7. Conclusion: Developing a National Narrative

Humpty Dumpty sat on a wall,
Humpty Dumpty had a great fall.
All the king's horses and all the king's men
Couldn't put Humpty together again.

Lewis Carroll (1871) *Through the Looking-Glass, and What Alice Found There*

'Oh, I've had such a curious dream!', said Alice

Lewis Carroll (1865) Alice's Adventures in Wonderland

The key lesson from our research and discussions is that we need a national narrative on pensions if we are going to build a consensus around retirement income provision. The alternative is to live in a Tower of Babel with any sensible messages drowned out by a cacophony of mixed and often contradictory signals that will just confuse the majority of pension scheme members in the retirement phase of their lives. The dream of a comfortable retirement could easily turn into a nightmare. We identify five key factors that need to make an appropriate contribution if the objective of a national consensus is to be achieved: the pensions industry itself, national media, the regulatory system, the political system, and the pension tax system (and the implications this has for the level of pension savings built up prior to retirement). We make a number of recommendations that will help support the objective.

7.1 Introduction

Everything used to be clear cut when it came to the generation of retirement income from funded occupational pension schemes. There was an accumulation phase, a de-risking phase leading up to a known retirement date, at which point the member took a 25% tax-free lump sum and the rest as a pension or an annuity that provided a retirement income for as long as the member (and possibly spouse or partner) lived. If there were weaknesses and inefficiencies in that system, there was a case for fixing them.

The simplest fix would have been to reduce the minimum income requirement (MIR) from £20,000 to a lower figure, such as £14,000.[998] This would have allowed many more people

[998] As a comparison, the full single tier state pension coming into effect from April 2016 will be around £8,000 (£155.65 per week). In a written statement to the House of Lords on 22 July 2015, the Pensions Minister, Ros Altmann, disclosed that only 37% of people would receive the full amount of new state pension in 2016.

to have greater flexibility over their retirement spending, while still ensuring they did not run out of money before they die. In two reports written in 2010, the Pensions Institute recommended a MIR of £14,000 (£280 per week) as being the level needed to keep people from claiming any means-tested benefits.[999] These reports were said to have influenced Treasury policy, although the Treasury decided to set a much higher MIR.

However, instead of fixing it, the Government decided to completely abandon this system and, in particular, the requirement to annuitise any pension assets at all. Pension schemes no longer need to fulfil their primary role of providing a life-long retirement income. There is no doubt that the new pension freedoms are very popular with pension savers. Indeed, free market supporters describe them as 'inspired'.[1000] It is clear the changes cannot be reversed.

Nevertheless, this does not change the fact that the decumulation decision – the optimal running down of assets in retirement – is extremely complex. It involves not only pension assets, but also non-pension assets and decisions have to be made about inheritance, taxation and long term care, etc. If mistakes are made and the assets are invested unwisely or spent too quickly, retired people do not generally have the option to re-enter the labour market to earn some more money in the way that younger people do. Further, these decisions might have to be made in the presence of reduced mental capacity, as is the case with someone with dementia, for example.

Nor does it change the fact that there are now two completely different and mutually inconsistent models of individual behaviour underlying the two different stages of DC pension schemes in the UK. In the accumulation stage, we have a model that assumes people are 'humans' and which exploits inertia and other behavioural barriers to get people to start saving a bit (certainly not enough) for their pensions. In decumulation, we have the model of 'econs', rational lifecycle financial planners, fully capable of managing the complexities of decumulation decision making, following 45 minutes of guidance and, ideally, some good-valued and highly focused advice.

Further, there is a real danger that people forget they face a lifetime budget constraint on what they can do. There seems to be a whole range of people who have not saved enough for their retirement, but still expect that their pension pot can be used to pay off pre-

[999] David Blake, Edmund Cannon and Ian Tonks (2010) *Ending Compulsory Annuitisation: What are the Consequences?*, Pensions Institute, July (www.pensions-institute.org/reports/EndingCompulsoryAnnuitisationConsequences.pdf);
David Blake, Edmund Cannon and Ian Tonks (2010) *Ending Compulsory Annuitisation: Quantifying the Consequences*, Pensions Institute, September (www.pensions-institute.org/reports/EndingCompulsoryAnnuitisationConsequences2.pdf)

[1000] For example, Allister Heath (2015) Business Comment, Daily Telegraph, 18 April.

retirement debts, dip into whenever they like, deliver a life-long income, and also make bequests to their descendants. It just doesn't add up, as many will find out in due course.

This brings us to the issue of consumer vulnerability. This has two key dimensions. The first is that many consumers, through ignorance, overconfidence, arrogance or reduced mental capacity, do not recognise their own vulnerability. The second is that many consumers are open to exploitation by being sold inappropriate, over-engineered high-cost products. They also face overpaying for advice. Even worse, they are open to fraud and investment scammers.

Making decisions about retirement income are the hardest financial decisions people ever have to make, because the risks in Table 1.2 are so significant and so poorly understood – and these risks are in addition to the importance of recognising that the pension pot cannot be spent twice. Getting it right requires a national narrative about what pensions are for. Everyone in Parliament – whatever their political affiliation – and industry has to sign up to this narrative, just as they did with auto-enrolment. If not, we will end up living in a Tower of Babel, with no signal and just a lot of noise, with a different narrative for each retiree. This cannot possibly be in the best interests of most retirees, especially the most vulnerable, since it will almost inevitably lead to poor outcomes and high charges. Anyone who seriously objects to this either believes in an unrealistic model of human behaviour or is pursuing a vested interest. We know that a national narrative works in other countries, e.g., Holland, where there is an accepted national narrative based on social solidarity between social partners. We also know that it can also happen in the UK, if only temporarily, as in the case of the consensus built around the Pensions Commission's reports in 2004-05.

So what can be done to help establish a national narrative and build a consensus around retirement income provision? Each of the following need to make an appropriate contribution:

- The pensions industry
- The national media
- The regulatory system
- The political system
- The pension tax system and the level of pension savings.

7.2 Contributing to a national narrative 1: The pensions industry

The first contribution needs to come from the pensions industry itself. This broadly comprises four key groups of agents: providers, advisers, investment managers and insurers. All are important for delivering the best products and services for pension savers in the new world of 'freedom and choice'. However, it is clear from our analysis in Chapters 2 and 3 that there are serious fissures in the relationships between these four groups, in particular, between investment managers and insurers – who are fighting a turf war over the control of pension assets in decumulation – and between providers and advisers – who are fighting a turf war over access to clients. Yet all these parties are needed to provide appropriate, effective and good-valued retirement income solutions.

Well-designed retirement income solutions have both an investment component – to provide stable inflation-adjusted returns and flexibility over withdrawals – and an insurance component – to provide a longevity hedge. But the products sold by investment managers do not have a longevity hedge and the products sold by insurers, while offering the necessary longevity protection, have low returns and little flexibility. But at present, there is no clear agreement on what an optimal retirement income solution might look like. There is no effective collaboration between investment managers and insurers in designing products that can be combined to provide solutions that offer both spending flexibility and protection against inflation and longevity risk.[1001] Similarly, there is no agreement on what a reasonable charge for this solution should be. We are just told that market forces will sort this out.

Further, parts of the industry, especially the insurance industry, have not in the past treated their customers fairly, as they are supposed to do. We were told by an industry insider that 'the insurance industry has a lot to answer for' and cited a 2008 Financial Services Authority study which reported an example of a company that said that the ABI code was a threat to its business model since it wanted to maximise internal annuity sales – rather than have its customers use the open market option – and gave bonuses to sales staff for doing so. The insider also went on to say 'if people make mistakes, this actually profits the industry, so what incentive does the industry have to stop this?' Clearly, this type of attitude by key players in an industry with many vulnerable consumers is not acceptable. Customers are told that they will be treated fairly and industry business practices must be consistent with this.

There is also a lot of thinly disguised hostility between providers and advisers concerning the appropriate level of advice for different market segments, how it should be delivered, the appropriate pricing model for advice in the different segments, and even about who should give that advice. Providers want to be able to give advice to scheme members. While this is allowed under US regulations and welcomed by US employers, it is frowned upon in the UK by advisers and regulators as not being 'independent'. In turn, advisers who are in the process of rebranding themselves as wealth managers believe that they can advise on and put in place retirement income and inheritance solutions for their clients without involving providers.

These divisions have been long standing and are, in part, the result of normal competitive pressures, compounded by the fact that most pension savers are disengaged from the

[1001] The NEST blueprint discussed in Chapter 5 is a notable exception.

pension saving process, do not understand the risks that they face, and are generally not skilled enough to exercise their sovereign rights as consumers to demand that producers and advisers provide them with the best designed and the best valued products and services.

On top of this, we need to recognise that professional services firms are prone to over-service their clients to build up fee and those operating in financial services are no different. There are some in the financial services industry who believe that there should be a tailor-made plan for every retiree. But, as we discussed in Chapter 3, this is an example of the 'interior decorator fallacy', namely the idea that retirement income strategies should be designed to reflect attitudes to, say, risk in the same way that interior decorators attempt to reflect the personal taste of their clients.[1002] For all but the most affluent, such a tailor-made plan would be far too expensive. We accept that one size doesn't fit all, but then neither does a bespoke plan with annual reviews for someone with a £50,000 pension pot when the charge is 0.75% p.a. Something much more simple and focused is required. If anyone is thinking of questioning this, they should remind themselves that the new single-tier pension has a capitalised value of around £200,000 and no one appears to be setting up shop to advise pensioners how to spend their state pension.

Looking forward, the pensions industry is just not going to be able to get away with how it has traditionally operated. Instead, the industry is going to have to work together to offer the best designed and the best valued products and services and show clearly how these fit in to the retirement journey of their clients. Commercial airlines have to do this for their customers, so why shouldn't those involved in the provision of retirement incomes? In addition, there needs to be much greater clarity over charges and fees. The full set of charges incurred in delivering a product should be made clear to customers. In terms of adviser fees, there needs to be much greater justification of ad valorem fees where the fee is unrelated to the amount of work done. Such fees are now very uncommon in most other types of professional services organisations.

'Freedom and choice' could be a disaster if these matters are not addressed. The particular segment of the market most at risk is mass market DC customers with pension assets between £30,000 and £100,000. Such consumers are unlikely to pay for full regulated advice and are therefore at risk of buying expensive, poorly designed products on a non-advised basis. Those with pension assets below £30,000 are likely to have most of their retirement expenditure needs met by the state pension and by welfare benefits – they will welcome the extra flexibilities that the new pension regime offers in terms of how they spend their pension pot. Those with pension assets above £100,000 are more likely to see the value of seeking advice.

[1002] See Peter Bernstein (1992*) Capital Ideas*, Free Press, New York.

The simplest solution to the problem facing the market segment most at risk is a safe harbour retirement income plan which combines:

- A simple decision tree and a limited set of default pathways
- Safe harbour products that deliver income flexibility as well as inflation and longevity protection, meet minimum design standards in terms of efficacy, and deliver clear value for money
- Financial help, most probably delivered over the internet.

If between them, providers, advisers, investment managers and insurers, are unable to deliver this solution, then we would regard this as considerably more serious than the market failure – the absence of voluntary pension savings by up 9 million employees in companies without a pension scheme – that the Pensions Commission was set up to investigate and resolve – via the introduction of auto-enrolment.

The resolution to this new potential market failure would be a national master trust drawdown scheme that has a public service obligation to accept any DC retiree, irrespective of their pot size. This might be a simple continuation of NEST's public service obligation to accept any employer for accumulation (if EU regulations permit).

Some industry practitioners are aware of the consequences of the industry getting it wrong. For example, Phil Loney, chief executive of Royal London, has said: 'George Osborne's pension reforms have the potential to become famous for helping people to improve their retirement incomes, but without plentiful and affordable financial advice they risk becoming an infamous example of political bungling. The reforms have been introduced too quickly and the population had so far failed to understand what it means for them. I fear that many will make the wrong, often irrecoverable decisions about their retirement and this will result in some very poor outcomes. The simple fact is that many people, perhaps most, have not engaged with pension freedom and lack the basic financial knowledge to take the next steps'.[1003]

7.3 Contributing to a national narrative 2: The national media

The second contribution needs to come from the national media. As Aileen Lynch, head of technical services at Compliance First, has written 'There's an unsettling dichotomy between the messages of the mainstream media ("This is your money and you are entitled to do with it whatever you want, whenever you please") and the more considered, long-

[1003] Reported in Jenna Towler (2015) Pensions freedom risks becoming 'infamous example of political bungling' – Royal London, Professional Adviser, 12 February.

term approach which is generally prevalent in financial services press and among advisers and providers'.[1004]

The national media has a very important role to play in getting the right message across about the real purpose of a pension scheme and the genuine risks that retirees face – much more now than in the days of final salary pensions when people received a life-long indexed pension and did not have to worry about the risks in Table 1.2.

However, there are two potentially significant long-term conseqences of the 'this is your money' view of a pension pot currently prevailing in the national media. The first is a potential moral hazard. If a sufficiently large number of people behave in a reckless way and withdraw all their money and spend it too quickly, then they could claim compensation for mis-selling. Further, they will also demand an increase in welfare benefits and that, in turn, could lead to inter-generational conflict, with the next generation of taxpayers refusing to bail out their profligate and reckless predecessors. The second is the focus on reducing inheritance tax for those already sufficiently well off that, when they die, they will leave significant assets in their pension pot. Ordinary tax payers will soon start asking why they should subsidise the transfer of tax-priviledged assets across generations of already wealthy families. The whole rationale for having tax incentives to encourage pension savings would soon come into question.

7.4 Contributing to a national narrative 3: The regulatory system

Our research has highlighted a number of problems with the current dual regulatory system, whereby The Pensions Regulator (TPR) regulates trust-based schemes and the Financial Conduct Authority (FCA) regulates contract-based schemes. Not only does this lead to inconsistencies in regulation, the two organisations have two different narratives. As a pension lawyer told us: 'The FCA looks at products and providers. It has individual customer protection as its focus. TPR is concerned more about giving guidance to trustees and employers at the level of the scheme'. See Table 7.1 for more details of the differences.

Table 7.1: Respective Strengths of the contract and trust-based regimes

Activity	Contract-based regime (FCA)	Trust-based regime (TPR)
Rigour of regulatory regime	Requirement to meet threshold conditions to conduct regulated activities. Ongoing monitoring including: • Supervision • Thematic reviews	It relies on trustees and other professionals to report any breaches and to comply with their statutory whistleblowing duties.

[1004] Quoted in Aileen Lynch (2015) Handle with care: Dealing with insistent clients safely, Retirement Planner, 18 November.

Communication with members	Requirement for communications that reflect where individuals are on the retirement journey. Prescriptive around the information provided to members – in some cases, this may make it more difficult for organisations to present information in the most useful way (e.g., if they are required to provide information that will not be used by the member).	Schemes able to tailor their communications to their members. Communications may be designed at the level of the scheme membership and may not reflect an individual's position on their retirement journey.
Compatibility with workplace pensions	Employees do not typically have a choice of pension scheme, this is down to the employer	
	FCA's requirement to promote consumer choice of their pension provider is not as relevant under automatic enrolment where it is the employer who chooses the pension scheme. This suggests that some of the information, such as the provision of information to help members make choices) provided, may not be used and that this may distract members from other important information.	Schemes have the leeway to provide information relevant to the members' situation – that can reflect the fact that the employer chooses pension schemes under automatic enrolment.
Activity	Contract-based regime (FCA)	Trust based regime (TPR)
Cost (including monetary costs and time) of managing pension schemes	Compliance entails a higher volume of work and cost than required by the trust-based regime. Pension providers must receive authorisation for certain activities.	Compliance requires lower volume of work – for example, lower levels of contact with the regulator. Trustees have the freedom to make decisions if they judge these to be beneficial to members.
Source: Melissa Echalier and Sarah Luheshi (2015, Table A) *Comparison of the Regulatory Frameworks for DC Pensions*, Pensions Policy Institute, October.		

Problems that have been identified with the current system include the following:[1005]

- TPR and the FCA constantly need to consult one another on a range of activities. According to Malcolm McLean, senior consultant at Barnett Waddingham: 'This is not only inefficient it is positively dangerous…With both auto-enrolment and the pensions freedom at critical stages of development, it makes no sense to proceed as we are. …A single regulator would be less confusing for consumers, would help to plug gaps in the current arrangements and provide greater consistency of treatment between trust-based and contract-based schemes…[It would also] provide a clear focus for direct action and early intervention where necessary'[1006]
- The two regulators are regulating very similar products for very similar consumers, but there are different protections for both. One example is the different approaches to retirement risk warnings.[1007] In January 2015, the FCA said that providers of contract-based DC schemes should issue tailored risk warnings that depended on an individual's circumstances assessed via a list of 11 questions to ensure consumers make well-informed decisions. By contrast, TPR encourages trustees to provide only generic risk warnings to scheme members and to direct them to Pension Wise
- Another example relates to a confusion in the proposed rules on transferring from DB to DC schemes when there are benefits with guaranteed annuity rates (GARs). The FCA states that a GAR turns a money purchase scheme into a safeguarded benefit, which means members with a GAR will need to take advice if they want to transfer. However, TPR defines a GAR as a money purchase benefit until it is taken, which means there should be no requirement for trustees to ensure advice is taken.
- There is also potential confusion when it comes to compensation. On the surface, everything appears to be clear-cut. The Financial Services Compensation Scheme covers 100% of the value of an annuity in the event that the insurance company providing the annuity defaults, £75,000 of the value of bank deposits, and £50,000 of the value of retirement and investment savings. But this compensation applies to individuals not to schemes and also depends on whether the FSCS treats the pension pot as an investment or a long-term insurance arrangement:

[1005] Some of these come from our interview panels.
[1006] Reported in Jenna Towler (2015) MPs push for single pensions regulator to protect post-freedom retirees, Professional Adviser, 10 March.
[1007] 'While both regulators have identified similar types of risk, their approaches are different with TPR focusing on enablement and education. It is also less prescriptive than the FCA in terms of its guidance, particularly around communication to pension savers. In contrast, the FCA is more pro-active in monitoring pension schemes' activities. This difference reflects the fact that it is the trustees who are responsible for playing a supervisory role in the trust-based regime' (Melissa Echalier and Sarah Luheshi (2015) *Comparison of the Regulatory Frameworks for DC Pensions*, Pensions Policy Institute, October).

  - For example, if a trust-based scheme invests via an insurance company, there are cases where it will not be covered by the FSCS. To illustrate from Standard Life's *Trust-based Pension Plan Key Features* document: 'Your plan is classed as a long-term contract of insurance. The trustees will be eligible for compensation under the FSCS if Standard Life Assurance Ltd (SLAL) becomes unable to meet its claims and the cover is 100% of the value of their claim. If your plan is invested in one of our funds that invests in a mutual fund run by another firm (including Standard Life Investments Ltd), the trustees are not eligible for any compensation under the FSCS if that firm is unable to meet its claims. SLAL is not able to make a claim on the trustees behalf, so the price of a unit in our fund will depend on the amount we recover from the firm. If your plan is invested in one of our funds that invests in a fund run by another insurer, the trustees are not eligible for any compensation under the FSCS if that insurer is unable to meet its claims. SLAL is not able to make a claim on the trustees behalf'.[1008]
  - Similarly, with a self-invested personal pension scheme. A SIPP comes under the FCA because it is contract-based, but if it is not set up as a life office wrapped product, the FSCS treats it as a pure investment which has a lower level of compensation.
- While it is very unlikely that a UK life office will become insolvent, the same cannot be said of the plethora of small master trusts that have emerged following the introduction of auto-enrolment. The entry and capital adequacy requirements for master trusts have been described to us as 'derisory'.[1009] While compensation for trust-based schemes comes under The Pensions Regulator and its compensation scheme, the Pension Protection Fund (which also runs another compensation scheme for cases of fraud, the Fraud Compensation Fund),[1010] this has not yet been seriously tested in the new world of auto-enrolment. NEST has its own separate regulations which again do not necessarily give full protection to members: 'Because NEST has been set up as a trust, our members are the owners of all the assets we hold on their behalf. If anything goes wrong their retirement pots remain their property. Member funds are not fully covered by the Financial Services Compensation Scheme. However, we invest some of our member's assets in contracts of insurance which are covered by the FSCS in certain circumstances'.[1011]

[1008] http://library.standardlife.com/tbp17.pdf
[1009] http://www.ft.com/cms/s/0/a0eabc40-732c-11e5-bdb1-e6e4767162cc.html#axzz40EwqWETE
[1010] https://www.gov.uk/workplace-pensions/protection-for-your-pension
[1011] http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/selecting-a-good-quality-pension-scheme,PDF.pdf

- Rajiv Jaitly states: [1012]

> *'..[I]t can be argued that multiple regulators weaken their regulatory reach. They are weakened because differences in objectives, functions and powers of enforcement between them create loopholes. The need for liaison between them creates bureaucracy and delay. These weaknesses create the potential for regulatory arbitrage. For example, three regulators police DC pension schemes and the financial services firms that provide investment funds for them: the Prudential Regulation Authority (PRA), the Financial Conduct Authority (FCA), and the Pensions Regulator (TPR). Each regulator has different powers in terms of intervention and fines. In particular, while the FCA and TPR share the role of regulating DC pensions, the former appears to have much wider powers than the latter. Despite the memorandum of understanding (MoU) between the FCA and TPR in relation to DC pensions, this asymmetry in power might tempt providers of automatic enrolment pension schemes to 'choose' what they perceive as a 'regulation light' 'trust' structure regulated by TPR rather than the FCA. Furthermore, the level of fines the regulators can impose – even by the FCA – might not be considered punitive by firms. With regulators having to abide by principles of proportionality, fines may be treated as no more than 'the cost of doing business.*
>
> *Retail investors who wish to challenge a firm's behaviour face a confusing process because the three regulators do not normally deal with consumer complaints. Complaints about firms regulated by the FCA are directed to the Financial Ombudsman Service (FOS), while those about pension schemes regulated by TPR go to the Pensions Ombudsman. There is also a grey area of overlap between them, for example in the case of transfers of members' money from defined benefit (DB) schemes to DC arrangements. The jurisdiction of compensation schemes such as the Financial Services Compensation Scheme (FSCS) and the Fraud Compensation Scheme (FCS) is also confusing.*
>
> *It may of course be possible to challenge an investment management contract through the courts, but the options are limited due to the way contracts are structured and shortcomings in the legislation on unfair contract terms.*

[1012] Rajiv Jaitly (2014) Collective Investment Schemes - Costs and Charges - Implications For Consumers - A Report For The Financial Services Consumer Panel; https://Www.Fs-Cp.Org.Uk/Sites/Default/Files/Investment_Jaitly_Final_Report_Full_Report.Pdf

The following is a sample of the comments of those we interviewed:

- 'The contract based-regime prioritises shareholder interests over savers' interests, whereas the trust-based regime gives absolute priority to savers. The FCA's regulatory duties are structured so that any attempt to move away from relying on information and competition only to remedy market failures would be crippled by judicial review, so it repeatedly fails to do anything useful in the pension space. The FCA is captured by the industry in a way TPR is not. The FCA does not want to do anything, whereas TPR culturally would like to in intervene if it was given more powers'.
- 'The failings at the FCA were exposed on 17 December 2014 at the Work and Pensions Select Committee where they unwisely said "you cannot stop fools acting like fools". The committee said this was an abdication of responsibility. The FCA are supposed to enforce TCF [treating customers fairly], but their own analysis showed that they were not doing this, e.g., they were aware that bonuses in insurance companies were linked to increases in internal annuity sales. The FCA finally listened on 17 December and rushed in the "second line of defence" [now called "additional protection"]. This move followed calls by a range of consumer organisations and providers including [our company], as noted in the Work and Pension Select Committee report'.
- 'The FCA is sometimes too prescriptive and sometimes not bold enough, e.g., it was forced by industry to bring in the emergency "second line of defence"'.
- 'The FCA needs to give providers more leeway'.
- 'TPR is all at sea and well behind the curve'.
- 'There is inconsistent and conflicting decision making at the EU level, e.g., between the European Parliament, the European Commission and EIOPA'.

According to Darren Philp, head of policy and market engagement at The People's Pension: 'We need to have more joined up policymaking to ensure no matter what pension scheme you're saving in, you get the appropriate level of protections and avoid confusing messages and a confusing regulatory landscape'.[1013] A similar view is held by Stephen Lowe, director at Just Retirement: 'Many retirees have a combination of trust-based occupational and personal pension plans, so the rules needed to straddle both regimes in order to ensure clarity and consistency. It's in the interests of the consumers, the regulators and the industry that we avoid the problems caused by trying to operate a two-tier system'.[1014]

[1013] Reported in Luisa Porritt (2015) Trustee briefing - Retirement risk warnings, Engaged Investor, 2 April.

[1014] Reported in Natasha Browne (2015) Government drops mandatory advice for small DB transfers, Professional Pensions, 27 January.

Martin Wheatley, then chief executive of the FCA, said he could 'sympathise' with the industry's frustration over the twin regulatory regime. He accepted that 'There are two sets of decision-makers putting out slightly different views. We are clear it must be tailored without being advice. TPR hasn't given that kind of precision'. He agreed that it was important to have 'reasonably common standard delivery' and argued for the same definition of guidance to protect people from receiving mixed messages. He also said that moving to a single regulator was a decision for policy makers.[1015]

According to those we interviewed, the current fragmented regulatory system fails to encourage the design of effective, value-for-money products and solutions with a safe-harbour status or to adequately protect consumers from mis-selling and fraud. The solution would be to have a single pensions regulator, specifically tasked with these responsibilities. It would also have a responsibility for trying to change regulations which contribute to bad outcomes. As an example, we were told that prudential regulations in the UK increase the cost of prudential capital and reduce the value of annuities by 20% compared with the US. Another example is EU regulations, particularly MiFID II. If drawdown is reclassified as complex under MiFID II, it is likely that only those with large pots (above £100,000) who can afford regulated advice will be able to buy the product. What will mass market consumers who want to use drawdown do in these circumstances?

The idea of a single regulator is supported by the Work and Pensions Select Committee in its report *Progress with Automatic Enrolment and Pension Reforms* published in March 2015.[1016] The report said that the potential increased risk to pension savers from mis-selling and fraud following the introduction of the new pension flexibilities from April 2015 strengthens the case for combining the regulators.

Dame Anne Begg MP, Chair of the Work and Pensions Committee at the time, said:

> *The new pension flexibilities give savers the freedom to use their money in the way they choose and have the potential to make retirement saving really attractive. But savers need to be properly protected from being ripped off in frauds or scams, or suffering financial loss from making the wrong decision about how to use their pension pots. The pensions industry has not always done enough in the past to help savers make the right decisions.*
>
> *What savers really need is a strong, single regulator to act in their interests. We are not convinced that the FCA is sufficiently focused on pensions. The comment made in evidence to us that it can't 'stop fools*

[1015] Reported in Natasha Browne (2015) FCA 'sympathises' with frustration over twin pensions regulation, Professional Pensions, 12 March.

[1016] Fourth Report from the Work and Pensions Committee: *Progress with Automatic Enrolment and Pension Reforms,* HC 668;

http://www.publications.parliament.uk/pa/cm201415/cmselect/cmworpen/668/668.pdf

> *acting like fools' does not inspire confidence in the FCA's willingness to be proactive in protecting savers. The Government is coming round to our way of thinking about the need for a single regulator. We believe that the big shift to the new pension flexibilities in April means that it is now time to make this change, which we originally recommended back in 2013.*

The report said a single regulator would have a clear focus on the entire retirement saving process: 'Savers would have clarity on who was responsible for providing guidance and redress, and employers and the pensions industry would have a single body to advise and supervise them'.

Nevertheless, combining the regulators would not be straightforward as pointed out by Melissa Echalier and Sarah Luheshi (2015), due to, e.g., the volume of contract, tax, trust and pension law needing to be changed to accommodate a move to a single regulator; and it is not clear where a single regulator should sit – whether this would be in the Department for Work and Pensions or Her Majesty's Treasury.[1017]

7.5 Contributing to a national narrative 4: The political system

The fourth contribution needs to come from the political system. It is increasingly clear that the five-year political business cycle is not suited to dealing with long-term issues like pensions, long-term care and long-term savings. Political parties, whether in power or in opposition, are totally focused on winning the next election and appear unable to think beyond that. It is therefore very hard to get any political party to adopt sensible long-term solutions to the problems of pensions, long-term care and long-term savings, especially if this involves sacrifices today, because it fears this would benefit its political opponents who could well be in power when the benefits begin to show.

This has fundamental consequences for intergenerational equity, since every generation passes the consequences of its own failures down to the next generation. While this can be a small problem when a population is growing, it becomes very severe when a population is rapidly ageing. To illustrate, a key reason why we would want each generation to hedge its own exposure to longevity risk is that, if it fails to do so, it is expecting the next generation to provide that hedge for free. The main objection to buying annuities – the classic longevity hedge – by the baby boom generation currently retiring is that they are 'too expensive'. But they will be even more expensive for the next generation to provide if significant numbers of baby boomers run out of money and demand that the next generation provides them with an income for life (aka an annuity) to keep them out of 'poverty'. For how much longer can the baby boom generation keep asking for a free lunch from the next?

[1017] Melissa Echalier and Sarah Luheshi (2015) *Comparison of the Regulatory Frameworks for DC Pensions*, Pensions Policy Institute, October.

One way of achieving a national narrative as well as dealing with the myopia of the political business cycle is to have a permanent Pensions, Care and Savings Commission (PCSC). This would be an independent body that would have cross-party support and would make recommendations on issues relating to pensions, long-term care and long-term savings. The PCSC would require an evidence basis for any policy recommendations, together with an impact and risk assessment. A particularly important role for the PCSC would be to ensure inter-generational equity.[1018] Since no generation can, during its working life, store for its retirement the goods and services it will consume in retirement, each generation depends on the next generation to provide those goods and services in a way that is not widely recognised. Models for how the PCSC might operate are the Low Pay Commission (LPC), the Office for Budget Responsibility (OBR), the Monetary Policy Committee (MPC), and the Committee on Climate Change (CCC).[1019] The PCSC would report directly to Parliament.

There is widespread support for such a commission and we consider some examples.

The Work and Pensions Select Committee report *Progress with Automatic Enrolment and Pension Reforms* cited earlier also called for an independent pension commission to build public confidence and long-term stability in the system.[1020] The commission would look at the following issues:

- To assess the impact of the Budget flexibilities on default investment strategies
- To consider whether a default decumulation option is required for savers making poor decisions
- To assess the impact of the reforms on the suitability and accessibility of retirement products
- To recommend market interventions where the market was not working in savers' best interest
- To tackle high charges and poor governance in legacy schemes
- To review auto-enrolment, including making recommendations on minimum contributions and defining adequacy of retirement income and how the policy should be assessed as a success. The report said using opt-out rates to measure success would not be meaningful in the long term
- To oversee any further changes in savings and tax policy

[1018] In January 2016, the Work and Pensions Select Committee launched an inquiry into 'inter-generational fairness' over concerns that the state pension and welfare system is unfairly favouring pensioners at the expense of younger workers (http://www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/inquiries/parliament-2015/intergenerational-fairness-15-16/).

[1019] https://www.theccc.org.uk/about/. For a risk assessment report which includes a chapter on Ethics by Lord Rees (pp 134-136), see http://www.csap.cam.ac.uk/projects/climate-change-risk-assessment/

[1020] Fourth Report from the Work and Pensions Committee*: Progress with Automatic Enrolment and Pension Reforms,* HC 668; http://www.publications.parliament.uk/pa/cm201415/cmselect/cmworpen/668/668.pdf

- To assess the minimum age at which people can exercise their pension flexibilities. The current age is 55 and this will rise to 57 in 2028 when the state pension age increases to 67. But allowing people to draw on the private pension ten years before state pension age could create unrealistic expectations about the age at which they can afford to stop working. The commission would consider whether this should be reduced to five years, except for those in ill health
- To look at issues relating to auto-enrolment: the challenges of extending AE to smaller employers, the level of minimum contributions for employers and employees, and how currently excluded groups, such as the self-employed and those in multiple low-paid jobs, can be brought into pension saving more effectively.

Dame Anne Begg MP said:

> *The scale and pace of recent changes in pensions policy have completely changed the retirement saving landscape. It is necessary to draw breath and review the extent of the changes and their implications.*
>
> *A new independent pension commission would be able to identify any emerging risks, and explore with stakeholders how these can best be addressed. The Turner Commission brought political consensus, full involvement of stakeholders, and detailed consideration of the wider impacts of major pensions policy changes. The successful introduction of auto-enrolment is a product of this. The current reforms have not always benefited from the same careful approach. A new commission is now needed to provide coherence in pensions policy and to build public confidence and long-term stability in the system.*

Also in March 2015, the Association of Consulting Actuaries (ACA) released a seven-point *Retirement Income Manifesto.*[1021] The ACA wants the Government to establish a long-term consensus by setting up and taking regular advice from a new standing Independent Retirement Income Commission. This would be charged with 'promoting the active extension and betterment of private retirement income provision and making recommendations on the future of state and public sector retirement provision'.

The ACA proposed the following remit for the Independent Retirement Income Commission:

- To review the structure of state pensions and the Government's timetable for raising the state retirement age to reflect both improvements in life-spans and overall financial costs to the taxpayer (given the current commitment to the 'triple lock' indexation of the basic state pension)

[1021] www.aca.org.uk/files/ACA_issues_Retirement_Income_manifesto-12_March_2015-20150312125512.pdf

- To advise every three years on the need or not for a general increase in retirement age to reflect increases in longevity so as to keep pension funding costs broadly stable over the long-term where scheme specific information is unavailable
- To recommend policies designed to encourage more employers and employees to invest in retirement income plans, including auto-escalation and other measures to maximise design flexibilities and choices, advising on financial and tax incentives to encourage wider coverage, whilst taking account of the UK economic, demographic and financial backcloth and life-style changes
- To review and make recommendations on tax incentives for long-term care products
- To promote legislative and regulatory simplification to encourage quality provision, accepting that legislation must continue to protect members' retirement incomes from the impact of employer or provider insolvency or default
- At the request of Government, to review on a periodic basis the structure and rules of the NEST scheme to ensure employees are offered an appropriate fall-back retirement income plan where no better scheme is offered by a sponsoring employer
- To ensure that over the long-term, the cost of public sector pensions, and those that are largely funded by the taxpayer, are transparent in cost to the taxpayer, are sustainable and are fair set against the scale of private provision available to the majority of taxpayers
- To report (within 6 months) on matters referred by Government to the Commission on an ad hoc basis and also on European directives that could have an impact on any of the above.

In June 2015, David Fairs, Chairman of the ACA, renewed the association's call for an Independent Commission which 'would help support joined-up decision making and we hope the new Pensions Minister, Baroness Altmann, and the new Economic Secretary, Harriett Baldwin MP, might persuade their colleagues that such a step would improve the long-term success of these fundamental pension reforms'.[1022]

In a report published in April 2015 called *The Case for an Independent Retirement Savings Commission*, the National Association of Pension Funds (NAPF), the Association of British Insurers (ABI) and the Trades Union Congress (TUC) call for an independent retirement savings commission.[1023] The NAPF sponsored a national survey[1024] which showed that 'an

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[1022] ACA says pressures on pension system underscores need for an independent commission and tax pause, press release, 11 June 2015.

[1023] NAPF, ABI, and TUC jointly call for an Independent Retirement Savings Commission, NAPF press release, 30 April 2015.

overwhelming majority of people (84%) agreed that an independent commission should be set up by a future Government and a similar proportion said it should be politically neutral (85%), impartial in its recommendations to Government (85%), and should focus not just on pensions, but include the wider range of issues that affect both when people retire and the kind of retirement they have (87%). Eight in ten (83%) were in favour of a permanent commission – one that would last more than one parliamentary term, would endure through future political cycles and provide independent, expert advice to all future UK Governments, regardless of their political make-up'.

Joanne Segars, chief executive of the NAPF, said: 'Today's report shows the breadth and depth of support that exists for creating an independent retirement savings commission. A new standing commission will help make sure the long-term interests of savers, not the short-term interests of politicians, are at the heart of pensions policy. That matters because someone starting work today will see eight or nine General Elections before they start to draw their pension – eight or nine potential swings of the pensions policy pendulum which will do little to build saver confidence. This support for a standing commission stretches well beyond the people who work in pensions to the everyday savers who will rely on their pensions for a decent income in retirement. The idea of such a commission is not a new one but it has yet to become a reality – our report shows there is growing chorus for that to change, and soon'.

She continued: 'We need to go back to first principles and agree a collective vision for what a good retirement savings system looks like for the long-term'. She also argued that the success of the original Pensions Commission, chaired by Lord Turner, built on:

- A shared understanding of the problem, namely that voluntarism meant too few people saving enough for old age
- A shared building of the policy solution – and a collective vision of what needed to change.
- A shared responsibility for the delivery and success of that solution – not just that the delivery of automatic enrolment should be shared between private sector and Government, but more importantly the shared acknowledgement that automatic enrolment could not fail.

She ended by saying that: 'The Commission's process of decision making – thoughtful, evidence-based and inclusive – laid the foundations for a consensus which has delivered one of the most far-reaching public policy interventions in recent decades across any part of

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[1024] Populus surveyed 1,015 adults aged over 18 in the UK online between 31 March and 2 April 2015. Data were weighted to be demographically representative of all adults in the UK.

Government. It is now unthinkable that any Government of any colour (or colours) would undo automatic enrolment, or that the social partners or industry would peel away from its core tenets. It is a part of the pensions landscape that is here to stay'.

Further support comes from:

- The International Longevity Centre – UK which published a report in February 2015 called *Consensus Revisited* in which it called for a pension commission 'divorced from the trappings of Government' to rebuild consensus-based policy making in pensions and, in particular, deal with the challenge of inadequate incomes in retirement. The commission would concentrate on three issues:
    - Defining target outcomes for retirement savings and extending working lives
    - Monitor progress against these targets
    - Consult on its findings and decide if there needs to be a policy update.
- The Savings and Investments Policy Project, managed by the Tax Incentivised Savings Association (TISA), published a report called *Our Financial Future* in March 2015, which recommended that the Government create a 'savings minister' with the responsibility for promoting savings initiatives, consumer guidance and financial education.
- Age UK has also called for an independent retirement savings commission was needed. Jane Vass, head of public policy, said: 'There is debate over the exact form it should take, but it needs to be independent and it needs to look at pensions in the round – including state pensions, private saving and retirement income'.[1025]
- Pensions Age's Unchaining Pensions from Politics (UPP) campaign. Supporters of the campaign 'wanted the commission to recommend long-term policies as a "road-map" to future pension development, taking into account the country's demographics and the needs of different generations. It should also establish what a "good" target outcome is for retirement saving and therefore provide savers with confidence. The commission should scrutinise and suggest proposals to change legislation. Suggestions were also made to expand its role and provide greater clarity of the interaction between retirement and health care needs, along with promoting flexible retirement and flexible working to manage the transitions from work to non-work/less work'. Jackie Wells, NAPF head of policy and research, said: 'The commission would be a purely advisory body, not a policy-making vehicle, and would make recommendations to Government based on independent, collaborative analysis of the best available evidence, which the Government would be free to reject. Ultimately, the aim of the commission would be to help future Governments

[1025] Reported in Stephanie Baxter (2015) Independent pensions commission demanded by July, Professional Adviser, 10 March.

ensure that policy decisions have the needs of savers – including their constituents'.[1026]

- Respondents to the Consultation Paper:
  - There was strong support from 82% of respondents for a permanent pensions commission in some form or another. Only 9% were opposed to a pensions commission.
- All the groups that we interviewed:
  - Providers and investment managers. While it is accepted that ministers must make final choices, especially if taxation is involved, all proposals should have been developed and examined in a measured and structured way. Examples of poor decisions that need to be avoided in future include: (a) the 2014 Budget, (b) the introduction of a charge cap half way through the auto-enrolment process, and (c) the political parties salami slicing the existing tax system (e.g., the Labour Party's proposals in the 2015 General Election to transfer resources to lowering student fees). There are some important issues that the Pensions Commission could deal with:
    - The current fragmentation of decision making in Government with HM Treasury (in relation to tax), the DWP and the Health Department all having a say.
  - Trade unions:
    - 'With some of the changes of the last few years, it would have been very helpful to have an independent commission opining on it. There is merit in ensuring it is statutory, as well as having a definite remit and an independence of its own'.
    - 'Charges, contributions rates, the statutory retirement age. What is a sensible draw down rate? There could be quite a few things it could do. Look at what are the right contribution levels. Everyone knows they should be higher'.
    - 'It could look at predicted long-term investment growth. It could provide a recommended amount of drawdown. You have got life expectancies and investment growth from a portfolio. You could say the recommended amount you can take out is £X. The problem with

[1026] Reported in Laura Blows (2015) Industry concerned politicians would 'sabotage' an independent pensions commission, Pensions Age, 28 April. See also Laura Blows (2015) Open letters sent to DWP and Treasury calling for independent pensions commission, Pensions Age, 2 June. The letters were signed by: Mike Allen, Director of Pensions, LPFA; Laura Blows, Editor, Pensions Age; Emma Douglas, Head of DC Distribution, LGIM; Dame Karen Dunnell, Chair, Longevity Science Panel (Legal & General); David Fairs, Chairman, ACA; Ammo Kambo, Charted Financial Planner; Kevin LeGrand, Head of Pensions Policy, Buck Consultants at Xerox; Ronnie Morgan, Strategic Market Insight Manager, Royal London; Darren Philp; Alan Pickering, Chairman, BESTrustees; Carolyn Saunders, Head of Pensions, Pinsent Masons; Rachel Vahey, Independent Consultant; and Jackie Wells, Head of Policy and Research, NAPF.

drawdown is the impact of the first five or six years is a big determinant of future years'.

- However, the model proposed for the Pensions Commission in the consultation paper – along the lines of the MPC – was not welcomed:
    - 'I do not think the MPC would be a very good model. You could have a Pensions Commission that makes big public recommendations to Government and hard for them to ignore. The Low Pay Commission (LPC) might be a better analogy. Also the social partnership basis on which it is based. For example, hearing evidence in public. It is very evidence-based. It is hard for the Government not to accept an LPC recommendation'.
    - 'For the LPC, the Government sets the remit. The remit of the LPC has been shaped by different political complexions of Government, but it has retained stability while being sensitive to the changing political environment'.
    - 'It is difficult for the minimum wage to go up without recourse to the LPC. They would not want to do that because of precedent. With pensions, there is the question of what the commission would look at. For LPC, it is quite tightly defined wage rates'.

Dr Yvonne Braun, director of long-term savings at the ABI, believes that one of the key responsibilities of the PCSC would be to consider intergenerational equity. Writing in *Retirement 2050: Identifying the Challenges of a Changing World*, published by the ABI in February 2015, she said (p. 29):'The long-term nature of pensions and retirement income mean that policy-making should take a long-term view as much as possible, with policies lasting beyond a single Parliament. An independent body (an 'Office for Intergenerational Responsibility' or a 'Retirement Commission') could have an important part to play in informing the policy debate and shaping a national long-term savings strategy, so the implications of the ageing society are assessed holistically, rather than by individual departments'.[1027]

This theme was taken up by Michael Johnson, research fellow at the Centre for Policy Studies, in briefing note published in June 2015 entitled *The Case for an Office for Inter-generational Responsibility*.[1028] He argues:

1027 https://www.abi.org.uk/~/media/Files/Documents/Publications/Public/2015/Pensions/Retirement%202050%20Identifying%20the%20challenges%20of%20a%20changing%20world.pdf

1028

The UK's debt mountain, combined with the risk of an anaemic long-term rate of economic growth, poses a serious threat to Generation Y's future economic wellbeing.[1029] *This, a generation already faced with unaffordable housing, college debts, fragmented careers, earnings stagnation, relatively thin occupational pension provision, and a rapidly retreating state pension age.*

An Office for Inter-generational Responsibility (OIR) should be established to co-ordinate the production of Inter-generational Impact Assessments and to scrutinise all tax reliefs and exemptions. It could reside alongside (or within) the Office for Budget Responsibility (OBR), and could fruitfully liaise with the (now expanding) Office of Tax Simplification.

An OIR should exude an ethos of fiduciary duty towards current and future taxpayers, and aspire to having a reputation for independence akin to that of the OBR. If it were to achieve this, it would help close what is currently a significant accountability gap between Parliament and the people (particularly future taxpayers). In addition, all tax reliefs and exemptions could be subject to a five year sunset clause, after which they would cease. Lobbyists would be required to present their cases directly to the proposed OIR, placing blue water between vested interest groups and ministers.

Politicians were less keen on having a PCSC. While recognising the problems that the commission would be trying to address, politicians said it was the responsibility of Government to deal with these. Steve Webb, when still Pensions Minister, called for the creation of a Department for Pensions and Ageing Society at a Resolution Foundation event in February 2015. This would bring together care, the ageing society and long-term savings in one department. He said:

Your pension outcome depends on every aspect of your life. It depends on your life expectancy, on what sort of education you've had, what your career path is, what sort of firm you work for, whether you're single, or married, or divorced. It depends on everything. So everything affects pensions. And that's what makes it so unendingly fascinating to me … that to get pensions policy right, you can't just think about pensions. You've got to think broadly. But what do we do in Government? I'm going to invent a word here … siloise. We don't see people, we see policies. Combining care, the ageing society and long-term saving in one place could solve the problem, with joint ministers bridging the gaps. Think about your needs in retirement. We focus on income needs but what about care needs, and

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http://www.cps.org.uk/files/factsheets/original/150616121816-ThecaseforanOfficeforIntergenerationalResponsibility.pdf?utm_source=Michael+Johnson+contacts&utm_campaign=bbea3fa3f8-pensionsminister&utm_medium=email&utm_term=0_d781b4fd08-bbea3fa3f8-303590773

[1029] Generation Y: those born between c.1980 and 2000, i.e. aged between 15 and 35 in 2015, also referred to as 'millennials'. They are preceded by Generation X (early 1960's to 1979 births).

> *what about the overlap between the two? Because presumably you need resources in retirement to live off and you need resources in retirement to meet your care needs, potentially. Do we have an integrated financial product for care and for pensions yet? Not in a meaningful way. Why not? Partly because we siloise.*

Many industry practitioners agree that a more joined up approach to pensions and long-term care is a good idea. For example, Darren Philp said: 'What we are seeing more and more is a lack of a joined up strategy when it comes to pensions policy and more widely. You have got a number of Government departments which are responsible for various aspects – the Treasury, the DWP, other bodies like HMRC, the FCA, the PRA, TPR, and it's all in a bit of a muddle. I think that, while it's quite good to have some healthy tension between different departments with different objectives, what we're seeing is policies that directly contradict each other and things not pulling in the same direction. To take one example, a lot of work was done on collective DC and defined ambition. The next minute, they open the whole retirement freedom market with the Budget reforms. The two don't really go hand in hand. Collectivisation and individualism are two very distinct things. For me, we need a long-term strategy that joins this up'.

Similarly, Malcolm McLean said: 'I understand Webb's frustration….I also understand what he means about working in silos. You speak to someone in the department and find out that they deal with one thing, but not with something else. I had an occasion to speak to the DWP about the state pension and had to speak to one person about the statements and the forecasts, somebody else about the qualifying conditions, somebody else about the new schemes'.

However, neither Mr Philp nor Mr McLean agree that overhauling governmental and regulatory structure is the best way to achieve more clarity and consistency. Philp says: 'The important thing is that when it comes to manifestoes and developing policies, they're done within a coherent framework and on the basis of evidence. That's one of the reasons why we've said that it would be good to have an independent pensions body, like an OFPEN, the Office of Pensions Responsibility, that analyses the evidence and holds the Government to account against its stated objectives'.

McLean argues that Webb's suggestion is impractical: 'To achieve what he wants, you would have to have one department covering the entire operation of Government, which is just not practical … The bigger the department, the more it subdivides down. Over the years, I think people have recognised the overlap that pensions have with a whole raft of other things. Social care is coming into focus now as something that should be linked into it. But I don't think you'll ever get to a situation where you'll be able to say we have everything confined into one department. It might be an aspiration, driven by some frustration about some of his experiences, but I don't think it's practical to cover everything'.[1030]

Nigel Waterson, the former shadow Pensions Minister, while accepting that 'some long termism in pensions and savings policy is what is needed, and the stability that only a broad political consensus can deliver', appears to be doubtful that a pensions commission is needed: 'Contribution levels must increase; auto-escalation must also be in the frame. All the current talk about decumulation is pretty academic if we don't get up contribution levels. We don't need a pensions commission to tell us this!'[1031]

Lord David Willetts, the pension expert and former MP, also believes politicians will be reluctant to surrender control of certain aspects of pension policy, but was more supportive of the idea of a pensions commission having some role:

> *I've looked at this from time to time and the fact is that the Treasury is never going to relinquish the lead on tax decisions, so then the only option becomes [delegating pensions policy to the Treasury] and that would be a very peculiar arrangement. So I personally think that a Treasury and DWP shared responsibility is the best that we can hope for, given the nature of the pensions issue.*
>
> *I remember the original Turner commission on pensions and I thought that part of his effectiveness came from the way it assembled a large amount of data that hadn't been properly brought together before. I think there is a case for a long-term commission to provide material evidence so that you've got a solid, analytical base, especially as it is shared across at least two Government departments.*
>
> *However, looking back now on my political career over 20 years, every area that I've worked in, the elite wisdom has been "Take the politicians out of it, hand it over to a commission". Voters actually expect when they vote to be changing the Government, they don't vote for power to be continuously in the hands of a group of arm's-length commissioners. I don't think that somehow decisions won't be taken by elected politicians – that's what a democracy is.*[1032]

We support the idea of having a standing Pensions, Care and Savings Commission. Such a commission could be justified on any number of grounds as discussed above. But perhaps the simplest justification would be to help avoid in future the kind of problems that have

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[1030] Reported in Louise Farrand (2015) Webb: End pensions silos and create a bigger department, Engaged Investor, 12 February.

[1031] Nigel Waterson (2015) A time for consolidation – why Altmann must avoid 'initiative-itis', Professional Pensions, 27 May.

[1032] Quoted in Louise Farrand (2015) David Willetts: 'Pure DC ends up with too much risk being borne by the individual', Pensions Insight, 16 March.

emerged with the introduction of ‘freedom and choice’ without any consultation with industry, as raised in our interview panels:

- ‘The Pension Commission had an evidence basis for its policy recommendation – auto-enrolment – namely, the success AE as a nudge in the US to increase DC savings. There was no evidence basis for “freedom and choice”’
- ‘Even supporters of these proposals could not deny that they failed the test of having an impact and risk assessment. Further, they are a clear example of short-term political populism at the expense of long-term stability’.
- ‘Failure by Government to put in place both success criteria – in particular, a definition of ‘what good outcomes are’ – and methods of measuring and monitoring outcomes in response to the new flexibilities, resulting in a complete data vacuum’
- ‘Coupling of flexibility and choice which disregards any understanding about how real people choose’
- ‘Lack of member engagement – a disconnect between auto-enrolment at the front end and “freedom and choice” at the back end. Engagement is not necessary for AE – it is critical for “freedom and choice” to work’
- ‘Whoever does it, it is crucial to have information and discussions with employees in the workplace to engage them. A workplace visit is the holy grail but is not commercially viable in small companies. But smart electronic communications can replace face-to-face meetings. Communication, information, education, simplified advice are all needed for engagement. Pension Wise does not deliver this’
- ‘Adequate financial education not in place for Flexiday; for example, most people are incapable of converting a lump sum into an income equivalent, believing that £50,000 is a ‘large’ lump sum, when it is only one third of the value of the new single-tier state pension of £8,000 p.a.’
- ‘Failure to put guided pathways with defaults in place for Flexiday’
- ‘No clarity on charge structures, unlike auto-enrolment’
- ‘Insufficient protection in place for consumers who are at risk of mis-selling or ‘rip off’ charges’
- ‘Failure to understand that safeguards only work if people are engaged and understand the risks’
- ‘Failure to recognise the likelihood of scams – criminals can now directly target individuals who can readily be fooled (even if they are also generally smart). The Insurance Fraud Taskforce has noticed that the criminals involved with trips & slips, whiplash and the claim management companies (dealing with PPI) have moved to pension liberation. You don’t actually have to be a criminal, just someone who recommends an unsuitable investment. Fraud might actually fall, because it is legal to promote high risk investments. But people will face cliff edge outcomes – either the investment performs very well, or you lose everything. The worst case would be to lose the entire pot and then have to pay tax on this’

- ‘No impact assessment on additional state spending if people spend all their money’
- ‘Failure to deal with the overarching need to encourage more saving’
- ‘Failure to recognise the consequences of “freedom and choice” for employers and their retirement management policy’
- ‘Failure to recognise the long-term consequences for occupational pension provision of the reduction in tax breaks – it reduces the incentive for employers to set up a pension scheme. Directors can no longer see a benefit in setting up a pension scheme, since they do not benefit as much as in the past. Lower income people just want the pot and not a pension. A whole range of people with higher incomes are likely to find themselves with considerably poorer pension arrangements than the baby boom generation’
- ‘Failure to recognise the complete lack of engagement by small employers’
- ‘Pensions are now just a savings product, so why not outsource the whole lot?’

In short, there is no longer a coherent national narrative about what pensions are for, just a lot of noise around a series of short-term policy initiatives. This prompted the following remarks from our interviewees:

- ‘What are we trying to achieve with pensions – there is no narrative?’
- ‘People want access to cash – more than ever now. Why? Because there are no well-established social/cultural norms about what to do at retirement’
- ‘We need a consensus – to get people to understand that pensions are there to provide an income and people still need an income in retirement. The worst thing would be for the lump sum to become the norm’
- ‘We are a long way from establishing good social norms and cultures in decumulation’
- ‘There is a complete lack of legislative and regulatory clarity’
- ‘Trustees are reluctant to help members – far too risky. Trustees are concerned about getting involved due to the regulatory vacuum. They can’t do the right thing in case they get sued. They can’t offer scheme drawdown without employer approval – which they won’t get’
- ‘What will IGCs do to encourage engagement and participation?’
- ‘Why would anyone bring a product to market at the present time? The reforms were horribly rushed – regulated providers will bring more products online in time, but the pension industry was not set up to deliver such freedoms, so the danger is that people will go elsewhere. This is the biggest short term danger’
- ‘There is no clear differentiation between regulated and unregulated businesses. In recent years, regulated businesses have improved capital adequacy, professionalism and reporting, so there is now a growing gap with unregulated businesses’
- ‘What is tax relief trying to achieve?’

The pension reforms that followed the 2014 Budget would not be the first example of what Anthony King and Ivor Crewe called 'cultural disconnect' in their recent book *The Blunders of Our Governments*.[1033] By this they meant a set of assumptions that look obvious to well-educated, middle-class politicians and officials but which collapse when tested in the real world. Perhaps the most famous example of cultural disconnect is the poll tax. King and Crewe argue that: 'The man in Whitehall not only did not know best; he did not know that he did not know that which he badly needed to know'. Since all the men in Whitehall paid their taxes, they assumed that everyone would too. The warning cry from a junior official 'Try collecting it in Brixton' went unheeded. The minister subsequently brought in to clear up the mess said: 'It needed exceptionally clever people to produce anything so stupid'.[1034]

The people who conceived the 'freedom and choice' regime appear to have very little understanding of longevity risk. We were told at the time that the only piece of information that people need to be aware of is their life expectancy. Yet around 50% of 65-year olds will live beyond their life expectancy, often by many years.

A new type of commission is needed to reduce the risk of anything like this happening again.

7.6 Contributing to a national narrative 5: The pension tax system and the level of pension savings

The fifth contribution needs to come from the pension tax regime and the level of pension savings it encourages.

7.6.1 The original system of pension taxation[1035]

The system of pension taxation in the UK used to be fairly straightforward. It was based on the exempt-exempt,-taxed (EET) framework:[1036]

- Exempt – the pension contributions by individuals and employers receive tax relief and employer contributions are exempt from national insurance contributions
- Exempt – no tax is charged on investment growth from pension contributions, and
- Taxed – pensions in payment are taxed as other income, but individuals are able to take up to 25% of their pension fund as a lump sum on retirement.

[1033] Anthony King and Ivor Crewe (2014) *The Blunders of Our Governments*, Oneworld Publications, London.

[1034] Other blunders discussed by King and Crewe include: the reforms that led to pensions mis-selling in the 1980s, entry into the Exchange Rate Mechanism, Individual Learning Accounts, the Millennium Dome, the Assets Recovery Agency, the Child Support Agency, changes to the insurance industry that led to payment protection insurance mis-selling, and the failed National Health Service data base.

[1035] The appendix to this Chapter shows how the system of pensions tax relief has developed since A-Day in 2006.

[1036] HM Treasury (2010) *Removing the Requirement to Annuitise by Age 75,* July, para 2.3.

The 2010 Conservative-Liberal Democrat Coalition Government introduced a set of five pension taxation principles consistent with the EET framework:[1037]

1. The purpose of tax-relieved pension saving is to provide an income in retirement.[1038]
2. Any changes to the pensions tax rules should not incur Exchequer cost and should not create any opportunities for tax avoidance.
3. Individuals should have the flexibility to decide when and how best to turn their pension savings into a retirement income, provided that they have sufficient income to avoid exhausting savings prematurely and fall back on the state.
4. In line with the EET model, pension benefits taken during an individual's lifetime should be taxed at income tax rates. The tax-free pension commencement lump sum will continue to be available.
5. On death, pension savings that have been accumulated with tax relief should be taxed at an appropriate rate to recover past relief given, unless they are used to provide a pension for a dependant.

The EET framework provides generous tax incentives to save for a pension and is also designed to be broadly tax neutral over the life cycle. The tax relief that is granted during the accumulation phase of a pension scheme is reclaimed when the pension is taxed during the decumulation phase, so that the same income is not taxed twice. This recognises a long-standing principle of taxation in the UK, namely that tax relief is given at the same marginal rate as income is taxed. There is an anomaly in that 25% of the pension pot can be taken as a tax-free lump sum. But broadly speaking, the EET system is generally regarded as fair at the level of the individual.

While the EET system might be broadly fair in the sense of being tax neutral over an individual's life cycle, it nevertheless favours higher rate tax payers at the expense of standard rate tax payers, and especially those who are higher rate tax payers in work and only basic rate tax payers in retirement. In 2013-14, the total cost to HM Treasury of pension tax relief was £34.3bn (although around £13.1bn was offset by income tax deducted from pension payments).[1039] A 2013 study by the Pensions Policy Institute[1040] showed that around 20% of tax relief was paid to additional rate taxpayers, who make up only 1% of UK taxpayers. Some 80% of UK taxpayers pay the basic rate of income tax but benefit from only 25% of the tax relief on pensions'. The PPI report states that 'there are

[1037] HM Treasury (2010) *Removing the Requirement to Annuitise by Age 75*, July.
[1038] Not a lump sum.
[1039] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/463101/September_2015_Pensions_publication.pdf (see PEN6)
[1040] Melissa Echalier, John Adams, Daniel Redwood and Chris Curry (2013) *Tax Relief for Pension Saving in the UK*, Pensions Policy Institute.

concerns that tax relief is expensive, poorly targeted and does not achieve its policy objectives'.[1041]

7.6.2 The new system of pension taxation

The pension reforms, introduced by the 2014 Budget, ended the requirement to annuitise pension wealth – the fundamental rationale of a pension scheme. Further, the 2014 Taxation of Pensions Act which – by ending the 55% tax charge on pension death benefits if the member dies before 75 – allowed pension assets to become inheritable. Both these measures have completely distorted the EET model and bring into question the whole system of very generous tax relief currently granted to pension savings and investment.[1042]

Tom McPhail, head of pensions research at Hargreaves Lansdown, believes the current system is now 'in a complete mess'. He said the five principles of pension taxation introduced in 2010 – in particular that a pension should be for retirement income and the state would reclaim tax benefits on death – had been 'torn up' by the Government that introduced them in the space of one parliament.[1043]

The abolition of the 55% tax charge on pension death benefits has conferred massive tax benefits on a small group of very wealthy people.[1044] They received tax relief on pension contributions and investment returns at the highest marginal rate in the accumulation stage and will be able to transfer those benefits tax free to their descendants if they die before 75. John Ralfe's letter to the Financial Times of 8 October 2014 stated: 'the…Government has created a simple way for the richest to avoid paying income tax and pass on wealth tax free to their grandchildren'. Andy James, head of retirement planning at Towry, said 'The new regime will bring pensions into overall inheritance planning for wealthy people. You can pay the maximum into a pension, currently £1.25m, and it could pass down the generations tax free….Sadly, the changes to the tax charges on death for pensions will not help those who are still struggling to build up sufficient funds to pay for their retirement'.[1045]

The ending of the 55% tax charge will have further serious unintended consequences as Craig Berry points out: 'At the moment, people are rightly able to bequeath DC pensions pots when they die. But those inheriting these pots are, rightly, heavily taxed when they do,

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[1041] The report goes on to consider some alternatives to the current system, such as 'changes to the tax-free lump sum and using single rates of tax relief rather than relief given at the saver's marginal rate'.

[1042] The appendix to this Chapter shows how pensions tax relief restrictions have developed since A-Day in 2006.

[1043] Reported in Jenna Towler (2015) Govt must clean up pension tax mess and scrap LTA - Tom McPhail, Professional Adviser, 5 June.

[1044] The 55% rate was set to recover the tax relief that a 40% tax payer received on contributions and investment returns during the accumulation phase of a pension scheme, taking account of the 25% tax free lump sum. This rate therefore made a pension scheme tax neutral over a higher-rate tax payer's life cycle.

[1045] Reported in Josephine Cumbo, Alistair Gray and George Parker (2014) UK pension death tax abolition seen as benefiting the wealthy, Financial Times, 29 September.

reflecting the significant tax relief that supported the savings being accrued in the first place. From now on, however, these restrictions will be virtually abolished. This has two immediate implications. Firstly, it further biases the pensions tax relief system towards the wealthiest savers, that is, those likely to leave inheritable pots behind. Secondly, and most importantly in terms of the economics of pensions provision, it means individuals will be encouraged to keep their savings invested in their pensions scheme. … In fact, not only is annuitisation no longer compulsory, for the wealthiest savers, it is now being significantly disincentivised. This brings us to the crux of the matter, and the most important long-term implication: all of this makes annuities more expensive. If insurance companies cannot rely on a steady stream of wealthy retirees buying annuities, they lose scale efficiences, and will have to make their products more expensive for the mass market. In two swift strokes, auto-enrolment begins to unravel. The historic compromise that led to DC pensions being universalised has been hugely undermined…… The only way that "ordinary savers" are going to be affected by this is that they are going to have to pay more to get those annuities. In short, they will be considerably worse off'.[1046]

Tom McPhail agrees that the abolition of the tax charge has reduced the attraction of annuities: 'The whole direction of government policy is going against allowing retirees to benefit from mortality cross-subsidy,[1047] which is one of the most valuable and economically-sound factors that can influence their retirement outcomes. The mortality cross-subsidy is a highly efficient way of maximising your retirement income. The current direction of policy is significantly undermining the stability of the pension system. I feel uncomfortable at the way the Treasury has suggested 18m people in DB schemes will be able to benefit from the new freedoms. That is an irresponsible attitude. People will want to transfer out and schemes will collude with them on this. They will offer maybe 95 per cent of the value of benefits, and people will take them up on it. I think it is cynical on the part of the Government to position this in this way'.[1048]

Natalie Holt, editor of Money Marketing, argues that the new regime provides a clear incentive to reduce inheritance tax: 'Whereas previously pensions were about providing for savers in their retirement, they may now be about sheltering assets beyond the person's lifetime'.[1049] According to Chris Marshall, technical officer at Hornbuckle, 'the change to IHT proposed by the Conservatives [which raises the threshold on primary homes to £1m] will disproportionately benefit the well-off (IHT currently affects only 8% of estates, and, according to the Institute of Fiscal Studies, the changes would mean limiting it to the top 6%), [whereas] the theme of changes to pension tax relief since 2009 has been to reduce

[1046] Craig Berry (2014), Pensions: End of the road for 'auto-enrolment' business model?, 30 September; http://touchstoneblog.org.uk/2014/09/end-of-the-road-for-auto-enrolment-business-model/
[1047] Also known as a mortality premium.
[1048] McPhail attacks 'irresponsible' Treasury reform agenda - Corporate Adviser, 29 September 2014.
[1049] MM leader: Look what happens when politicians are too hasty, 2 October 2014.

the cost to the taxpayer by getting those at the top of the income ladder to pay for it, or at least to limit the amount they save into pensions, and thereby decrease how much tax relief they get'.[1050]

Nevertheless, inheritance planning cannot be explicitly used to avoid paying inheritance tax on pension assets. As Michelle McGagh states: 'pensions are now being seen as a way to pass on money to the next generation tax efficiently. This means wealthier pensioners who do not need their pensions to live on can ring-fence their savings for their family. However, there is a concern that HMRC will not look kindly on those it believes are gaming the system'.[1051] For example, if someone makes extra large contributions or consolidates a number of pensions and then dies within two years, HMRC could view under the 'disposition of assets' rules and levy IHT if it believes individuals are using pensions to shelter money.

In the Autumn Statement in November 2015, the Treasury clarified the situation. It said it would legislate to ensure an IHT liability will not arise when a pension scheme member designates funds for drawdown, but does not draw all of the funds before death, with the change backdated to apply to deaths on or after 6 April 2011.

7.6.3 What is the role if any of pension taxation relief?

Now that there is no requirement to annuitise, one of the original justifications for providing tax relief has gone. A pension scheme is now no more than a wealth accumulation scheme. That raises some fundamental questions. Why should tax payers subsidise pensioners buying Lamborghinis or transferring their pension wealth to their grandchildren? It is still possible to make the regime tax neutral, but why bother in the first place? These questions have prompted renewed interest in the role of pension tax relief since the introduction of 'freedom and choice'.

In March 2015, the ACA published a consultation paper, *Creating a Sustainable Pensions Tax Framework*, which called on all political parties to cooperate with industry in a fundamental review of pension taxation that will lead to a sustainable pension taxation system that can be readily understood and can properly incentivise retirement savings.[1052] The ACA said it had significant concerns that further reductions will be made to pension tax relief whichever party or parties form the next Government and that the changes will be placed on an already overly complex system.

[1050] Chris Marshall (2015), Assessing the Tory IHT/pension tax relief pledge, Professional Adviser, 14 April.
[1051] Michelle McGagh (2015), Using pension to dodge IHT could land you tax bill, Citywire, 11 May.
[1052]
www.aca.org.uk/files/Creating_a_sustainable_Pensions_Tax_Framework-4_March_2015-20150304075543.pdf

The paper's main recommendations are:

- There should be no 'knee jerk' changes to the pension taxation system after the General Election. The ACA notes that even a reduction in the Lifetime Allowance (LTA) might look a simple change – but it brings a new range of individuals into a potentially complex net and creates a new 'protected case' for schemes to have to deal with – so its impact should not be underestimated
- The next Government should initiate a fundamental cross-party review of the pension taxation system working closely with employers, pension providers, consultants and administration providers to ensure the new system is practical
- The review should ensure that full details of the current reliefs, and their distribution between various constituencies, are understood
- Changes to pension taxation should have cross-party support so that any new framework can endure
- Any new framework should be given an appropriate lead time so that those who manage schemes can change systems appropriately and employers and individuals can plan properly for any new change
- Once in place the new framework should not have any changes made to it for many years.

The ACA argues that any significant reduction to the amount of tax relief granted on contributions could lead to a withdrawal from pension savings which is counter to recent government policies, such as auto-enrolment, which are designed to encourage greater participation. It believes that complexity results in individuals being put off saving for retirement, employers are deterred from establishing and maintaining pension schemes beyond the minimum enforced by auto-enrolment, and, for individuals who do save diligently (and for employers supporting this), the costs of ensuring compliance with current tax law means ultimately that there is less money available for retirement savings.

The tax system could also be used to provide appropriate incentives. An example of this would be to scrap stamp duty for older people to help them move out of under-occupied homes, a proposal made by Legal & General in June 2015.

The insurer has published a report called *Free up Housing Stock – Report into the Last Time Buyer Market*.[1053] The report focuses on 'last-time buyers' (LTBs), those aged over 55 who are sitting on housing wealth of £820 billion that is forecast to increase to £1.2 trillion by 2020. It estimates that 5.3 million last-time buyers live in under-occupied homes with 7.7 million spare bedrooms, equivalent to 2.6 million family homes. However, 3.3 million last-time buyers want to downsize, typically from a four-bed to a two-bed property. While a third of older people considered downsizing in the last five years, only 7% did so. This has

[1053] http://www.legalandgeneralgroup.com/_pdfs/press-release/LTB_Front_Cover_Report_Final.pdf had the effect of stalling the property market as younger families can neither find nor afford suitably large homes. To get around this, L&G believes LTBs should be offered tax breaks, such as scrapping stamp duty 'to incentivise right-sizing' and to encourage people to sell their home and downsize in later life, freeing up family-size properties for younger generations.

L&G also wants to deal with the 'chronic undersupply of age-specific housing', given that just 2% of the UK's housing stock is classified as retirement housing. Another problem is that the majority of the retirement properties available in the UK are sold on a leasehold basis which will not be attractive to many buyers. The report says: '[We need] increased volumes of homes across all tenures, including freehold, shared equity and rented options, [that] would allow the system to cater to a wider variety of needs and offer flexibility as people's needs change in later life'. The report would also like to see a larger 'new homes bonus' given to those buying retirement-specific property or a 'council tax holiday for new retirement homes' for the first three years.

L&G has set out a 10-point plan to make downsizing easier. Its recommendations are:

- Government to support provision of age-specific housing
- Housing connected with infrastructure, social and health systems
- Retirement housing shouldn't just be leasehold properties
- More mid-market supply on top of affordable housing
- Public policy should support urban locations for retirement villages
- Greater tax reliefs to encourage downsizing
- Consolidate benefits, which influence retirement housing
- Planning authorities should standardise approaches
- Remove development levies imposed by planning system
- Government should encourage use of equity release.

Nigel Wilson, chief executive of L&G, said: 'Helping young people to get onto the housing ladder through initiatives like Help-to-Buy is important, but enabling older people to realise their downsizing dreams could have a far greater impact in terms of unlocking family housing stock for people to buy'.[1054]

Michael Johnson, in a report entitled *Who Will Care for Generation Y?*, published by the Centre for Policy Studies in June 2015, again considers the question of intergenerational fairness.[1055] He estimates the size of the tax burden being passed to the next generation. His calculations show that the gap between the UK's liabilities and assets grew by an

[1054] Reported in Michelle McGagh (2015) Retirees need tax breaks to downsize, says insurer, Citywire, 2 June.
[1055] http://www.cps.org.uk/files/reports/original/150602131332-WhoWillcareforGenerationY.pdf

‘unsustainable’ 51% in the five years to end-March 2014, to £1,852 billion. At 111% of GDP, this is equivalent to £70,000 per household. If the state pension, the largest of all unfunded liabilities (roughly £4,000 billion) is included, the burden per household rises to £221,000. The report warns that Generation Y could be the first generation to experience a quality of life below that of its (baby boomer) parents.

Mr Johnson comments: ‘Baby boomers have become masters at perpetrating inter-generational injustice, by making vast unfunded promises to themselves, notably in respect of pensions. Indeed, such is their scale that if the UK were accounted for as a public company, it would be bust. In any event, Generation Y will have to foot the bill.… Reining back on unfunded promises means either stop making them, or fund them now, which would require higher taxation (or additional cuts in public spending)’.

To improve transparency and put a brake on deferring costs, the report outlines six proposals:

1. The UK’s Whole of Government Accounts (WGA) balance sheet should include a liability to represent future State Pension payments [which they currently do not do], based upon a realistic expectation of the future cash outflow, discounted using the UK gilt yield curve.
2. Draft legislation which, if implemented, would produce unfunded spending commitments, should be accompanied by an Inter-generational Impact Assessment to quantify the impact on the young, i.e., future taxpayers.
3. An Office of Fiscal Responsibility should be established, under the aegis of the Chancellor, to scrutinise the effectiveness and value for money of all tax reliefs and exemptions.
4. All tax reliefs and exemptions should be subject to a five year sunset clause, after which they would cease. Lobbyists should be requested to present their cases directly to the proposed Office of Fiscal Responsibility, to ensure blue water between vested interest groups and ministers.
5. Departmental budgets should be set both gross and net of expenditure on tax reliefs and exemptions, to ensure transparency as to the true level of financial support to each area of public policy.
6. The Prime Minister should embellish his doctrine of personal, professional, civic and corporate responsibilities by adding a fifth category: inter-generational responsibility.

In October 2015, Michael Johnson published another Centre for Policy Studies report entitled *An ISA-Centric Savings World*, in which he proposed replacing the EET pension tax system with one similar to the TEE system of ISAs.[1056] In particular, he proposed that:

- All income tax and National Insurance Contributions (NICs) relief on pensions contributions be scrapped, to be replaced by a more redistributive 50p Treasury incentive per post-tax £1 saved. This should be paid irrespective of the savers tax-paying status, thereby nailing the conundrum that because income tax is progressive, tax relief is inevitably regressive. A 50p incentive would significantly help realise the Pension Commission's vision for median earners to have a two-thirds total combined earnings replacement rate.
- Employer contributions, taxed as employee income but eligible for the Treasury incentive, would be paid into a Workplace ISA, operating within the auto-enrolment arena. Withdrawals would not be permitted until the age of 60, thereby trapping the incentive, along with income and net capital gains. Thereafter, they would be, ideally, tax-free.
- Auto-enrolled employee contributions, paid post-tax but attracting the Treasury incentive, would go into an employee's Lifetime ISA.
- The Workplace ISA and Lifetime ISA could reside within an ISA warehouse, alongside other segregated ISA cells dedicated to specific saving purposes (Help-to-Buy, long-term care, etc.). The ISA warehouse could become a universal, all-purpose savings vehicle to serve everyone from cradle to grave. Simplicity to the fore.
- Each ISA cell would have its own (tax-based) incentives and deterrents, to reflect prevailing policy objectives. They would share a modest annual allowance, such as £8,000, subject to Treasury modelling confirmation. A smaller incentive, for example, could accommodate a higher annual allowance.

The report introduced the idea of an ISA Pension, secured with Workplace ISA assets, from the age of 60. Mr Johnson argues: 'The primary driver for moving from pensions' EET framework to the TEE world of ISAs is the inflexibility of pension savings prior to 55. This is at odds with how those in Generation Y, in particular, are living their lives. Many eschew pension saving, thereby missing out on tax relief, but engagement with ISAs is high. Ready access and flexibility is valued above tax relief: EET is patently failing the next generation. In addition, a single TEE tax framework for savings would represent a marked simplification of the savings arena. ..Given the individual and societal benefits of annuitisation, a Treasury-funded inducement should be considered, such as a 25% income uplift. Indeed, this approach could be extended to today's ISA suite. Participation would be optional, consistent with 2014's pensions' liberalisation'. He described the current system pension

[1056] http://www.cps.org.uk/files/reports/original/151007092342-AnISACentricSavingsWorld.pdf tax relief as 'expensive, incompatible, inequitable, illogical, incomprehensible and, crucially, an ineffective use of Treasury funds'.

7.6.4 The Government's consultation

The newly elected Conservative Government released a consultation paper on pension taxation in July 2015.[1057] The consultation will examine whether there is a case for overhauling the current EET system of tax relief, where relief is given on contributions and investment income but the benefits on retirement are taxed.

The Government said the key principles any reform should meet are:

- It should be *simple and transparent*. The Government said it believes that greater simplicity and transparency may encourage greater engagement with pension saving and strengthen the incentive for individuals to save into a pension
- It should allow individuals to take *personal responsibility* for ensuring they have adequate savings for retirement. It should encourage people to save enough during their working lives to meet their aspirations for a sufficient standard of living in retirement
- It should *build on the early success of automatic enrolment* in encouraging new people to save more
- It should be *sustainable*. Any proposal for reform should also be in line with the Government's long-term fiscal strategy.

One option to be examined is bringing the tax treatment of pensions into line with ISAs (i.e., replacing the EET system with a TEE system) along the lines proposed by Michael Johnson who has estimated that such a move could save the Government £10bn a year. In launching the consultation in the Budget on 8 July 2015, the Chancellor, George Osborne, said: 'Pensions could be taxed like ISAs. You pay in from taxed income – and it's tax free when you take it out. And in-between it receives a top-up from the Government. This idea, and others like it, need careful and public consideration before we take any steps. So I am today publishing a green paper that asks questions, invites views, and takes care not to pre-judge the answer. Our goal is clear: we want to move from an economy built on debt to an economy built on the more secure and productive foundations of saving and long- term investment'.

The idea of having a consultation was welcomed by industry. For example, Hugh Nolan, chief actuary at JLT Employee Benefits, said 'We welcome any genuine consultation to put

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[1057] HM Treasury (2015) Strengthening the incentive to save: a consultation on pensions tax relief, Cm 9102, July;
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/442159/Strengthening_the_incentive_to_save_consultation__print_.pdf

pensions onto a sound footing for the future, recognising that it's just one form of overall saving'.[1058]

However, the proposal to tax pensions like ISAs was criticised in some quarters. An early critic was the Pensions Minister Ros Altmann who said 'a pension is not an ISA' and a switch could be 'dangerous' for retirees, claiming pensions under the new regime would be 'too easy to spend too soon'. She said: 'I do fear that making pension withdrawals tax free at a relatively young age (60s and 70s is not old these days) offers dangerous incentives to stop locking the money in for later life. Policy must be mindful of offering the right incentives not the wrong ones….Just saving from taxed income isn't attractive…It's important to ensure money is kept in pensions for longer'. Under Mr Johnson's proposed framework, employer contributions would be locked in until retirement, while only the employee contributions would be accessible at any time.[1059] Another critic was Steve Webb, the previous Pensions Minister. He argued that a move to pension ISAs would be a 'fallacy' and a huge step into the unknown' which could undermine long-term saving: 'The taxation of pension incomes provides a "brake" on the Lamborghini. Having to pay tax makes you think twice about withdrawing the lot in one go; if pensions are tax free, what would hold you back?'[1060]

A number of providers, asset managers and advisers have also come out against the proposal, claiming it would damage the savings culture:

- Zurich said that, according to a survey it conducted, tax relief on contributions is the most powerful way to incentivise people to save for retirement, with more than two-thirds of over-55s surveyed agreeing with this. Gary Shaughnessy, chief executive of Zurich UK Life, said: 'A move to ISA-style pensions could reverse the early success of auto-enrolment. If individuals are taxed on employer contributions, there is a very real concern that they would opt out to avoid a hit on their take-home pay'.
- Royal London CEO, Phil Loney, believes savers would not trust the system, concerned that the Government would have changed its mind about offering tax-free cash by the time it comes to their retirement.
- Axa Wealth head of retirement planning, Andy Zanelli, argued that the proposals would lead to more people taking out accessible savings products and drawing their cash before retirement and hence running out of money. He said: 'If you are trying to address the savings issue by allowing them to put money into something accessible it won't work. It's counterproductive. If ISAs and pensions do the same

[1058] Quoted in Natasha Browne (2015) Summer Budget - Government eyes scrapping tax relief on pension contributions, Professional Pensions, 8 July.

[1059] Reported in Josephine Cumbo and Jim Pickard (2015) Pensions minister questions Osborne plan, Financial Times, 16 July.

[1060] Quoted in Katie Morley (2015) 'Pension Isas' will encourage pensioners to buy Lamborghinis, Daily Telegraph, 29 September.

thing people might promote the ISA in place of the pension. People would be tempted to draw money in times of a "crisis" and everybody defines "crisis" differently. If there is one allowance for both products nobody would go for the pension'. [1061]

- Aviva published research which said that two-thirds of companies believe that a shift to an ISA system would lead to employees saving less into their pension.
- AllianceBernstein said a move to an ISA-style system 'would represent such a significant shift as to undermine long-term confidence in the robustness of pensions – savers would lack confidence in locking their money up in a system which could potentially change the tax treatment without prior notice'. Further, it would not improve the incentive to save, but instead make it 'considerably more complex' for employees currently paying a higher rate of tax, and would be 'highly costly' to introduce across the industry.[1062]
- A survey of 170 advisers by A J Bell found that there was only 4% support for ISA style pensions, with 59% saying they did not think the pension tax relief system needs to change.
- Almost half of advisers – 42% – thought it is right that tax relief is received at the rate tax is paid, while 40% said there has been enough change and a period of stability is required. Only a third of the advisers questioned said they would like to see a flat rate incentive, the majority of which supported one set at 30%, in between the basic rate of 20% and the higher rates of 40%-45%. About 8% favoured a system of matching Government contributions on a two for one basis.[1063]

Zurich, AXA and Aviva agree that the pension tax system should be simplified rather than unified with ISA tax relief. They propose that the Government introduces a flat rate tax relief of 33% – a £1 top-up to their pension for every £2 saved – and removes the current £1.25m lifetime allowance. [1064]

The National Association of Pension Funds (NAPF) has argued that ending tax relief on contributions by switching from EET to TEE would not necessarily save the Government money and could instead cut the tax take by 15%. It said: 'Modelling a central scenario, which assumes different proportions of contributions from different types of taxpayer — both before and after retirement — the tax take for TEE would be 15% less than under the current system'. The NAPF also said it was a 'myth' that higher-rate taxpayers benefited

[1061] Reported in Carmen Reichman (2015) Zurich warns against shift to 'ISA-style' pension tax relief, Retirement Planner, 15 September; Carmen Reichman (2015) Axa Wealth: ISA-pension merger would 'harm savings culture', Retirement Planner, 14 September.

[1062] Reported in Andrew Pearce (2015) Buyside urges pensions reform rethink, Financial News, 30 September.

[1063] Reported in Carmen Reichman (2015) Advisers shun govt plans for ISA-style pensions and flat rate tax relief, Professional Adviser, 19 October.

[1064] Reported in Jenna Towler (2015) Aviva urges govt to scrap unfair pension tax relief, Retirement Planner, 14 September.

more from the current system than basic-rate tax payers: 'Under the current system, pound for pound saved before tax, higher earners generally get a lower amount of pension to spend and pay more tax on their pension savings than lower earners. Non-taxpayers and basic-rate savers who drop a tax bracket in retirement do well out of the current system. They would lose from a shift to TEE, but would be winners under a single rate of tax relief of 25%'.[1065] Joanne Segars, NAPF chief executive, said in a statement on 30 September 2015: 'The Government says it wants to incentivise saving but it also wants to increase the revenue to the Exchequer – but these two objectives are incompatible and lead to quite different courses of action. There is a very real risk that to increase the tax take in the short-term, the Government will gamble away the long-term interest of savers'. The NAPF chairman, Ruston Smith, went further and said that the proposed Government changes to pensions tax relief threatened to turn pension revolution into pension implosion': they could 'literally dig up and smash the foundations set to create a society of lifetime savers – putting pressure back on our ageing society'.[1066]

In October 2015, the National Institute of Economic and Social Research (NIESR) published *An Economic Analysis of the Existing Taxation of Pensions (EET) versus an Alternative Regime (TEE)* and found that under TEE, personal savings would fall, resulting in lower consumption, a lower capital stock and productivity and a higher interest rate. There is also a 'dynamic inconsistency problem inherent in TEE' as a future Government could reverse the policy or re-introduce taxation on pension income.[1067]

The Government said it would announce its new policy on pensions tax relief decision in the March 2016 Budget.

7.6.5 The effectiveness of pension tax relief

While providing an incentive to save for those who understand pension tax relief, a survey of 1,794 working adults aged below 65 conducted by YouGov and published by The People's Pension in September 2015 revealed that 74% of pension savers do not understand (59%) or have not heard of pension tax relief (15%). The provider suggested the Government's consultation into tax relief was an opportunity to raise awareness about it and encourage people to save more. Darren Philp said: 'This research confirms that tax relief is not well understood and calls into question whether it is really acting as an incentive to save. Incentives only work where they are clear and understandable. Unfortunately, the current

[1065] Reported in Josephine Cumbo (2015) Pension body opposes shift to ISA-style taxation, Financial Times, 23 September.
[1066] Reported in Helen Morrissey (2015) NAPF 2015: Changes to tax relief could bring pension implosion, Professional Pensions, 14 October.
[1067] Reported in Rebecca Shahoud (2015) NIESR says TEE is not sustainable long-term, Professional Pensions, 28 October.

system is just not up to the job'. The survey also revealed that 62% would be more likely to increase the amount they saved if the Government matched their contributions.[1068]

We would argue that the following factors should be taken into account when designing a system of pension taxation and pension tax relief that encourages the optimal level of pension savings. We believe that the role of tax policy should be to help achieve one or more Government aims when private sector outcomes are considered to be sub-optimal or undesirable. In terms of pension tax relief, potential Government aims might be (different Governments will put different weights on these):

1. To encourage the level of pension savings needed to achieve a target standard of living in retirement which might be defined as:
   a) 'essential' – income sufficient to cover an individual's minimum basic expenditure needs
   b) 'adequate' – income sufficient to achieve a minimum lifestyle to which an individual aspires in retirement
   c) 'desired' – income sufficient to achieve the full lifestyle to which the individual aspires in retirement.
2. To encourage individuals to make provision for long-term care. (While this is not directly a pension issue, the relationship between the joint increases in longevity and morbidity inevitably link the two.)
3. To achieve tax neutrality over the life cycle. One objective of pension tax relief is to encourage larger pension funds than otherwise, but to do so in a way that is tax neutral to each generational cohort, so that the cumulative value of tax reliefs during the accumulation phase broadly equals the present value of tax that will be collected during the decumulation phase (both valued at the date of retirement).
4. To achieve a degree of equity between members of the same generation through a redistribution of resources between low- and high-income individuals, men and women etc.
5. To achieve a degree of equity across generations and, in particular, to avoid unfair burdens falling on future generations.

It is also important to recognise the two principal types of individual decision makers, 'econs' and 'humans'. As we discussed in Chapter 3, 'econs' are fully rational lifecycle financial planners. They perfectly understand and value the role of pensions in redistributing consumption over the lifecycle from the work phase to retirement. 'Econs' will start and optimally manage their own pension schemes regardless of any tax incentives.

[1068] Reported in Michael Klimes (2015) People's Pension: three quarters don't grasp importance of tax relief, Professional Pensions, 22 September.

‘Humans’, by contrast, have behavioural traits and face behavioural barriers which inhibit them from behaving optimally. In a pension context, a particularly important behavioural trait of humans is a poor understanding of the time dimension of their lives. Many humans have a good understanding of the present and the near future, but have very little comprehension of the distant future. The idea of thinking about their older self in 10 years’, 20 years’ or 30 years’ time is completely alien to them. This leads to a practice known as hyperbolic discounting which implies that people exhibit short-term impatience and long-term patience. The classic illustration of this is that, given the choice between one apple now and two apples tomorrow, most people choose the apple now (short-term impatience or the desire for instant gratification). But given the choice between one apple in 100 days and two apples in 101 days, most people choose the two apples (long-term patience or a willingness to exhibit deferred gratification). Transposed into a pension context, humans can see the benefits of saving for retirement if it is explained to them (deferred gratification), but since they only live in and comprehend the present, they never start the pension plan (i.e., without a pre-commitment device, they never get to that 100th day in the future where they would exhibit long-term patience and see the benefits of deferred gratification), since they are unwilling to give up current consumption (short-term impatience and instant gratification always dominate). Another related behavioural trait is inertia: people see the benefits of saving for retirement, but never get around to starting their pension plan. Another one is lack of willpower: again people see the benefits of saving for retirement, and may even start a pension plan, but they do not have the willpower to maintain it over the long investment horizon required.

Now let us look at the role and effectiveness of pension tax relief with these two different types of decision maker. The position with econs is straightforward: they will plan their pension plan optimally regardless of any tax incentives. In fact, pension tax incentives are not needed for econs. However, the evidence suggests that the proportion of econs in the population is low. Most people are humans.

The role and effectiveness of pension tax relief in the case of humans depends on how severe their behavioural barriers are. If the barriers are low – people understand the value of pensions, and are willing to save for a pension, but suffer from inertia – then people just need an incentive or a nudge to get started. Tax relief provides such a nudge. UK pension tax policy is predicated on idea that most people are humans and need some encouragement to start a pension scheme. Governments have, however, differed in their view about how severe the behavioural barriers are. Before 1988, people were obliged to join their employer’s pension scheme as a condition of employment, although they still received the tax relief. This suggests that prior to 1988, Governments believed that the behavioural barriers were sufficiently high that nudges alone would not be adequate and that compulsion was needed. However, between 1988 and 2012, there has been no compulsion to join a company pension scheme. The Government’s argument in 1988 was that people should be free to choose how they spend their money, suggesting they thought that most people were in fact econs. The declining membership of workplace pension schemes, especially in the private sector, since 1988 provides evidence that this is not the case and that most people are indeed humans. This has been accepted by all Governments since the Pension Commission recommended auto-enrolment (a classic example of the use of inertia to help humans overcome a behavioural barrier) in workplace pension schemes in 2005. AE was introduced with all-party support in 2012.

With this in mind, we can now examine the potential reform of pension tax relief in the light of the five aims of Government pension tax relief policy above:

1. The cost of the tax relief here depends on both the chosen target standard of living for each individual (essential, adequate, or desired) and the number of individuals covered. Clearly, the more generous the target, the more generous the tax relief and the less the Government has available to spend elsewhere. The number of individuals covered will also depend on the success of auto-enrolment. If auto-enrolment is successful in bringing more people currently without pensions into the pension system, then total tax relief will rise. If auto-enrolment fails, an alternative way – possibly the only way – of getting more people to join a pension scheme is compulsion. This would, in turn, reduce the need for such generous tax relief.

2. The current situation with long-term care provision needs to be resolved. Most people do not seriously prepare for the possibility of long-term care until it is too late, with the result that 50,000 people a year are forced to sell their homes to pay for care. This has led to the following question being asked: Why should people make sacrifices to pay off a mortgage if they are going to be penalised in this way, when those who did not bother to buy a home get their care costs paid by the state? Currently, annual care costs vary between £30,000-50,000 depending on the extent of nursing care required. The 2011 Dilnot Commission on Funding of Care and Support recommended that: the amount any individual should be required to contribute to the cost of their social care should be capped at between £25,000 and £50,000 (excluding normal room and board costs) and that the means-test threshold be increased to £100,000. The total cost to the Government was estimated to be £2.2bn.

   One in five of us will need care for an average of two years. This means that long-term care is a classic insurance problem with a standard insurance solution. Above a certain minimum income level, individuals could be encouraged to take out long-term care insurance, possibly by diverting some existing pension tax relief for this purpose. If we all did this at a young age, the annual premiums would be fairly modest. But there is a free rider problem to consider. If the scheme is voluntary, some people will choose not to participate, despite the tax relief, in the belief that since everyone else is covered, they will be able to slip through the net if they need care which they might not. The young in particular are likely to believe that they will never need to draw on the insurance policy. There is a danger that sufficient numbers of people will not participate for these reasons. So compulsion might be the only effective way of dealing with the free rider problem, in which case again tax relief is not necessary.

3. The net cost to HM Treasury of pension tax relief (tax relief on pension contributions, on investment income of pension funds and lump sum withdrawals less tax liable on pension payments) was £22.8bn in 2012-13.[1069] It is impossible to tell from this figure whether it is consistent with tax neutrality over the life cycle, but we can say that we are not currently in a state of tax neutrality, since there has not so far been a year in which pension tax relief has not exceeded pension taxes. This might happen in the future as more baby boomers retire and if taxes exceed relief. But the taxes would have to exceed the relief by a substantial margin in the years ahead: the net tax relief between 2000-01 and 2009-10 alone was £168.7bn. A tentative conclusion, therefore, is that the current system does not lead to tax neutrality when aggregated over individual life cycles within one age cohort: the structure of tax reliefs is too generous compared with the taxes subsequently collected. Pension taxes could be reformed to rectify this. They could also be reformed to make post-retirement work more attractive (the Government's decision in the 2012 Budget to remove the higher income tax thresholds for older people militates against this, however).

4. If the Government wants to cap the total cost of tax relief, especially if the pension tax system is not neutral over the life cycle – a fact that benefits the better off – then one solution favouring greater equity is to make the system less generous for the better off. This can be done on both the contribution and benefit side. In terms of contributions, the Government has already severely capped the level of contributions which attract tax relief. It would not be sensible to reduce this cap any further, since this would greatly penalise people who do not start a pension scheme until late in their working life and hence need to make very high annual contributions to catch up. So a better way might be to remove higher rate tax relief on pension contributions and only allow tax relief at the basic rate or a new flat rate of, say, 33%.[1070] In terms of benefits, the (currently tax-free) lump sum could be taxed above a certain level. A more extreme solution would be to remove the tax-free lump sum altogether. This, of course, would be extremely unpopular. Also the lump sum plays an important role in providing a rainy day fund for people in

[1069] http://www.parliament.uk/written-questions-answers-statements/written-question/commons/2015-02-10/223929; see also https://www.gov.uk/government/statistics/registered-pension-schemes-cost-of-tax-relief
[1070] This would, however, break a long established principle of the UK tax system that income is taxed and any offsets are tax relieved at the same marginal rate.

retirement: many people are not able to finance big ticket expenses, like boiler or car repairs, from their pensions. Nevertheless, while politically unpopular, the proposed reforms here would not only deal with equity issues, they would also help the system move closer to tax neutrality over individual life cycles.

5. Finally, the issue of intergenerational equity: no generation is entitled to unfairly burden generations which do not yet have the vote or which have not yet been born. It is also unwise for them to try and do so, as these later generations can choose not to honour the obligations that have been placed upon them and which they have not agreed to. This becomes more likely if the later generations are smaller in size and poorer than the earlier generations, a possibility that seems increasingly likely in the UK and other parts of the developed world – unless there is mass immigration, a possibility which now seems equally likely. This reinforces the argument that the pension tax system should be tax neutral between generations and should not involve the tax liabilities of one generation being passed on to future generations.

To summarise, the effectiveness of pension tax reforms in encouraging an optimal level of pension savings will largely depend on the balance between three types of individual:

- Econs – reforms will not alter the behaviour of econs who have already optimally set up their pension schemes, regardless of the level of tax relief; indeed econs do not need any tax relief to set up a pension scheme
- Humans facing extreme behavioural barriers – no amount of tax relief is going to nudge such people into setting up and maintaining a pension scheme, so again there is no need for tax relief in this case. Making occupational pensions compulsory rather than voluntary is the clear solution here, but all Governments have shied away from this, afraid of the accusation that this would be another form of taxation.
- Humans facing moderate behavioural barriers – here nudges in the form of tax relief will be effective. However, the biggest beneficiaries of pension tax relief are always going to be higher income and better educated people, unless tax relief is genuinely made tax neutral over the life cycle through some combination of limits to the tax relief on contributions (such as restricting it to the basic rate or a new flat rate of 33% which is probably less distortionary than increasing the cap on contributions) and increased taxes on benefits (such as taxing the lump sum above a certain limit).

7.7 Recommendations

Our discussion in this Chapter leads us to make the following five recommendations.

Recommendation 7.1: Reviewing the working relationships within the pensions industry

We recommend that the pensions industry – via its trade associations – conducts a review of the working relationships of its various components – providers, advisers, investment

managers and insurers – to remove the serious fissures and thinly disguised hostilities that currently exist, and which impede customers getting the best solutions for their needs.

All these parties are necessary to provide appropriate, effective and value-for-money retirement income solutions, yet the evidence we have gathered for this report suggests that the working relationship between the parties is not working effectively in the best interests of customers.

Recommendation 7.2: Creating a single pensions regulator

We recommend that the Government creates a single pensions regulator, with the regulatory powers of the Financial Conduct Authority over contract-based schemes transferred to The Pensions Regulator.

This would be consistent with the enhancement of the powers of independent governance committees in contract-based schemes to match those of the trustees in trust-based schemes proposed in **Recommendation 3.6**. It would also help to provide greater consistency of treatment between trust-based and contract-based schemes. Particularly important in this context is the issue compensation in the event of the insolvency of a pension scheme or a service provider to a scheme. Our research shows that there are many serious and significant discrepancies between the compensation rules of trust-based and contract-based schemes. The creation of a single regulator would help to bring clarity and consistency to pension savers' rights and protections.

Recommendation 7.3: Establishing a pension tax and tax relief framework that reflects how people behave

We recommend that the Government establishes a pension tax and tax relief framework that encourages the optimal level of pension savings given the reality that most people are 'humans' not 'econs'.

The aims of the pension tax and tax relief framework would be:

6. To encourage the level of pension savings needed to achieve a target standard of living in retirement which might be defined as:
    a) 'essential' – income sufficient to cover an individual's minimum basic expenditure needs
    b) 'adequate' – income sufficient to achieve a minimum lifestyle to which an individual aspires in retirement
    c) 'desired' – income sufficient to achieve the full lifestyle to which the individual aspires in retirement.

7. To encourage individuals to make provision for long-term care. (While this is not directly a pension issue, the relationship between the increases in longevity and morbidity inevitably link the two.)
8. To achieve tax neutrality over the life cycle. One objective of pension tax relief is to encourage larger pension funds than otherwise, but to do so in a way that is tax neutral to each generational cohort, so that the cumulative value of tax reliefs during the accumulation phase broadly equals the present value of tax that will be collected during the decumulation phase (both valued at the date of retirement).
9. To achieve a degree of equity between members of the same generation through a redistribution of resources between low- and high-income individuals, men and women etc.
10. To achieve a degree of equity across generations and, in particular, to avoid unfair burdens falling on future generations.

Recommendation 7.4: Establishing a permanent independent Pensions, Care and Savings Commission

We recommend that the Government establishes a permanent independent Pensions, Care and Savings Commission which reports to Parliament.

Its remit would be:

- To assess the impact of the Budget flexibilities on default investment strategies
- To consider whether a default decumulation option is required for savers making poor decisions
- To assess the impact of the reforms on the suitability and accessibility of retirement products
- To recommend market interventions where the market was not working in savers' best interest
- To tackle high charges and poor governance in legacy schemes
- To review auto-enrolment, including making recommendations on minimum contributions and defining adequacy of retirement income and how the policy should be assessed as a success. The committee said using opt-out rates to measure success would not be meaningful in the long term
- To oversee any further changes in savings and tax policy
- To assess the minimum age at which people can exercise their pension flexibilities. The current age is 55 and this will rise to 57 in 2028 when the state pension age increases to 67. But allowing people to draw on the private pension ten years before state pension age could create unrealistic expectations about the age at which they can afford to stop working. The commission would consider whether this should be reduced to five years, except for those in ill health

- To look at issues relating to auto-enrolment: the challenges of extending auto-enrolment to smaller employers, the level of minimum contributions for employers and employees, how currently excluded groups, such as the self-employed and those in multiple low-paid jobs, can be brought into pension saving more effectively
- To review the structure of state pensions and the Government's timetable for raising the state retirement age to reflect both improvements in life-spans and overall financial costs to the taxpayer (given the current commitment to the 'triple lock' indexation of the basic state pension)
- To advise every three years on the need or not for a general increase in retirement age to reflect increases in longevity so as to keep pension funding costs broadly stable over the long-term where scheme specific information is unavailable
- To recommend policies designed to encourage more employers and employees to invest in retirement income plans, including auto-escalation and other measures to maximise design flexibilities and choices, advising on financial and tax incentives to encourage wider coverage, whilst taking account of the UK economic, demographic and financial backcloth and life-style changes
- To review and make recommendations on tax incentives for long-term care products
- To promote legislative and regulatory simplification to encourage quality provision, accepting that legislation must continue to protect members' retirement incomes from the impact of employer or provider insolvency or default
- At the request of Government, to review on a periodic basis the structure and rules of the NEST scheme to ensure employees are offered an appropriate fall-back retirement income plan where no better scheme is offered by a sponsoring employer
- To ensure that over the long-term, the cost of public sector pensions, and those that are largely funded by the taxpayer, are transparent in cost to the taxpayer, are sustainable and are fair set against the scale of private provision available to the majority of taxpayers
- To report on matters referred by Government to the Commission on an ad hoc basis and also on European directives that could have an impact on any of the above
- To conduct a cost-benefit analysis of any proposed pension reforms
- To investigate whether the Government should be recommended to introduce products such as longevity bonds or deferred annuities to help hedge longevity risk
- To examine the issue of inter-generational equity. For too long Governments have kicked this can down the road. Eventually they will run out of road, and this could happen sooner than we all think.

Recommendation 7.5: Adopting a national retirement savings target of 15% of lifetime earnings

We recommend that the Government adopts a national retirement savings target of 15% of lifetime earnings, achieved through auto-escalation, to avoid future pensioner poverty.

7.8 Conclusion

The unifying thread that runs through funded pension scheme is the requirement to annuitise enough pension wealth, at the appropriate age, to provide an adequate lifelong income in retirement when combined with the state pension – which is the rationale for establishing a private-sector pension scheme in the first place. It is this requirement which makes a funded pension scheme different from any other type of savings scheme.

When annuitisation becomes optional, that unifying thread is no longer present and there is a real danger that the pension system begins to unravel. At best, it just becomes a tax-favoured arrangement for operating a multi-purpose spending pot and once the money has been spent for one purpose, it cannot be spent on another. At worst, it becomes a honey pot for thieves and other opportunists: while you cannot steal someone's pension, you can steal their pension pot, as a number of people are now discovering. Lying between these extremes are millions of people who are now in control of their pension fund and who will be trying to do the best for themselves and their families. But for anyone who understands the risks in Table 1.2, many of these people could well find themselves in the same kind of control as a yachtsman in the middle of the Atlantic in a force nine gale.

A great deal of effort will now have go into re-establishing what a good pension scheme is, as outlined in Table 1.1. This will need a commonly agreed national narrative. If we do not achieve this, we could end up in the position where people's aversion to annuitisation combined with their willingness to pay highly for both flexibility and guarantees in drawdown products leaves many of them not much better off and possibly worse off than if they purchased an annuity to begin with. In other words, the behavioural bias against annuities could be used by the pensions industry to extract as much if not more from a customer than a 'terrible poor value' annuity.

And to establish a national narrative that builds a consensus around retirement income will need the support of all the king's horses, all the king's men – and all the king's women. This is a significant challenge. But it is one that is well worth the effort because 'pensions ARE precious'.[1071]

1071 Ros Altmann, Pensions Minister, quoted in in Jenna Towler (2015) Pension fraud 'increasingly linked' to investment scams, Professional Adviser, 7 August.

The key elements of a national narrative
• The primary purpose of a pension scheme is to provide an income in retirement for however long the scheme member lives – that is, it will not run out of money before the member dies. • A pension scheme needs to offer accessibility, inflation protection (either directly or via investment performance) and longevity insurance. • A pension scheme needs to provide value for money with the benefits clearly and transparently exceeding the costs. • Individuals should not be expected to manage the risks involved in the generation of retirement income from pension savings themselves. • Middle Britain – with pension assets between £30,000 and £100,000 – should be recommended to use a retirement income plan that involves a simple decision tree with a limited set of pathways. • The retirement income plan would be self-started following a guidance or advice surgery. • The plan member would choose from a set of safe harbour products approved by the regulator. The purpose of the decision tree is to identify the products that are most suitable for meeting the plan member's needs. The aim is to achieve a simple solution that is appropriate (i.e., 'good enough') for those who do not wish to make any financial decisions themselves. • The safe harbour products would include annuities, drawdown products and longevity insurance that meet minimum design standards in terms of efficacy and deliver clear value for money. • The plan member would have flexible access to the pension pot until the point that longevity insurance kicks in. • A national narrative requires the integration of the accumulation and decumulation phases. An essential part of this narrative is 'an adequate pension needs adequate contributions'. To have an adequate pension in retirement, Middle Britain, needs to understand that – together with the employer – it has to save 15% of its lifetime earnings in a pension scheme. • A parallel narrative is required to address the needs of the millions of private-sector workers who are self-employed or whose contracts of employment exclude them from auto-enrolment.

Appendix: The Professional Pensions guide to how pensions tax relief restrictions have developed since A-Day in 2006.[1072]

Pension tax allowances since 2006		
Tax Year	Annual Allowance (£)	Lifetime Allowance (£)
2006-07	215,000	1,500,000
2007-08	225,000	1,600,000
2008-09	235,000	1,650,000
2009-10	245,000	1,750,000
2010-11	255,000	1,800,000
2011-12	50,000	1,800,000
2012-13	50,000	1,500,000
2013-14	50,000	1,500,000
2014-15	40,000	1,250,000
2015-16	40,000	1,250,000
2016-17	40,000	1,000,000*
* Indexed to CPI from April 2018		

Budget 2009

The first major tax relief restrictions since A-Day in April 2006 began with Alistair Darling's 2009 Budget, when he announced he would restrict higher-rate tax relief on pension contributions for people with incomes over £150,000.

Restrictions had previously been governed by the A-Day reforms, which gave an absolute lifetime allowance of £1.75m and an annual allowance of £245,000 (limits for the 2009/2010 tax year).

In his 2009 Budget, Darling said that, from 2011 and for incomes above the £150,000 level, the value of pensions tax relief would be tapered down until it is 20% for those on incomes over £180,000 - making it worth the same for each pound of contribution to pension entitlement as for a basic rate income tax payer.

In addition, Darling said that, in anticipation of this change, he was also introducing legislation to prevent individuals taking advantage of the pensions tax relief while it is still

[1072] Jonathan Stapleton (2015) How pensions tax relief has been slashed since 2006, Professional Pensions, 17 March; http://www.professionalpensions.com/professional-pensions/news/2162378/budget-2012-guide-tax-relief-restrictions available to them at a higher rate - and making substantial additional pension contributions prior to the restriction taking effect.

Darling said: ‘It is difficult to justify how a quarter of all the money the country spends on pensions tax relief goes, as now, to the top 1.5% of pension savers’.

Pre-Budget Report 2009

In his pre-budget report of December 2009, Darling announced higher-rate tax relief restrictions - originally announced in the April 2009 budget - would now include employer contributions and affect those with relevant income of £130,000 and over rather than the previously announced figure of £150,000 and over.

This would have effectively meant anyone with income of £130,000 or more would not receive higher-rate tax relief on their contributions.

It was believed as many as 150,000 people could be caught out by this extension of higher-rate tax relief restrictions.

A statement by HM Treasury at the time confirmed: "From April 2011 tax relief on pension contributions will be restricted for individuals with gross incomes of £150,000 and over, where gross income incorporates all pension contributions, including the value of any benefit funded by, or eventually funded by, an individual's employer.

‘Tax relief will gradually be tapered away so that above £180,000 it is worth 20%, the same rate received by a basic-rate income taxpayer. To provide more certainty for individuals around whether they are affected, and to reduce administrative burdens for schemes, this will be subject to an income floor at £130,000 of pre-tax income (excluding the value of any employer pension contributions)’.

Budget 2010

In what would be his last Budget, Darling rejected industry pleas to change the way it was going to implement pensions tax relief restrictions.

Darling confirmed: ‘Tax relief on pensions will be restricted but only for those earning £130,000 a year’.

HM Treasury also published a summary of the responses it received on its consultation on implementing the restriction of pensions tax relief - and outlined the Government's response and the next steps for developing the restriction ahead of its proposed introduction in April 2011.

But it rejected pleas from the pensions industry to reduce the annual or lifetime allowance instead - saying such a move would hit lower earners.

It said: "A reduction in the annual or lifetime allowance would potentially apply to pension savers with much lower incomes, particularly in DB schemes. Furthermore, it would allow high-income individuals to continue to benefit from a higher rate of tax relief than other pension savers.

‘In addition, alternative options could not be implemented fairly without making significant adjustments to the pensions tax system that would also add their own complexity’.

It continued: ‘The Government does not propose any changes to the annual allowance or the lifetime allowance at this stage’.

And the Treasury remained adamant that restricting tax relief was the right thing to do.

It said: ‘The Government remains clear that the restriction of pensions tax relief is proportionate and necessary, and many stakeholders agreed that action to restrict the amount of relief going to those on the highest incomes is appropriate.

‘The measure also represents an important part of the Government's consolidation of the public finances. In restricting relief on pension contributions, the Government's objectives are to rebalance the pensions tax system to ensure that pensions tax relief remains affordable, and to address the disproportionate levels of relief going to those on the highest incomes, around 2% of pension savers’.

The Budget also announced further decisions on how the restriction of relief would be applied and delivered - noting that deemed contributions to defined benefit pension schemes will be valued using the age-related factors method.

And it said the restrictions would primarily be delivered through self assessment - noting tax returns would be modified to report additional information to HMRC and to calculate the restriction of pensions tax relief.

It said, where individuals are affected, HMRC will collect a recovery charge reflecting the restriction of relief through self-assessment.

A cost-benefit analysis, published at the time of the Budget, revealed that HM Treasury had trebled its estimate of the one-off costs that pension schemes, employers and individuals would incur as a result of the tax on higher earners' pension contributions.

The new impact assessment said the one-off costs incurred during the transition to the new regime will total £900m - or around £3000 for each of the 300,000 taxpayers affected - compared with the £305m estimate published in December.

The increase is particularly pronounced for employers, whose one-off costs are now expected to be £330m rather than £40m. Annual costs are now expected to be £115m, rather than £90m.

Emergency Budget 2010

In his Emergency Budget - held just after the coalition Government came to power - Chancellor George Osborne announced he would work with the pensions industry on 'alternative ways' to implement pension tax relief restrictions - and was considering reducing the annual allowance to as little as £30,000.

Osborne said: 'Many businesses are alarmed at complexity. I have listened to those concerns, however, I must also protect £3.5bn revenue it would create.

'I will work with industry on raising same amount of revenue - potentially by reducing the annual allowance'.

In a Treasury document - published alongside the Budget - the Government said 'provisional analysis suggested an annual allowance in the region of £30,000 - £45,000 might deliver the necessary yield'.

The document also confirmed the Government has 'reservations' about the approach adopted in Finance Act 2010 - saying it could have 'unwelcome consequences for pension saving, bring significant complexity to the tax system, and damage UK business and competitiveness'.

It said the Government wanted to engage employers, pension schemes, experts and other interested parties to determine the best design of a regime - looking at a wide range of issues that will need further consideration.

National Association of Pension Funds chief executive Joanne Segars feared the proposals as they stood would cost between £2.5bn to £3bn to implement and lead to senior corporate decision-makers disengaging from workplace pensions, eroding employer interest in the schemes.

The trade body suggested reducing the amount of pension contribution eligible for tax relief from £255,000 to about £50,000, which will limit the tax relief available to high earners, but in a way less harmful to pension provision.

'This will be less damaging to pension saving and cost far less to implement', Segars said.

Treasury announcement - October 2010

In October 2010, the Treasury confirmed the annual allowance would be cut from £255,000 to £50,000; the lifetime allowance reduced from £1.8m to £1.5m, and the factor for valuing final salary benefits increased from 10 to 16.

It said this would replace the 'complex proposal' legislated for by the Labour Government.

The Treasury said the measure would raise £4bn a year - but would be targeted at those who make the most significant pension savings

It said these new allowances will for the time being be frozen - with options for indexing to be considered from 2015-16.

Pension benefits for deferred pensioners will be exempt from the annual allowance regime.

The Treasury estimated the changes would affect 100,000 pension savers - 80% of those will have incomes of more than £100,000.

However, the Government said it was committed to protecting individuals on low and moderate incomes as far as possible.

It said to protect individuals who exceed the annual allowance due to one-off "spike" in accrual, the Government would allow individuals to offset this against unused allowance from the previous three tax years.

The Treasury said it would also introduce a CPI exemption - which would mean only pay rises in excess of CPI inflation would be taken into account for final salary benefit calculations.

In addition, it said it would consult on options enabling people to meet tax charges out of their pensions.

The Treasury said in order to protect the public finances it was necessary to introduce the reduced annual allowance from April 2011. The Government said it planned to introduce the reduction in the lifetime allowance from April 2012.

Financial secretary to the Treasury Mark Hoban said: 'We have abandoned the previous Government's complex proposals and developed a solution that will help to tackle the deficit but not hit those on low and moderate incomes. We have taken a tough but fair decision.

'The coalition Government believes that our system is fair, will preserve incentives to save and - compared to the last Government's approach - will help UK businesses to attract and retain talent'.

Budget 2011

In his 2011 Budget, Osborne confirmed the planned £50,000 annual allowance for tax free pension contributions.

It confirmed the move, first announced on 14 October, last year would come into force from 6 April 2011

The document also confirmed the lifetime allowance would be £1.5m.

Budget 2012

In the run-up to the the 2012 Budget, a cut to the annual allowance emerged as the 'strong favourite' to be announced by the Chancellor.

The Liberal Democrats had been calling publicly for cuts to higher-rate tax relief to fund a hike in the income tax threshold to £10,000.

At the time it was said three options were on the table: a cut in the higher-rate tax relief from 40% to 20%, a further reduction in the annual allowance or changes to the size of the tax free lump sum available on retirement.

Industry commentators believed it was '75% likely' a cut in annual allowance would be included in the Budget but hoped the Government would leave tax relief 'alone entirely'.

In the end, the Government decided to make no further changes to tax relief.

Autumn Statement 2012

Chancellor George Osborne announced he would cut the annual allowance from £50,000 to £40,000 and reduce the lifetime allowance from £1.5m to £1.25m from the 2014/15 tax year.

The Chancellor said the cut to the tax-free allowance would save the Treasury £1bn a year by 2017/18.

He said 98% of the population have less than a £1.25m pension pot and noted the median pot in the UK was £55,000 with 99% of savers' annual contributions less than 40,000.

Osborne said the average annual contribution was less than £6,000.

The Autumn Statement said that in 2010-11, tax relief for pension savings cost the Government around £33bn - with over half of this relief going to higher rate taxpayers.

And it said, even with changes made to reduce the cost of pensions tax relief, the Government was still likely to forgo around £31bn in tax revenues this year, rising to £35bn in 2015-16.

Budget 2013

The Government has confirmed it would end tax relief on contributions to schemes set up for employees' spouses or families as part of a clampdown on avoidance.

HM Treasury revealed in the budget that it would include legislation on the practice in the Finance Bill 2013.

It said: 'As announced at Budget 2012, legislation will be included in Finance Bill 2013 to remove the tax and NICs incentives for employees and employers respectively from arrangements where an employer pays a pension contribution into a registered pension scheme for an employee's spouse or family member as part of their employee's flexible remuneration package'.

Autumn Statement 2013

The Chancellor announced he would abolish the 55% tax charge levied on beneficiaries of individuals who die under the age of 75 with a joint life or guaranteed term annuity.

In a widely anticipated move, the Government said beneficiaries would be able to receive any future payments from such policies tax free where no payments have been made to the beneficiary before 6 April 2015.

It said the tax rules would also be changed to allow joint life annuities to be paid to any beneficiary.

If the annuitant dies after the age of 75 then the beneficiary will pay the marginal rate of income tax, or 45% if the funds are taken as a lump sum payment. Lump sum payments will be charged at the beneficiary's marginal rate from 2016-17.

The announcement will bring tax treatment for annuities in line with income drawdown. The original proposals would have weighted the decision-making in favour of the riskier - but more flexible - income drawdown option.

Budget 2014

The Government announced it would scrap restrictions on how people take pensions income as part of a radical overhaul of tax relief.

From 27 March 2014, the Government said it would slash the minimum income requirement for retirees entering flexible drawdown from £20,000 to £12,000 and raise maximum GAD limits for those in capped drawdown from 120% to 150%.

In a widely anticipated move Osborne also raised trivial commutation limits from £2,000 to £10,000 and the trivial commutation lump sum limit will increase from £18,000 to £30,000.

However the Government said it planned to be even more radical - saying that from April 2015 it would allow anyone over the age of 55 to take their entire pensions pot as cash, subject to their marginal rate of income tax in that year.

The Government also said it would raise the age at which an individual could take their pension savings under the tax rules from 55 to 57 in 2028.

And said it would offer all DC scheme members access to free and impartial face-to-face guidance on the range of options available to them at retirement.

Delivering the changes Osborne said: ‘We will legislate to remove all remaining tax restrictions on how pensioners have access to their pension pots. Pensioners will have complete freedom to draw down as much or as little of their pension pot as they want, anytime they want. No caps. No drawdown limits. Let me be clear. No one will have to buy an annuity’.

Budget documents revealed the move would increase tax income by £1.2bn a year by 2019.

The Government estimated the move would raise £320m in 2015/16, £600m in 2016/17; £910m in 2017/18 and £1.2bn in 2018/19.

Budget 2015

Chancellor George Osborne confirmed the lifetime allowance would be reduced from £1.25m to £1m from the 2016-17 tax year, netting the Treasury an extra £600m a year.

But he said he would index the lifetime allowance from the 2018-19 tax year - and also ruled out making any further change to the annual allowance.

Delivering the Budget, Osborne said: ‘From next year, we will further reduce the lifetime allowance from £1.25m to £1m. This will save around £600m a year. Fewer than 4% of pension savers currently approaching retirement will be affected.

‘However, I want to ensure those still building up their pension pots are protected from inflation so from 2018 we will index the lifetime allowance’.

This comes after Labour leader Ed Miliband revealed his party would cut the lifetime and annual allowances in an effort to reduce university tuition fees if it wins the general election.