Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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

30 September 2015

Dear Sir, Madam,

Financial Services Consumer Panel response to the consultation on pensions tax relief

This is the response of the Financial Services Consumer Panel to the HM Treasury consultation on pension tax relief.

The Panel understands the government aims to ensure consumers are incentivised to take responsibility for their pension saving, making use of a simple and transparent system of government support that is financially sustainable.

There is no doubt that consumers find pensions complex and confusing, but the Panel is not aware of any evidence that the complexity of tax relief on pension contributions is a barrier to saving into a pension. Equally, we do not know of any evidence that tax relief encourages pensions saving. Indeed, what research there is consistently indicates a low level of consumer awareness of tax relief.

The Department for Work and Pensions (DWP) sought to remedy this in its recent campaign on auto-enrolment, which emphasised the benefits of tax relief, and promised that, if individuals paid into their pension, their employer and the government would also pay in. The government now appears to be considering reneging on this tax promise, even before all employees have been auto-enrolled.

The Consumer Panel does not have a position on the desirability of one approach to tax relief over another. However, we do think the government should carry out a robust analysis of the impact on consumers of changing the current system, including a consideration of the transitional arrangements and the resulting complexities for those who may simultaneously hold pots under both the current and new system.

Inadequate saving for retirement by UK consumers is a real concern, but tax relief is not the only issue. There are many factors that contribute to the reluctance to save in a pension. The industry does not help. Consumers are confused by the extensive use of jargon and legalese in terms and conditions (which are themselves often variable); opaque charging structures and hidden costs; products with different names that do the same thing; and overly complex fund choices.

The lack of information about future returns is also a factor. It is not clear how consumers can be expected to take responsibility for their own saving when they have

little or no information about what they might get back. This does not just apply to occupational or personal pensions. The government has not even told those reaching state pension age in 2016 how much they will receive, although it is becoming clear that the simple flat rate of around £150 per week originally envisaged is unlikely to be a reality for many, possibly most, consumers. Add to this the constantly changing policy landscape, and it is not surprising that consumers have no confidence that the system will deliver their retirement aspirations. This is a real deterrent to saving.

Yours sincerely,

Sue Lewis
Chair
Financial Services Consumer Panel

Consultation Questions

Question 1: To what extent does the complexity of the current system undermine the incentive for individuals to save into a pension?

The fact that consumers may not understand exactly how tax relief works is not the reason they find pensions complex. Rather, there is plenty of evidence that the main problems lie with the pensions industry: the complexity of the products on offer, opaque charging structures, and the lack of comprehensible information about what consumers can expect to get for their investment.

The consultation refers to these wider complexity issues, citing in particular the Office of Fair Trading's (OFT) market study into defined contribution workplace pensions. The Panel agrees with the OFT, and we have included its findings in our own research on investment costs and charges.[1] The Panel's conclusions[2] emphasised findings of previous studies, that fund managers too frequently exercise poor control of costs, which are not necessarily visible to investors and which managers can deduct directly from the value of funds, rather than treat as a business cost that they meet out of their own pockets.

In November 2013 DWP produced some illustrative calculations to accompany the Pensions Bill, which showed that a 1% annual charge over a working lifetime reduces the value of a pension pot at retirement by around a quarter.[3] Excessive charges can hence have a severe impact on retirement income.

The Panel believes the government needs to do two things. The first is to reform the asset management industry, to eliminate conflicts of interest, and ensure competition works in the interests of consumers. This may be thought beyond the scope of this exercise, but, as a minimum, the Panel believes that bringing greater clarity to the costs and charges of saving into a pension would make it easier for people to plan for their retirement, and alleviate the deep-seated distrust of the asset management industry that has persisted over the years.[4]

Question 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?

The consultation does not define a 'simpler system', meaning that the exact alternative to the current system of tax relief is unclear, although the government appears to have in mind a shift to Taxed-Exempt-Exempt (TEE).Assuming this to be the case, we have a few observations:

- Moving to TEE could cause significant detriment for consumers actively saving into a Defined Benefit (DB) scheme. If a decision was made to exclude DB schemes from these changes, this would further widen the gap between the best off and worst off in retirement;

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[1] https://fs-cp.org.uk/sites/default/files/investment_discussion_paper_investment_cost_and_charges.pdf
[2] https://fs-cp.org.uk/sites/default/files/investment_report_executive_summary_for_the_fscp.pdf
[3] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/269318/pensions-bill-2013-information-pack.pdf#page=45
[4] The asset management industry consistently ranks lowest among all consumer markets for 'trust' in the European Commission's Consumer Market Scoreboard (http://ec.europa.eu/consumers/consumer_evidence/consumer_scoreboards/index_en.htm).

- A change to TEE would effectively entail the abolition of "pension" providers as they currently exist, instead shifting to more generic portfolio management services (which often operate with the same cost opacity as the pensions industry). This would also lead to a massive increase in funds under management for stocks and shares ISAs;
- There may be long-term fiscal implications for taxpayers, especially once receipts from affluent pensioners of the future dry up;
- To ensure the most efficient use of the power of time to build assets, the Panel would urge the government to build on the learning acquired from the Saving Gateway pilots[5], in particular, by considering the use of matched contributions from government.

However, it is impossible to say what would be likely to result in greater engagement and better outcomes for consumers without thorough scenario modelling. This should include lessons learned from countries that have other variations (notably TEE), and transitional issues. It should include detailed analysis of winners and losers, including the impact on consumers having concurrent pots. Particular consideration should be given to how tax incentives (for both employers and employees), employer contributions and costs and charges affect pension pot sizes at retirement. The distributional effects are also important, for example, the effect of moving to TEE might be smaller pension pots for those who have lower incomes during their working lives, while at the same time increasing the take-home income in retirement of those who are able to build up larger pension pots.

The government could also consider simplification of the current system. If the overall aim is to reduce the cost of pension tax relief then this could be achieved with a single rate of relief applied to all pension payments equal to the basic rate of tax. Removing all but basic rate tax relief would save money in the short term, whilst not reducing the pension pots of those on lower incomes.

The government might also look at matched funding rather than tax relief. The advantages of matched funding as a saving incentive are well evidenced, notably in the evaluation of the Saving Gateway pilots[6]. Matched contributions could be made every few years, to encourage people to keep their money invested.

Question 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?

People already take a great deal of personal responsibility with their financial decisions, but they are constantly hindered in engaging more actively by the complexity and opacity of the pensions industry.

Although it is impossible to tell how consumers would react to a different system (whether simpler or not) without extensive consumer research, it is unclear how the abolition of pensions tax relief would make any meaningful contribution to ensuring individuals save more for their retirement.

However, there are initiatives the Panel believes the government could support to enable people to plan better for their retirement, independent of tax incentives.

[5] http://www.bristol.ac.uk/geography/research/pfrc/themes/psa/saving-gateway.html and http://www.ifs.org.uk/publications/3981

[6] Ibid

Simplifying pension statement

First, providers should ensure that their customers can easily understand their pension statements. The Panel would like the FCA to standardise common language for use by pension providers as quickly as possible. Given the recent pension reforms and the emergence of new drawdown and uncrystallised pension fund lump sum (UPFLS) products, this should happen before the market and firms become entrenched in using language that will only serve to alienate consumers.

Creating a Pensions Dashboard

Second, we believe the government should support the development of a "Pensions Dashboard". People need to be able to see how much they can expect to receive from their pension contributions in order to judge whether they are saving adequately or not. The dashboard would allow individuals to see their total pension entitlement from different sources (for example workplace pension scheme, any personal pension and their state pension). A similar system, set up by statute but operated and funded by providers, is already in place in the Netherlands[7], Belgium[8] and Sweden[9]. DWP, supported by the FCA, Pensions Regulator and industry, could take a leading role in the creation of such a dashboard.

Extending auto-enrolment

Third, the government could consider widening the eligibility criteria for automatic enrolment. If people are auto-enrolled into a pension, the effectiveness of saving incentives matters less, at least in regard to the decision to save in the first place.

Research recently undertaken by the Pension Policy Institute in conjunction with Age UK estimated that 5.2 million of those currently employed and 50% in total of the working age population are not eligible for auto-enrolment[10].

The position of the self-employed is particularly precarious. They are not eligible for auto-enrolment, and only a fifth contributes to a personal pension. Moreover, their numbers are growing: in 2014, there were 4.5 million self-employed people in the UK (a proportion of the total workforce higher than at any point over past 40 years), and the rise in total employment since 2008 has predominantly been among the self-employed.[11]

Access to auto-enrolment pension schemes could make a significant contribution to their financial wellbeing in retirement.

Question 4: Would an alternative system allow individuals to plan better for how they use their savings in retirement?

As we said in response to question 3, the main need is for a Pensions Dashboard that aggregates pot size forecasts from all sources, and also shows expected state pension entitlement.

It could be argued the current system encourages individuals to think about how they access and use their savings: the tax implications of withdrawing a lump sum should give 'pause for thought', this would not apply if all withdrawals were tax free.

[7] https://www.mijnpensioenoverzicht.nl/pensioenregister/
[8] http://www.onprvp.fgov.be/nl/about/paginas/mypension.aspx
[9] https://www.tyoelake.fi/en/uutiset/2014/Pages/Pensions-from-Sweden-in-Orange-Envelope.aspx
[10] http://www.ageuk.org.uk/Documents/EN-GB/For-professionals/Policy/partners/Underpensioned_BN_020915.pdf?dtrk=true
[11] http://www.ons.gov.uk/ons/dcp171776_374941.pdf

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

The government recognises that it will have to consider carefully any macro-economic implications of reform. This is especially so with any change to the manner in which Defined Benefit (DB) pension schemes are funded, particularly unfunded public sector schemes.

For schemes in deficit (which most DB schemes are), the removal of tax relief for employer contributions could have a disastrous effect. The Panel urges the government to determine the effect that any change to the tax relief system will have on DB schemes in both the private and the public sector.

Question 6: What administrative barriers exist to reforming the system of pensions tax, particularly in the context of automatic enrolment? How could these best be overcome?

As we have already set out, it may be possible for consumers to have concurrent pots under the current system and the new 'simpler' system. This, together with the increasing numbers investing in to a workplace pension through auto enrolment means the potential administrative impact of running concurrent systems for investment firms and employers could be substantial.

Question 7: How should employer pension contributions be treated under any reform of pensions tax relief?

The Panel believes that removal of tax relief from employers' pension contributions could have severe detrimental effect in the long term. Employers will have no incentive to pay anything above the minimum required by law and indeed may not be able to afford to do so.

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

Sustainability can only be established by undertaking substantial modelling and analysis.