currently faced by the UK economy, as the government tackles the current record budget deficit.

Part of the terms of reference given to the Commission was to consider the growing disparity between public sector and private sector pension provisions. This had to be considered in the context of the overall reward package.

Defined benefit pension schemes remain the norm in the public sector, whilst in the private sector these have massively declined due to their unsustainable costs. It is now more typical for a private sector employee to be offered membership of a defined contribution pension scheme, where retirement benefits depend on contribution levels, investment growth and annuity rates at retirement.

The Commission was asked to publish an interim report in September 2010 before publishing a final report in March 2011. This final report needed to be ready in time for the Budget on 23rd March 2011, which suggests that the Budget could contain policy decisions based on the recommendations.

Recommendations at a glance

Whilst the report makes 27 separate recommendations, there are several which are likely to attract the biggest headlines and be of greatest concern to scheme members.

Changing the salary basis

The report proposes that pension benefits should be changed from a 'final salary' to a 'career average earnings' basis. In simple terms, this means that pension benefits would be calculated based on the average salary during the career of the scheme member, rather than their salary in the final few years of employment.

Retiring later

The report also suggests that the scheme retirement age should be increased, in order to reflect the fact that people are living for longer.

Lord Hutton is recommending that uniformed services (the armed forces, police and firefighters) should see their pension age rise to 60.

Changing the inflation basis

A further recommendation in the report is to change the way in which inflation is used to recalculate pension benefits. This is in an attempt to reduce the cost of providing public sector pension benefits and therefore means a reduction in the value of benefits.

We have looked at all three of these proposals in more detail later in this briefing note.

Which schemes will this cover?

The recommendations in the final report from the Independent Public Service Pension Commission cover a range of public sector pension schemes. In addition to a number of smaller pension schemes, the report covers the following:

- Principal Civil Service Pension Scheme
- Armed Forces Pension Scheme
- NHS Pension Scheme
- Teachers' Pension Scheme
- Local Government Pension Scheme
- Judicial Pensions Scheme
- Department for International Development's Overseas Superannuation Scheme
- Research Council's Pension Scheme

Members of any of these schemes should look closely at the proposals and ensure they understand the likely impact of these proposals on their own retirement planning.

Career average pensions

The report proposes that the link with final salaries is broken when calculating benefits, to be replaced with career average earnings.

This means that the pension entitlement for each employee will still be linked to their salary, but related to their career average earnings rather than the salary in the final few years of employment.

It is being proposed that schemes working on this basis are introduced before the end of this Parliament in 2015.

Some groups, such as the armed forces and police, could be allowed a longer transition from final salary to career average earnings.

What is actually being proposed is a Career Average Revalued Earnings (CARE) scheme. Benefits from this type of pension scheme are dependent on three factors:

- The total length of pensionable service in the scheme.
- Career averaged earnings which are adjusted each year to keep pace with inflation.
- The accrual rate of the pension scheme, which is the proportion of salary that is received for each year of pensionable service (for example, 1/60th).

It is being proposed that the link with final salary is maintained in respect of benefits already accrued, so the Career Average Revalued Earnings basis would only be used for benefits accrued from the date this new scheme is introduced.

Later retirement age

Another key recommendation within the report is to increase the Normal Pension Age to bring it in line with the State Pension Age. Normal Pension Ages within public sector pension schemes will then be regularly reviewed, to ensure they remain appropriate.

The Commission explains they have a preference for keeping scheme Normal Pension Ages and the State Pension Age linked, so any future increases to the State Pension Age are likely to translate to increases to public sector pension scheme retirement ages as well.

Between April 2010 and November 2018, the State Pension Age for women is being increased to 65. The State Pension Age for both men and women then increases in stages between December 2018 and April 2046. It is being increased from 65 to 68 during this time.

Under current rules, some public sector employees are able to retire from age 55 but the majority have a Normal Pension Age of 60.

We expect the proposals to mean that members of the uniformed services (armed forces, police and firefighters) will have to wait until age 60 before they can receive their pension benefits. For all other public sector members, we expect to see the Normal Pension Age increased to 65 by November 2018 and then increased further in line with the State Pension Age following that.

Changing the inflation basis

One proposal in the report is for pension benefits to be updated in line with average earnings during the time benefits are accrued. This will mean pension benefits keep pace with earnings inflation as they are being accumulated.

For benefits in retirement, it is being proposed that pensions should be indexed in line with price inflation, so they maintain their purchasing power during retirement. This would use the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI) measure of price inflation.

A controversial proposal within the report is that, during times of negative price inflation, this should be carried forward to reduce future increases in pension benefits.

This means that any future period of deflation would not see pension incomes reduced, but would slow down future pension income increases.

Other proposals

The report contained a number of other proposals for public sector pension schemes:

- The value of pension benefits should be taken into account when considering the total remuneration package for public sector members in the future.
- Schemes should ensure an adequate level of income in retirement for members who have a full career in the public sector.
- Pension promises already made to staff should be honoured, so these proposals will only apply to future pension accrual.
- Lower and higher earners should have the same pension benefit design, but will be differentiated through tiered contribution rates, with higher earners paying more to fund the cost of providing their pension benefits.
- Members should be able to retire earlier than the Normal Pension Age, and if they decide to do this their pension benefits would be adjusted down to reflect the earlier retirement and longer time spent in retirement.

About Informed Choice

Informed Choice is a leading firm of Chartered Financial Planners, working with individuals, trustees and business owners to help them to build, manage and protect their wealth.

We were named as **IFA of the Year** at the Money Marketing Financial Services Awards 2010 and we are four times winners of the Gold Standard for Independent Financial Advice. We were named **Best Retirement Adviser** at the Moneyfacts Good Advice Awards 2010.



We are a firm of Chartered Financial Planners. This means we have satisfied rigorous criteria relating to professional qualifications and ethical good practice. It means you can be confident that you are dealing with one of the UK's leading firms that is wholly committed to providing you with the best possible advice, service and support.

Informed Choice managing director Martin Bamford is the author of this briefing note. Martin is an experienced Chartered Financial Planner and Certified Financial Planner (CFP) professional. He is the author of several personal finance books, including two that became WHSmith Business Book of the Month.

Martin was named Best IFA Individual at the Unbiased.co.uk Media IFA of the Year Awards 2011.

Our briefing notes provide commentary on key financial planning issues, to enable clients and professional connections to understand the implications. We welcome conversations with individuals and professional advisers on any of the issues raised in this briefing note.

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