UKSIF
UK Sustainable Investment and Finance Association

30 September 2015

Pensions Consultation 2015
Pensions and Savings Team
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Dear Sir/Madam,

Thank you for the opportunity to comment on HM Treasury's document on *Strengthening the incentive to save: a consultation on pensions tax relief*. This response outlines the concerns held by UKSIF members regarding a move away from the current system of taxed-exempt-exempt (TEE) and highlights several key considerations for HMT before any such change is introduced.

**About the UK Sustainable Investment and Finance Association**

UKSIF is the membership network for sustainable and responsible financial services in the UK. We promote and support responsible investment and other forms of finance that advance sustainable economic development, enhance quality of life and safeguard the environment. We also seek to ensure that individual and institutional investors can reflect their values in their investments. UKSIF was created in 1991 to bring together the different strands of sustainable and responsible finance nationally and to act as a focus and a voice for the industry. UKSIF's 240+ members and affiliates include financial advisers, institutional and retail fund managers, pension funds, banks, research providers, consultants and NGOs. For more information about UKSIF, please visit www.uksif.org.

We do not intend to offer policy proposals on how pensions should be treated for tax purposes. We do however, seek to emphasise the views of our members that ultimately the aims of this process should be to ensure individuals have adequacy of income in retirement and ensuring a sustainable pensions system in the UK. It is right the Government focuses on incentivising people to save, but any changes to the current tax relief regime should be geared towards encouraging people to save *more* to ensure they have an adequate pension pot to retire on.

1. **To what extent does the complexity of the current system undermine the incentive for individuals to save into a pension?**
2. **Do respondents believe that a simpler system is likely to result in greater engagement with pension saving? If so, how could the system be simplified to strengthen the incentive for individuals to save into a pension?**

We do not agree with the implication that the current system is too complex for savers to understand. There must be some level of complexity and feedback from UKSIF members has been that the current system is less complex than has been argued by the Government. Equally, treating pensions like ISAs, as has been proposed by the Chancellor, may not be as simple as it seems. Fundamentally changing the pensions landscape again will add to the overall complexity of the system and make it more difficult for people to understand. For individuals who do not understand tax relief, changes to it are unlikely to encourage them to start saving; removal of upfront tax relief is *more likely* to undermine incentives to save. Clearly there may be wider issues around financial education that could be addressed here.

A move to a taxed-exempt-exempt (TEE) system, an example given in the consultation document and something that has been widely discussed over recent weeks, is likely to impact individual savers most when they are young and can least afford it, which will undermine the incentive to save. The Hargreaves Lansdown research team found that a significant proportion of investors said they would save less into a pension if the upfront tax reliefs were withdrawn from the pension system. This result is based on a survey of 2,370 investors between 12th to 17th August 2015.

The Government's implicit assumption that individuals are engaged with their pensions is inaccurate for the majority of individuals in workplace schemes. A lack of engagement with pensions is something that was explicitly recognised by the FCA as it developed the rules for independent governance committees[1] and one of the reasons automatic enrolment was introduced. Automatic enrolment has been hugely successful so far and the Department for Work and Pensions estimates that there are currently 10 million workers in the eligible target group.[2] The eligible target group is defined as workers who are aged between 22 and state pension age, earning over £10,000 and previously were either (i) not saving in a pension scheme; or (ii) saving in a pension scheme where the employer contributions were less than 3% of the worker's salary, and was not a defined benefit scheme. Of those, 9 million are estimated to be newly saving or saving more as a result of automatic enrolment by 2018. It will be necessary to wait for small and micro employers to fulfil their automatic enrolment duties, but based on DWP's analysis it is not clear that the complexity of the system or lack of engagement with pensions will undermine this process.

3. **Would an alternative system allow individuals to take greater personal responsibility for saving an adequate amount for retirement, particularly in the context of the shift to defined contribution pensions?**

UKSIF members want to encourage a system which results in greater responsibility for savers and increased saving for the long-term, but there has been some concern that the Government may have lost sight of what a pension is for. A pension is intended to provide retirement income security for the remaining life of the scheme member in contrast to an ISA which is intended to provide wealth. A move to a system without tax on withdrawals removes the inherent hurdle to taking cash, as opposed to an income purchased with cash, suggesting a defocus on the purpose of a pension: adequacy of income in retirement. This makes it far easier for people to make "bad" decisions when they retire. As one member said to us recently, many individuals want the

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[1] FCA Final rules for independent governance committees, https://www.fca.org.uk/static/documents/policy-statements/ps15-03.pdf

[2] DWP Workplace pensions: Update of analysis on Automatic Enrolment, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/460867/workplace-pensions-update-analysis-auto-enrolment.pdf

pensions infrastructure necessary to give them protection over making these “bad” choices. Individuals will have different needs in retirement and it is right they have the flexibility to use their savings as necessary, although the Government should take care it puts in place safeguards to ensure income adequacy remains a priority.

The Government should also review as a matter of urgency whether current contribution rates under automatic enrolment are sufficient for savers to retire on. If contribution rates are too low, they should be increased over several years or there is a significant risk to the sustainability of the overall system from bad outcomes for savers as a result of inadequate income in retirement. This issue could become even more pressing in a system where contributions do not attract tax relief. One of the benefits of the current exempt-exempt-taxed (EET) system is that it encourages individuals to consider whether they will have adequate income throughout their retirement. Individuals in DC schemes are discouraged from taking cash on their retirement unless they are prepared to take a significant hit on their funds. A 2014 OECD report[3] warns of the risks inherent in the new pension freedoms, and makes clear the new flexibilities “could be detrimental to both retirement-income adequacy and incentives to work, due to individuals’ myopic behaviour and insufficient financial literacy”.

The success of auto-enrolment so far and the move away from DB schemes has meant that increasingly individuals in pension schemes carry the risk and responsibilities of saving for retirement. The Government must recognise there is a necessary balance to be struck in the rules between allowing people the flexibility to use their savings as appropriate and ensuring they have sufficient means to live during retirement.

5. **Should the government consider differential treatment for defined benefit and defined contribution pensions? If so, how should each be treated?**

Many DB schemes are now closed and many others are implementing significant deficit reduction plans. It raises questions over how these schemes are dealt with- certainly changes to the pensions tax relief system will be far more difficult in the case of DB. Employers have guaranteed a final pay-out for scheme members, therefore any tax on their contributions would need to be compensated. It is unclear how contributions from employers related to deficit reduction plans would be treated. Many UKSIF members have called for DB schemes to be excluded from any reform of the system. Clearly this would mean a move to TEE could result in a two tier system of pensions between DB and DC. This would also very likely impact on confidence in automatic enrolment, just as 9 million people are entering DC schemes until 2018: removing tax relief from contributions would also likely increase the opt-out rate.

The shift to DC has highlighted the importance of employer contributions which are hugely significant in allowing people to have enough to retire on. For both DB and DC schemes, however, there would be significant transitional impacts. Switching from EET to TEE would result in significant costs to payroll systems and increase schemes’ administrative load. An NAPF

[3] OECD Pensions Outlook 2014, http://www.oecd-ilibrary.org/finance-and-investment/oecd-pensions-outlook-2014_9789264222687-en

survey of its members estimated that the median cost to a large employer of making changes to payroll, administrative and member communications would be £50,000. If extended to the all 6,595 large employers (250 or more employees) this amounts to almost £330,000,000.[4]

It remains unclear how the tax changes would be implemented. Presumably they would not be retrospective and would only apply to future payments, or the result would be millions of scheme members switching from EET to TEE and therefore facing no tax at all.

In March over 5.2 million people had been automatically enrolled into a DC pension scheme.[5] A change now to TEE would mean everyone currently enrolled in a pension scheme, including those new savers, would now be required to have a new pension. The result would be two accounts with each provider and two payments on retirement: one taxed and one not. Clearly the administrative burdens, the costs and the time necessary for such a change need to be fully examined by the Government and we would welcome analysis of the effect of any proposed changes. If the purpose of changes to the tax relief is to create a more understandable and less complex system, creating one with two parallel tax regimes may not be the way to do it.

8. **How can the government make sure that any reform of pensions tax relief is sustainable for the future?**

As we have stated, the sustainability of the UK pensions system should be at the forefront of any decision on whether to implement changes. The UK has endured various reforms to the pensions system over the past few years, the most recent being the major shake-up announced at the 2014 budget which introduced the new pension freedoms. It is our view that these changes need time to bed in; millions[6] of small and micro businesses are still in the process of auto enrolling their employees into a pension, the majority of which do not have the same resources, capacity or expertise as many large corporates that have already fulfilled their auto-enrolment responsibilities. Making additional changes to the system now may add a further layer of complexity and cost which must be considered and mitigated by the Government before they are introduced.

Given these issues, we believe strongly that if the Government does make changes to pensions tax relief it is essential that it secures cross party agreement on the changes. Clearly no Government can bind its successor, but securing a political consensus that would limit major changes to pensions, including on tax issues, for a generation would be welcomed by UKSIF members. This would help to bring much needed stability to the system and allow the many reforms that have been made over recent years to properly bed in.

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[4] NAPF, Pension taxation myth buster, http://www.napf.co.uk/PressCentre/Press_releases/0482-Pension-taxation-myth-buster-from-NAPF.aspx
[5] TPR Automatic Enrolment Commentary and Analysis, http://www.thepensionsregulator.gov.uk/docs/automatic-enrolment-commentary-analysis-2015.pdf
House of Commons Library briefing note,
[6] www.parliament.uk/briefing-papers/sn06152.pdf

There is also political risk inherent in changing the tax approach to pensions. Savers have no guarantee that they will not be taxed again through future changes. The NAPF have questioned whether, in any move towards a TEE system, it is feasible for savers to trust future governments not to tax retirement income regardless of the wider fiscal picture. The Office for National Statistics (ONS) forecast that as a proportion of the population there will be 50% more people aged over 65 in 2065 compared to today. The Office for Budgetary Responsibility (OBR) indicates the strain on public services begins to rise at 65, increases at around 75 and rises even further at 85. The combination of these two factors and a move to TEE would result in further strain on public finances while simultaneously reducing the tax contribution of pensioners in the future, potentially risking a move to TET.[7]

The Government should not assume that workplace pension schemes will continue to contribute above the statutory minimum regardless of changes to the system. This is not necessarily the case. The 2014 NAPF annual survey showed that continued changes to the system would force many schemes to review their pension provision. If only those schemes that responded to the survey were to reduce their contributions to the statutory minimum the loss to pension savings would be £2.3 billion per year, or over £11 billion in one parliamentary term. The political risk of further changes to the pensions system will have a significant impact in undermining incentives to save.

We trust that our comments are self-explanatory, but if you would like any further clarification, I hope that you will not hesitate to contact us.

Yours sincerely,

**Simon Howard**

Chief Executive

UK Sustainable Investment and Finance Association (UKSIF)

[7] NAPF, Pension taxation myth buster, http://www.napf.co.uk/PressCentre/Press_releases/0482-Pension-taxation-myth-buster-from-NAPF.aspx