Memo to politicians: pensions are different – and trust is vital

Pensions are complex, long-term financial arrangements that rely on pension savers' confidence. The runup to the budget shook that trust.

Has there ever been a greater period of uncertainty for UK pension schemes than the gap of almost four months between the election of the Labour government and its first budget?

With the new government promising to improve public services while seemingly ruling out increases to income tax, VAT and national insurance, taxation of pensions looked like a soft option.

From election day on 4 July until the budget on 30 October, the Treasury allowed that view to spread as the media reported that Chancellor Rachel Reeves was at different times considering:

- Introducing a single rate of tax relief on pension contributions
- Charging national insurance on employers' pension contributions
- Reducing the generosity of tax-free lump sums
- Applying inheritance tax to more pension pots

In the end, only extending inheritance tax made it into the Chancellor's statement. The policy has its complications but isn't too disruptive. The initial response of the pensions industry was to breathe a sigh of relief.

Testing pensions taxation options had real-world results

But the Treasury's apparent testing of options in public had real-world results. With three weeks until budget day, press reports said Reeves was considering cutting the limit for cash-free lump sums from £268,275 to £100,000.

Unsurprisingly, this caused a surge in enquiries from pension savers looking at drawing their lump sums early to avoid an unexpected tax. And some savers exercised this option to withdraw money from the tax-efficient pension wrapper.

Now HMRC has ruled that pension savers shouldn't have been allowed to repay lump-sum withdrawals after the budget clarified their position. This ruling appears at odds with the Financial Conduct Authority's 30-day cooling off period for pension withdrawals.

The Telegraph reports that a saver withdrew £138,000 before the budget and now cannot pay the money back into her pensions. She had thought she could repay the money under the FCA's rules.

Confusion can undermine faith in pensions

As well as affecting individual savers, this is the kind of confusion that undermines faith in pension saving as the best way to provide for our financial future. There are lessons to be learned.

When it comes to pensions, clear communication is vital. If the government lets stories run about changes to taxation of pensions, savers will react.

The government's response to the story about cutting the tax-free allowance was: "We do not comment on speculation around tax changes outside of fiscal events."

But that isn't good enough. Savers will take action based on partial or incorrect information about their pensions if no authoritative voice tells them otherwise.

Clear communication from government is vital

We don't know how the story got into the press. It would have been better if it had never appeared – along with all the other speculation about pensions. But once it was there the government should have made a decision and communicated it quickly and clearly.

Instead, pension savers had time to worry, contact their pension providers and take actions that may not have been in their long-term interests. In fairness to the pensions industry, it is not always easy to take just your tax-free lump sum. Pension providers check with customers that they understand what they are doing and refer them to MoneyHelper for guidance.

But savers withdrew their lump sums anyway. The lesson for all politicians is that pensions are different. They are hugely consequential for people's financial futures, and perception is vitally important. And most people don't really understand how they work.

If the government hadn't ruled out a VAT increase and media reports said a change was coming in the budget, I might have brought forward buying a new kitchen or car. If the VAT rise didn't materialise, I might have been irritated but it wouldn't affect my long-term financial health.

The confusion could have broader consequences as well. As we have said before, moves that makes pensions more complicated or changes the rules can chip away at confidence among savers when we need them to be more engaged.

The runup to the budget suggested that all options were open to Reeves to make changes to pensions. That isn't the way to instil confidence in pensions as the best way to save for retirement.

If, as some experts expect, the Chancellor has to raise more tax sooner rather than later we would urge her to keep her thoughts about pensions within the Treasury – and to comment clearly on any reports that could cause panic among pension savers.

The government wants people to save more for their futures. But if people start to lose trust in their pensions this will undermine that vital goal. We hope the Chancellor builds this thinking into her communication strategy. ?

Image
Dear Rachel Reeves: tread carefully on pensions before your budget



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Insights

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