PENSIONS AND LIFETIME SAVINGS ASSOCIATION

1 February 2023

The Rt Hon. Jeremy Hunt
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
SW1A 2HQ

Dear Mr Hunt,

RE: PLSA 2023 BUDGET REPRESENTATION

The Pensions and Lifetime Savings Association (PLSA) welcomes the opportunity to submit views in advance of the forthcoming 2023 Budget.

The PLSA's mission is to help everyone achieve a better income in retirement. We work to get more people and money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers. We represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members include asset managers, consultants, law firms, fintechs, and others who play an influential role in people's financial futures.

Cost of living concerns are, rightly, at the forefront of the nation's mind. The measures put forward in this Budget submission look to balance this while ensuring that people can expect an adequate standard of living when they come to retire. We do this by arguing that:

- The pensions tax relief system provides crucial support for people by boosting their savings over the long term. If the Government does choose to introduce a reform, we urge you to consider our **"Five Principles for Pensions Taxation"** and to consult extensively to avoid unintended consequences.
- The Government should set the groundwork for reforming Automatic Enrolment (AE) over the next decade, so that it gets a greater range people saving and balances contributions between savers and employees. As a minimum, we ask the Government to implement its declared policy of introducing pensions saving from the first pound of salary by the mid-2020s and to set a timetable for increasing contributions as soon as possible.
- The current State Pension age and the triple lock should remain in place. The UK will already have one of the highest State Pension ages in the OECD when it reaches 67 in 2028. Healthy life expectancy, and the gaps between years of life in healthy and unhealthy condition, need to be taken into account when deciding State Pension age to ensure that the single age is set fairly across generations. The gap in life expectancy at birth between local areas of the UK was 11.3 years for males and 8.7 years for females in 2017 to 2019. Given the important role the State Pension plays in pension adequacy, it's value should be set at a level that prevents pensioner poverty.
- The Government should continue to engage with the pensions sector when looking to the productive finance agenda to ensure that the barriers to investing in illiquid assets can be properly balanced against schemes' fiduciary duty.

We believe that the measures set out in this representation will continue to help the Government go on supporting UK pensions, millions of savers and the wider UK economy.

If you, or your officials, would like to discuss any of the issues raised, please do not hesitate to contact Katy Little (Parliamentary and Stakeholder Manager) katy.little@plsa.co.uk in the first instance.

Yours Sincerely,

Nigel Peaple

Director of Policy and Advocacy

Pensions Tax Relief: Five Principles for Reform

There is frequent speculation that the Government may be considering reforming pensions tax relief as a source of additional revenue. We understand that this is a difficult economic time, and that the Government is rightly looking to safeguard the UK's finances. **However, the PLSA does not believe that now is the right time for a fundamental reform of pensions tax relief.**

Many people are not saving enough for their retirement and tax relief acts as an important incentive to help people save. **However, if the Government does choose to introduce a reform, we urge you to consider our 'Five Principles for Pensions Taxation' report and to consult extensively to avoid unintended consequences. The five principles are:**

- **Promotes adequacy**: provides financial support and incentivises saving for retirement.
- **Encourages the right behaviours**: helps savers make the right decisions about retirement saving.
- **Fair**: helps everyone – the employed and the self-employed - save for retirement.
- **Simple to adopt & administer:** avoids unreasonable transition and on-going costs for employers and schemes.
- **Enduring & sustainable**: designed to avoid repeated change and so builds confidence in long-term saving.

The PLSA has also explored how a selection of workers with different levels of income and in different types of workplace pension scheme would be affected by a number of potential reform options including: removal of higher rate tax relief, the introduction of a single rate at 25% or 30%, and the adoption of a TEE rather than an ETT approach.

Our analysis finds that the removal of the higher rate of pensions tax relief (a 20% single rate) would be of no benefit to the majority of taxpayers who pay basic rate income tax. However, such a reform could see a person who pays higher rate income tax for almost all of their working life face a reduction in their private pension income before tax of over 20%, irrespective of the type of scheme they belong to.

The PLSA also estimates that the removal of higher rate tax relief on pension contributions could result in around 3-4 million taxpayers each paying an average of £2,000 more tax each year. These are likely to arise particularly in the case of highly skilled workers who have good pension schemes, such as those commonly used in the public sector, such as for the NHS and education.

Importantly, the analysis reveals that the rise in taxation would not only affect people who pay higher rate income tax but also people who earn towards the upper end of the basic rate income tax band, ie. people earning from the mid-£40ks upwards.

Even the introduction of a new, more generous, single rate of 25% would only result in a modest uplift in pension income for those savers who will benefit from it. **Our overall assessment continues to suggest that no single reform of the current system is perfect. Most reform options leave many people with lower pension savings and create very substantial cost and complexity for employers and occupational pension schemes.**

In addition to this, we know the Government is looking to help those aged 50 and over to re-join the workforce. One of the barriers to this is the Money Purchase Annual Allowance (MPAA). The

MPAA is a restriction on the amount you can pay into your pension and still receive tax relief on - it starts when a person starts to draw from their DC pension pot for the first time. Under MPAA, if someone accesses their DC pension post 55, their annual allowance for future saving is reduced from £40k per year to £4k per year**. We would like to see the MPAA reformed to encourage people of retirement age to go on working whilst also supporting their pension saving for the future.**

Continued support for automatic enrolment (AE)

Automatic enrolment (AE) is a genuine success story and enjoys widespread support across all political parties and the pension industry. Thanks to AE, millions of people who had not previously saved into a pension scheme are now setting money aside for their retirement. It is imperative for the future retirement security of savers that AE continues to succeed and enjoy high levels of support.

However, even for those currently within the scope of AE, contributions at the minimum automatic enrolment rate combined with the State Pension will often be insufficient to provide an adequate income in retirement. According our latest report – **Five Steps to Better Pensions: Time for a New Consensus –** more than 50% of savers will fail to meet the retirement income targets set by the 2005 Pensions Commission. We also estimate that nearly 20% of households are currently projected to fall below the minimum **Retirement Living Standard** and face poverty in retirement.

The report also recommends five steps for reform:

- **National objectives:** The creation of clear national objectives for the UK pension system - 'adequate, affordable and fair' objectives - combined with regular formal monitoring of whether it is on track to achieve these goals.
- **State pension:** Reform of the state pension so that everyone achieves the Minimum Retirement Living Standard, to prevent pensioner poverty.
- **AE reform:** Reform AE to get more people saving (such as younger people, multiple job holders and gig economy workers) and at higher contributions (by removing band earnings and gradually increasing contributions from 8% to 12%, split evenly between employers and employees). This is so that people on median earnings are more likely to achieve the Pensions Commission's Target Replacement Rates.
- **Under pensioned groups:** Additional policy interventions to help under pensioned groups (including women, gig economy workers, self-employed people and others).
- **Industry initiatives to achieve better pensions:** Actions to help people engage with pensions, receive higher contributions, or get better pension outcomes.

We recognise that it is a challenging time to be asking people to pay more into their pension, but, we would urge the Government to lay the foundations that would put workplace pensions on a path to give todays workers an adequate income in retirement **As a first step, we ask the Government to introduce legislation to follow through on the recommendations in the 2017 AE Review by extending AE to workers between 18 and 21 and removing the Lower Earnings Limit (LEL) so that people start saving from the first pound of**

earning. The Government has committed to doing this by the mid 2020's, if the Government is serious about hitting this target it is imperative to find parliamentary time to allow these reforms to take place. By extending the scope of AE in this way, it will allow a greater number of people to start saving earlier, and in particular benefit under-pensioned groups, such as women, ethnic minorities, younger people, multiple job holders and gig economy workers.

We would also like to see the Government set out a timetable for increasing pension contributions. Increasing contributions gradually, and in a manner that is sensitive to current and future affordability concerns for both individuals and businesses, to reach 12% by the early 2030s will help make extra saving affordable. First, the employer contribution should gradually increase from 3% to 5% to match that of the employee, with contributions reaching 10%, and then both the employer and employee contributions should increase by a further 1% to reach 12% over time. Increasing minimum contributions is the single most effective reform to get more people on the right track. State Pension increases will also significantly improve retirement outcomes even for those that would otherwise be unable to afford increased in-work saving, for example those with caring responsibilities and the under-pensioned. The framework must at the same time protect those on lower incomes from inadvertently over-saving.

State Pension

There have been increasing reports that the Government is looking to raise the age at which people can receive the State Pension to 68 by the end of the 2030s. The PLSA believes that any changes to this age must be considered in relation to changes in level and other considerations associated with the whole pension system; the State Pension is one of five pillars of the modern retirement system. Moreover, the UK will already have one of the highest State Pension ages in the OECD when it reaches 67 in 2028. The average state pension age in the OECD will not reach this level until between 2044 and 2046.

In addition to this, data from the ONS on Healthy Life expectancy (from birth) between 2018-2020 shows both a regional disparity and a downward trend in most regions of the UK. The gap in life expectancy at birth between local areas of the UK was 11.3 years for males and 8.7 years for females in 2017 to 2019. Healthy life expectancy, and the gaps between years of life in healthy and unhealthy condition, need to be taken into account when deciding State Pension age to ensure that the single age is set fairly across generations.

The Government has previously stated its intent is to maintain about a third of expected adult life supported by the State Pension, as such**, the PLSA believes that it is appropriate to have no further increases in State Pension age. Instead, there should be a period of stability, at minimum until further conditions are met and for any increase to the State Pension Age, a minimum of 15 years notice should be provided.**

We would also urge the Government to commit to the triple lock policy, given that the state pension makes up the majority of most people's retirement income. It is important that the state pension ensures, at a macro level, that no one is at risk of poverty in retirement. We argue this level should be equivalent to the PLSA's Minimum Retirement Living Standard for each individual, currently equivalent to £10,900 per annum. **The new State Pension, at £9,628 per year, is currently approximately 15% short of our proposed new poverty avoiding level.** Meeting this measure will entail gradually increasing costs but these are, perhaps, the cost of an ageing society. It is also the case that current mechanisms such as the Triple Lock, which we support, will gradually reach this higher level if retained for a number of years**. The Triple Lock therefore plays a vital role in helping everyone – today's pensioners and future pensioners – towards achieving an adequate pension throughout their retirement.**

Facilitating investment in illiquid assets

The Government has outlined its ambitions to encourage DC pension schemes to invest in illquid and sustainable assets such as clean energy, house building and local communities. The PLSA supports the Government's ambition to ensure pension funds have the opportunity to invest in the widest range of assets to deliver good outcomes for savers. Steps that have been taken to remove barriers and improve schemes' access to a broad range of alternative investments such as the introduction of Green Gilts and the Long-term Asset Fund, are welcome, and will also play an important role in facilitating capital investment in long-term infrastructure.

As long-term owners of capital, pension funds are well-placed to reap the benefits of investing on behalf of savers and continue to seek to build portfolios of assets which provide stable cash flows and diversification benefits for the next 15 or even 50 years. This is the case for both the growing defined contribution (DC) market, as auto-enrolment brings in a younger cohort, and millions of savers, but also for larger, more mature defined benefit (DB) schemes, which will be paying benefits for decades to come.

It is important to recognise, though, that the UK pensions sector, which looks after over £2trn of assets on behalf of tens of millions of savers, is not homogenous. Each fund will, by law, have its own prudently managed well-diversified investment strategy and an approach designed to suit its members' particular needs. Above all else, trustees' primary duty is to look after the saver first. There is no single 'right answer' when it comes to how much pension fund trustees should invest in long-term UK assets.

Evidence suggests that regardless of size, type or maturity of scheme, diversification of investments is well-established as common practice with schemes investing across all asset classes, geographies and a range of risk profiles. It does however remain the case currently that investing in illiquid and alternative assets can often be more complicated, more costly and more resource intensive. Where this is the case, such investments are much less compelling value for money than alternative options, irrespective of their potential upsides.

As part of the Productive Finance Working Group, we have been in discussion with Government about overcoming the structural and practical hurdles to investing in illiquid assets. We hope to improve the availability and so broaden the range of investible products available to trustees. We would like the Government to keep an open dialogue with the pensions industry as to how schemes can best support the Government's agenda on this issue.