Pointmaker

A PENSIONS AND SAVINGS MANIFESTO

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SUMMARY

- **Given the UK's dependence on imported capital, and the prospect of rising competition for capital, particularly from other (developed) nations with ageing populations, we need to catalyse a broad-based savings culture. In other words, we need more people saving more.**
- **The aim should be to increase the nation's household savings ratio from 3.3% (Q4 2016) to, say, the 1980's average of 11%.**
- **The principles for the reforms are:**
  - **Improving the effectiveness of HM Treasury support for pensions and savings: the direct cost to the Treasury was £46.1 billion a year in 2015-16, with billions more lost to HMT through other mechanisms such as salary sacrifice schemes.**
  - **Simplicity: the current pension and savings framework is hideously complicated with few individuals able to understand the complexities of the system.**
  - **Social fairness: currently the well-off receive the greatest incentive to save.**
  - **Inter-generational fairness: the current system exacerbates the generational divide in the UK.**

The proposals detailed in this paper would achieve these aims by:

1. Restructuring the incentives to save.
2. Raising the private pension age to 60.
3. Enhancing the Lifetime ISA.
4. Introducing a Workplace ISA to reinforce automatic enrolment.
5. Introducing auto-protection.
6. Liberating the National Employment Savings Trust.
7. Seeding a Sovereign Wealth Fund with LGPS assets.
8. Implementing other proposals such as merging Income Tax and NICs.

1. RESTRUCTURE THE INCENTIVES TO SAVE[1]

- **Scrap Income Tax relief on pension contributions** (2015-16 cash cost to HM Treasury: £30.4 billion).

- **Scrap NICs rebates on employer contributions** (2015-16 cash cost to HMT: £15.7 billion).

- **Introduce a single 25% bonus on post-tax contributions** made to pension pots by individuals and employers, paid irrespective of tax-paying status. Alternatively, provide a **50% bonus on the first £2,000** of post-tax contributions, and **25% up to an annual bonus cap.**

- **Cap the total annual bonus at £2,500** by reducing the annual allowance from £40,000 to £10,000 (or £8,000 for the alternative structure). Unused bonus allowances should be allowed to be carried forward for up to ten years (i.e. "rolled up").

- Scrap today's £1 million Lifetime Allowance.

Observations

- Scrapping tax relief would address a fundamental conundrum: because Income Tax is progressively structured, tax relief is regressive. Consequently, it mostly goes to the wealthy, who save anyway: tax relief is an ineffective use of scarce Treasury resource.

- The word "bonus" would be a much-needed improvement to the language of incentives. Given that "tax relief" is not understood by half of all adults, it is no surprise that many people are unmoved by it. Replacing "tax relief" with "bonus" would represent a simplification of the savings arena: gone would be ludicrous complexities such as the high earners' annual allowance taper.[2]

- NICs rebates on employer contributions directly benefit company shareholders: invisible to employees, they are an ineffective incentive to save. It would be better to redeploy them as bonuses paid on employer contributions, paid directly into personal accounts, where they would be visible….and therefore more engaging. In addition, scrapping NICs rebates would put an end to salary sacrifice schemes, a tax arbitrage at the Treasury's expense (costing roughly £2 billion per year). Furthermore, such schemes are unfair because they are only available to those with an employer-sponsor (not, for example, the self-employed).

- Reducing the annual allowance to £10,000 (or £8,000) would impact only a tiny minority of the population (a few percent). Only the very highly paid are in a position to save more than this in a single year (and they do not need to be incentivised to do so).

- Ending the Lifetime Allowance would be a much-welcomed simplification of today's complex pensions framework, at a relatively small cost to the Treasury.[3]

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[1] Further discussed in *Retirement saving incentives: the end of tax relief and a new beginning* (CPS, 2014); *Time for TEE: the unification of pensions and ISAs* (CPS, 2015); *What of DB, in a TEE World?* (CPS, 2016); and *An ISA-centric framework beckons* (CPS, 2016).

[2] However, the impenetrable jargon associated with pension pot decumulation, such as Uncrystallised Fund Pension Lump Sum, would remain.

[3] For example, cutting the Lifetime Allowance from £1.25 million to £1 million (from 2016-17) is forecast to save £245 million in 2016-17, rising to £570 million in 2020-21; HM Treasury, *Budget 2016.*

- The alternative incentive structure of a 50% bonus on the first £2,000, and 25% on the next £6,000, would be significantly redistributive. It would also be politically attractive because, on the first £2,000 saved, it would double the rate of savings incentive for basic rate taxpayers (84% of working adults).

- These proposals would put an end to today's bipolar (EET / TEE) savings arena, a huge simplification.[4] They should also leave the Treasury with scope to realise a net saving of at least £10 billion per year (perhaps for deficit reduction).

2. THE PRIVATE PENSION AGE: SHOULD BE 60, ASAP

- Today's private pension age of 55 (scheduled to rise to 57 in 2028) should be rapidly raised to 60 by 2022, i.e. by a year every year, commencing later this year. In addition, DWP should consider preparing people for a private pension age of 65 by 2032, say, i.e. a one year increase every two years from 2022.

Observations

- Today's private pension age of 55 is an anachronism, out of step with post-war improvements in life expectancy. Access to pension pots at 55 encourages people to leave the workforce early (potentially leaving them short of savings later in life), at a time when we need to encourage working for longer.

- A private pension age of 60 would be consistent with the commencement of penalty-free access to Lifetime ISA savings.

3. ENHANCE THE LIFETIME ISA[5]

- A Lifetime ISA should be automatically established when a baby's name is registered, with a provider nominated by the parents. There should be no access to savings until 18. A kick-start £500, say, could be included (perhaps only offered to low-earning parents), resuscitating the Child Trust Fund (CTF) concept, albeit within the Lifetime ISA. Existing CTFs could be assimilated into the Lifetime ISA.

- The upper age limit of 39 for opening a Lifetime ISA should be raised to 49 (i.e. "under 50").

- The Lifetime ISA's 6.25% "surcharge" on non-property-related withdrawals made before 60 should be eliminated, by reducing the penalty charge from 25% to 20%.

- The Lifetime ISA's annual contributions limit (£4,000) should be raised to the proposed annual allowance (£8,000 or £10,000), with the same bonus structure as pension pots.

Observations

- The Lifetime ISA was so named because the original proposal was for a single savings vehicle to serve from cradle to grave.[6] The idea was to encourage saving early, and to harness the positive power of compounding over many years. The purpose of the "18 to under 40" age range that actually materialised for opening a Lifetime ISA is

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4 Retirement savings products are codified chronologically for tax purposes. Pensions are "EET", i.e. Exempt (contributions attract tax relief), Exempt (income and capital gains are untaxed, bar 10p on dividends), and Taxed (capital withdrawals are taxed at the saver's marginal rate). Conversely, ISAs are "TEE", except for the Lifetime ISA, which is effectively EEE for basic rate taxpayers.

5 See *The Lifetime ISA: potential next steps* (CPS, 2016) and *Introducing the Lifetime ISA* (CPS, 2014).

6 See *Introducing the Lifetime ISA* (CPS, 2014).

unclear. Extending "under 40" to "under 50" would not significantly compromise any intention to retain a term commitment to saving in return for an up-front incentive. That said, pension pot contributions are already accessible days after the receipt of tax relief (i.e. either side of the 55th birthday).[7]

- Most people do not appreciate that the 25% penalty on non-property-related, pre-60 withdrawals from the Lifetime ISA is not the same as the 25% bonus: it includes a 6.25% "surcharge".[8] Its purpose is unclear: what behavioural change is it seeking to achieve? As a deterrent to pre-60 withdrawals, say, it palls into insignificance when compared to annualised pay-day loan rates, so why bother with it? Reducing the 25% penalty to 20% would eliminate it and establish economic symmetry vis-à-vis the bonus.[9]

4. A WORKPLACE ISA TO REINFORCE AUTOMATIC ENROLMENT (AE)[10]

4.1 Workplace pensions: flawed perspective

- Today, workplace pension schemes are set up from the wrong perspective, with the employer/provider relationship pre-eminent. Employers choose their providers, and they then select which funds to offer; this is more likely to reflect employers' preference for low risk, not necessarily what is best for the employees.

- A recent survey of auto-enrolled scheme members found that an extraordinary 39% of those surveyed were unaware that they were a member of a workplace pension scheme.[11] It also found that 95% had never tried to change their fund, 91% did not know where their funds were invested, 80% did not know how much was in their pension pot and 34% did not know who their pension provider was.

- Engagement is clearly lacking, partly because being a member of a remote, nebulous occupational pension scheme does not engender a sense of personal ownership. Few scheme members have, for example, identified a beneficiary after they die. In addition, employer-sponsored pensions schemes are impractical: they are not, for example, readily portable when an employee moves jobs…..hence the need for the pensions dashboard.

- Meanwhile, automatic enrolment's statutory minimum employee contributions are set to quintuple by April 2019 (from 0.8% to 4%), potentially against a backdrop of rising mortgage rates. This, potentially combined with ongoing stagnant earnings growth, would squeeze disposable incomes. In addition, an increasing number of small and micro employers are reaching their staging dates, many without HR Departments to dissuade employees from opting out. If opt-out rates are to be kept low, engagement must be improved.

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7 While pension pot withdrawals are taxable, half of all pensioners pay no Income Tax.

8 A post-tax £100 LISA contribution would attract a £25 bonus. If a 20% penalty were applied to the total £125, then the saver would receive a net £100, ending up "square". As it is, he will have to repay 25% of £125, leaving him with £93.75, i.e. bearing a £6.25 "loss", or surcharge.

9 Bar HM Treasury's economic interest in a LISA's interim asset performance. If assets rise, the 20% penalty would be larger in cash terms than the original 25% bonus, and vice-versa.

10 Detailed in *The Workplace ISA: reinforcing auto-enrolment* (CPS, 2016) and *The Workplace ISA and the ISA Pension* (CPS, 2015).

11 Survey size: 938 auto-enrolled scheme members (Decision Technology, 2017).

4.2 Proposals

- Employees should be allowed to choose where auto-enrolled contributions are paid into, between:

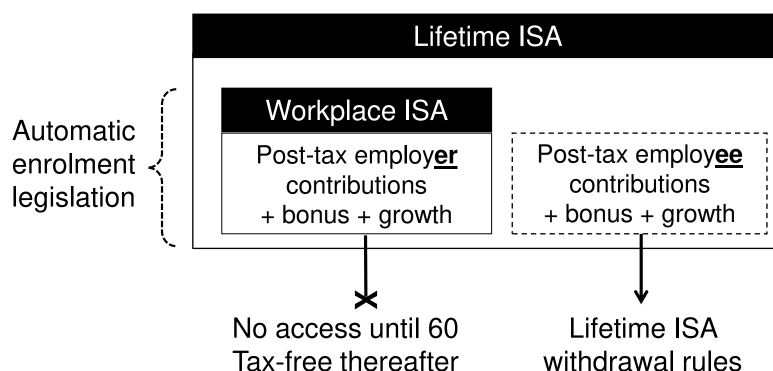
  (i) in respect of employee contributions, the employer's occupational scheme and a personal Lifetime ISA; and

  (ii) in respect of employer contributions, the employer's occupational scheme and a Workplace ISA.

- All contributions (made post-tax) should be eligible for bonuses up to the annual allowance, which would be shared between employee and employer contributions.
- Employee contributions (and bonuses) made from 50 would be directed to the Workplace ISA (no contributions can be made to a Lifetime ISA from age 50).
- Workplace ISA contributions and allied bonuses would be locked up until the age of 60 (say) and, thereafter, withdrawals should be tax-free.
- Workplace ISA assets should enjoy the same Inheritance Tax treatment as today's pension pots, and should be excluded for means testing purposes, as per today's pension assets.
- The Lifetime and Workplace ISAs would fall within auto-enrolment's legislative embrace.

4.3 Observations

- Automatic enrolment is currently being reviewed, and the Advisory Group's Terms of Reference requests advice on strengthening the engagement of individuals with workplace pensions. It also refers to providing a stronger sense of long-term personal ownership. These objectives resonate strongly with these proposals. Including the Lifetime ISA within AE would give employees improved access to their own contributions (relative to pension pots), as well as a stronger sense of personal ownership of them. Being in control is closely allied to being motived, and therefore engaged. This should help keep opt-out rates low (and perhaps encourage larger contributions).
- Introducing the Workplace ISA would assuage criticism that the Lifetime ISA will encourage employees to opt out of AE, and therefore miss out on their employer contributions. This message requires some untangling, for it is rare indeed for a savings vehicle to be described as "too attractive". The industry's angst is, of course, self-serving, and disregards the fact that many within Generation Y are already prioritising saving for a home over a pension pot. Some within the pensions industry would appear to forget that this is the age of the customer.

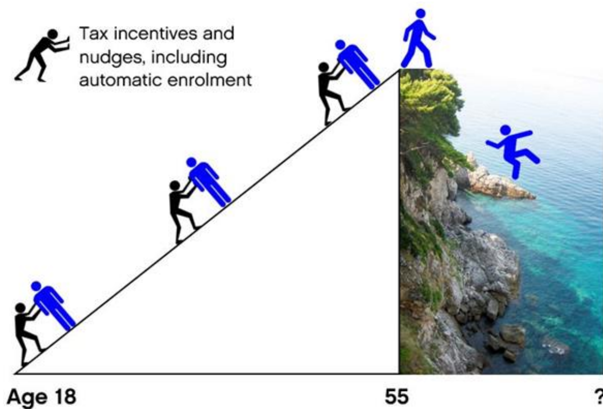


- Workplace ISA contributions and bonuses could be invested in a low-cost, diversified default fund, with an "opt-out" for employees wanting to direct their own investments.

- There is no reason why people should require multiple savings vehicles: simplicity demands a single vehicle, accommodating workplace and all other savings. The Workplace ISA could be housed within the Lifetime ISA (which would also bring employer contributions closer to the individual).

5. INTRODUCE AUTO-PROTECTION[12]

From the age of 55, you are on your own



- Auto-protection should be introduced, with two distinct components:

  (i) "auto-drawdown" at private pension age, in the form of an annual income drawdown default of between 4% and 6% of pot assets, paid monthly; and

  (ii) "auto-annuitisation" of residual pots, perhaps twenty years after private pension age.

Observations

- The introduction of auto-protection would address a major policy inconsistency, whereby the state nudges and incentivises people to accumulate retirement savings, only to desert them at private pension age. Many individuals risk wallowing in indecision when pondering the complexities of decumulation. Meanwhile, they are exposed to downside financial risks in later life, notably premature exhaustion of savings.

- Auto-protection would substantially reduce these risks (also helping to protect the state). "Auto-annuitisation", in particular, would facilitate the collective hedging of individuals' exposure to the unquantifiable risks of longevity (including later-life exposure to investment market risks and cost of living inflation).

- People would be free to opt out of one or both phases of auto-protection to pursue alternatives, consistent with 2015's pension liberalisations. There is no desire to prevent people from doing what they want with their own savings.

6. LIBERATE THE NATIONAL EMPLOYMENT SAVINGS TRUST (NEST)

- NEST should be encouraged to continue developing decumulation options, including a collective drawdown capability to enable retirees to pool their longevity risk.

- NEST, as a potential provider for the self-employed, should be mandated to produce proposals for how to bring a form of auto-enrolment to them.

[12] See *Auto-Protection* (CPS 2017).

Observations

- The Government's recent response to its Call for Evidence paper NEST: Evolving for the future (July 2016) is that it does not propose that NEST should begin to offer additional decumulation options at this time.13 This is based upon reassurances received from the industry regarding its intention to innovate. There is little evidence to suggest that material developments will be forthcoming anytime soon. Meanwhile, NEST has already put considerable thought into products aimed at mass market decumulation. It should be allowed to continue, including operating pilot schemes: this would help spur much-needed innovation, and competition, in the decumulation arena.[14]

7. SEED A SOVEREIGN WEALTH FUND WITH LGPS ASSETS[15]

- The Government should de-fund the Local Government Pension Scheme (LGPS) and use the assets to seed a sovereign wealth fund, with a significant allocation to infrastructure. As a *quid pro quo,* a Crown guarantee could be provided on the pension promises, which would be met subsequently on a pay-as-you-go basis.

Observations

- Active fund management of the LGPS's assets has been an expensive folly. Assets have under-performed the major UK and global equity and bond indices and scheme members' and taxpayers' contributions continue to be innocuously eroded by unnecessary, high and recurring fees and costs.
- Notwithstanding the advent of asset pooling, the 89 funds and their operational overhead remain, primarily a legacy of history. Consequently, the structure of the LGPS is becoming ever more labyrinthine, an ineffective and inefficient bureaucracy riddled with costly functional replication. Administering authorities' claims that their fund's local identity is important is self-serving nonsense, and meaningless to the membership.
- Seeding an infrastructure-focused sovereign wealth fund with the LGPS's assets would socialise the benefit of the assets across the whole of society: we all use airports, railways, roads and utilities.
- A recent FCA report into the asset management industry reinforces the rationale for this proposal.[16] It is refreshingly direct, providing a robust, independent and damning condemnation of fund management.

8. OTHER PROPOSALS

- Prepare the ground for raising auto-enrolment's minimum statutory contribution rates. Today's destination of 8% of band earnings is universally acknowledged as insufficient: we should aim for 16%. Restructuring the saving incentive would help achieve this. If a 50% bonus were available on the first £2,000 of all contributions, and employees and employers each increased their contributions by 2%, then today's 4% (employee) + 3% (employer) + 1% (tax relief) structure would become 6% + 4% + 5.5% (bonus), for a total of 16.5%.

[13] *NEST: Evolving for the Future; Government Response*, page 23; DWP, 2 March 2017.

[14] See *Auto-protection* (CPS, 2017).

[15] *The LGPS: a lost decade* (CPS, 2017).

[16] Market Study MS15/2.2; *Asset Management Market Study, Interim Report*; FCA, November 2016.

- For retirees who want certainty of income in retirement until the day they die, annuities have no competition. In five years' time the annuities market could be growing rapidly, perhaps in a rising interest rate environment. The industry should establish a not-for-profit national annuities auction house to automate the process of shopping around, adding to pricing tension and transparency.[17] All aspiring annuity providers would be required to participate: this would be akin to making the exercise of the Open Market Option mandatory for aspiring annuitants. Initially, only a limited number of standardised single- and joint-life, inflation-protected lifetime and deferred annuity contracts would be listed. Pre-auction aggregation of small pots by the auction house would encourage stronger bids.

- Simplify the regulatory framework.[18] Concentrate all DC schemes within the Financial Conduct Authority's domain, including group personal pensions (currently regulated by the Pensions Regulator, TPR), and fold the Pension Protection Fund (PPF) into TPR. The FCA and TPR could then be left to focus on two distinct communities: the contractual DC savings framework and voluntary DB arrangements (i.e. provision of pensions by employers). These require the monitoring of quite different risks (DC and DB), requiring different forms of communication.

- Signal the end of the State Pension's triple lock indexation (the maximum of earnings, prices and 2.5%), sometime during the next Parliament, perhaps to be replaced by CPI. (With inflation rising, the fixed 2.5% is of diminishing value; annual CPI was 2.3% to March 2017).

- End the 25% tax-free lump sum. This encourages some people to stop working earlier than otherwise, it is costly (the annual opportunity cost to the Treasury is over £5 billion) and, without it, annuities would be up to 33% larger.

- Develop the pensions dashboard to provide utility, not just a static data display.[19] The pensions dashboard could become the ultimate disruptor of incumbent industry providers, but merely providing information will not embed it into the consciousness of the general public. Utility is crucial, particularly the ability to consolidate disparate pension pots with a single provider. All industry participants should be compelled to submit data to ensure that the dashboard is fully functioning.

- Assimilate all ISAs into an ISA warehouse, a universal, all-purpose savings vehicle to serve from cradle to grave.[20]

- Combine Income Tax and National Insurance into a single Earnings Tax.[21] While not directly related to the savings framework, a dramatic simplification of the tax regime would help prepare the ground for fundamental reform of saving incentives.

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17 See *A market-orientated solution to the problem with annuities* (CPS, 2012).

18 See *Pensions regulation: governance to the fore?* (CPS, 2014).

19 See *The pensions dashboard: vital for UK plc* (CPS, 2016).

20 See *An ISA-Centric Savings World* (CPS, 2015).

21 See *NICs: the end should be nigh* (CPS, 2014).

THE AUTHOR

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