Response to HM Treasury Consultation Paper Strengthening the incentive to save

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1 INTRODUCTION

1.1 Altus Consulting advises a wide range of financial services providers including insurers, retail banks and investment platforms, all of whom offer retirement savings and income products to their customers. The outcome of HM Treasury's consultation on incentivising pension savings and the future of tax relief could have broad-reaching implications for our clients' operations and business models.

1.2 Altus welcomes the opportunity to respond to this consultation. This response represents our own views and does not attempt to represent those of our provider clients.

1.3 Our focus is on improving the operational efficiency of the financial services industry. Consequently our response aims to explore drawbacks with the current system and the pros and cons of alternative models.

2 CONSULTATION RESPONSE

2.1 Summary

- Pensions are not well understood by consumers. Language introduced by successive legislation only serves to worsen this situation.
- Consumers and the industry both desire stability. The continual and rapid rate of change we have seen in the last decade is unsustainable for the industry and serves to confuse the customer.
- Tax relief is not well understood and not very effective in incentivising pension saving for the majority. If it is to be removed, it should be done decisively in one go rather than in a "death by 1000 cuts".
- The success of automatic enrolment demonstrates that "nudge" and inertia-based policies are more effective than tax relief in increasing savings.
- Altus advocates the introducing an independent policy body to drive pension policy, to take short-term politics away from savings product with a 50 year planning horizon.

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

Every major change to pension rules introduces opaque new terminology. From Contracting Out to Crystallisation, and Eligible Jobholder to UFPLS, successive governments and the pension industry at large seem unable to de-mystify the subject for the general public. Such terminology breeds distrust, confusion and, ultimately, turns customers away towards simpler savings vehicles that they do understand. This is demonstrated time and again in consumer surveys, and in the success of ISAs, a far simpler and less restrictive product that has changed little over time. Many consumers clearly prefer bricks and mortar investments to pensions – they have been shown to generate similar returns over time to pensions, and people can relate to housing in a way they never can with something as "virtual" as a pension plan.

The mystique around fees and charges by providers and asset managers is almost as troublesome as the terminology and complexity of pension products. AMCs, AMDs, dealing fees, clean and super-clean funds, platform charges etc. all confuse the average consumer. Unlike the mortgage and loans business, there is no clear single measure across the pensions industry that can be meaningfully used to compare any two pension plans. Again this leads to mistrust and disengagement.

A third key issue is the lack of portability, perceived or real, of some types of pension plan. Many schemes will not release pension transfers without full advice, and pension transfers are still taking much longer than they really ought to in today's world of straight-through-processing and electronic messaging. Pension transfers compare very poorly to a change of bank account (within 7 days), faster BACS payments (less than 2 hours) and Stocks and Shares ISA Transfers over TeX (in some cases as little as 2 minutes).

2.3 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?

We believe any new system needs the following to increase consumer engagement:

- A simple product structure, explained in everyday language.
- It is easy to join, ideally automatically. Auto-enrolment is increasing engagement in pensions, as the low opt-out rates testify. This policy is succeeding where previously, the policy of tax relief alone had seen scheme membership seriously declining over time.
- It is trusted and well regulated.
- It is accessible and relevant to the consumer – given the long-term nature of pension saving, the ability to access at least some of the funds early (or borrow against them) encourages more saving. The recent pension freedoms have driven an uplift in savings.
- It is open and transparent, i.e. it is easy for consumers to see what membership costs and what their pot is worth.
- It is portable – employees can take it with them to their next employer.
- The risk and responsibility are shared between employer, state and the individual.
- The pension savings regime is stable and (as far as possible) free from political interference.

Michael Johnson's CPS research papers present compelling evidence that tax relief is regressive and does not provide an effective incentive for most consumers. He has proposed a lifetime ISA as a replacement, which includes a limited form of flat-rate tax relief regardless of the policyholder's income. On the face of it, this does present some attractive advantages, including:

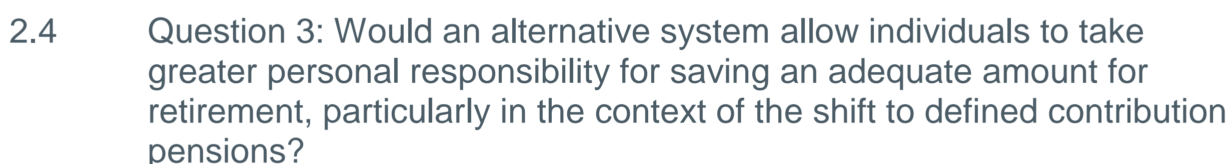
- It addresses the imbalance of tax relief which currently benefits higher earners most.
- It uses simpler language, similar to the ISA product that people understand and like.
- It harnesses auto-enrolment and the employer covenant.
- It improves access by offering early withdrawals of one's own contributions.
- It could be easily portable, with appropriate industry agreement to open standards and market practices.
- It reduces the long-term cost to taxpayers.

However, there are risks with this proposal:

- It is still not sustainable. Many billions of pounds could be generated in annual savings to the Treasury, however it is simply replacing one form of tax relief with another. In addition, it fails to address the long-term care crisis looming large as the baby-boomer generation heads into old age.
- Tax status, allowances and thresholds are subject to raids by future governments.
- It does nothing to increase transparency of fees and charges.
- It risks diluting (and complicating) the well-understood ISA "brand".
- In common with other reforms, there are transitional issues; anything but the status quo presents challenges on how to deal with tax reliefs and benefits accumulated under the current regime. As "Simplification" in 2006 and protections granted as a result of repeated changes to lifetime allowance more recently illustrate, shifting to a new regime often entails more complexity than the old system.

Altus Consulting believes that what consumers really need is a believable commitment from Government to set the rules once, and leave them in place for a generation. One way to achieve this would be to put in place an independent, apolitical policy body in charge of retirement and long-term care policy, to give consumers the confidence that long-term stability, not short term fiscal imbalance, is driving the agenda. Government's role would be to vote on policy proposals and set the budget, leaving the policy detail and implementation to the neutral policy body.

Ultimately, we believe the only way to remove the temptation of successive governments to erode away the rate of tax relief available to pension schemes is to remove it altogether. Since there is strong evidence to suggest that most consumers do not understand tax relief and few are incentivised to save more as a result, removing tax relief, compelling automatic enrolment and using some of the savings to increase basic state pension and fund long term care may present the best solution.



2.4 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?

Altus Consulting believe that mechanisms exist to urge consumers into saving regularly. Auto-enrolment has shown that inertia is a very strong driver. New technologies such as mobile messaging can be used to good effect to "nudge" savers into topping up additional small amounts into their accounts, and apps can be designed to visualise the benefits of additional savings. These techniques can be effective regardless of the type of savings product adopted, however a simpler product is more likely to be popular with consumers.

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

A Taxed-Exempt-Exempt system could provide more certainty for consumers planning for their retirement. Knowing that future savings are not subject to an unknown rate of tax could aid planning.

Equally, certainty that rules would not be changed for a set period (as they often are annually at present) would benefit consumers and providers.

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

There is already a differential treatment between the 2 types of scheme, wherein the lifetime allowance can generate a higher pension for Defined Benefit scheme members than for Money Purchase members.

If there were to be any differential in future, if anything the bias should be towards Money Purchase members, in recognition of the additional investment and longevity risks they bear. However, we believe it is generally preferable to maintain a single set of rules where possible.

2.7 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?

In short, all current technology systems, processes, administration skills and knowledge, provider and adviser business models and best practice advice are based around existing rules. All these would need to change under a new tax system. At best, new pension schemes would be set up on existing ISA administration systems, with schemes on the old regime being managed on existing technology.

In addition, there is the problem of what to do with “legacy” pensions. A change would require either closure to new business and wind down of existing schemes gradually over next 50+ years, running in parallel with the new regime, or enforced transfer to the new regime. If moving from EET to TEE, would there have to be a blanket tax applied to all existing pension savings? And what would this mean for pensions now in payment?

Automatic enrolment relies on the government contribution to make 8%, already too low. Removing tax relief would be simpler long term but increase employer or employee costs. Implementing the CPS “Lifetime ISA” proposal or similar would mean wholesale changes to payroll and pensions administration software.

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

Employer contributions should continue to be mandatory as they are now under auto-enrolment. If moving to TEE, these would have to be taxed as employee benefits in kind to prevent personal tax avoidance by salary sacrifice.

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

As discussed above, an independent, apolitical policy body should be put in charge of retirement and long-term care policy, to give consumers the confidence that long-term stability is driving policy. This could work in a similar way to the Bank of England’s Monetary Policy Committee, with the Government / Treasury setting budgets and policy goals and the Policy Committee putting forward White Papers and implementing the rules.

Up-front tax relief could be abolished altogether by mandating auto-enrolment, with the money saved going towards further improving the (non-means-tested) basic state pension and provision for later life care.

A basic state pension “fund” could be set up with this additional money invested in infrastructure investment projects, to gradually erode reliance on the current “pay as you go” system.

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