

Strengthening the Incentive to Save: A Consultation on Pensions Tax Relief

**Consultation response from the
Commissioner for Older People
for Northern Ireland**

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The Commissioner for Older People

The office of the Commissioner for Older People for Northern Ireland (COPNI) is an independent public body established under the Commissioner for Older People Act (Northern Ireland) 2011.

The Commissioner has an extensive range of general powers and duties which will provide the statutory remit for the exercise of her functions. In addition the Commissioner may provide advice or information on any matter concerning the interests of older people. Her wide ranging legal powers and duties include amongst others:

- To promote and safeguard the interests of older people (defined as being those aged over 60 years and in exceptional cases, those aged over 50 years);
- To keep under review the adequacy and effectiveness of law and practice relating to the interests of older people;
- To keep under review the adequacy and effectiveness of services provided for older persons by relevant authorities (defined as being local councils and organisations including health and social care trusts, education boards and private and public residential care homes);
- To promote the provision of opportunities for and the elimination of discrimination against older persons;
- To review and where appropriate, investigate advocacy, complaint, inspection and whistle-blowing arrangements of relevant authorities;
- To assist with complaints to and against relevant authorities;
- The power to bring, intervene in or assist in legal proceedings in respect of relevant authorities;
- To issue guidance and make representations about any matter concerning the interests of older people.

The Commissioner's powers and duties are underpinned by the United Nations Principles for Older Persons (1991) which include Independence, Participation, Care, Self-fulfilment and Dignity.

Context for Reform

There already have been substantial reforms enacted or about to be enacted in the fields of public and private pensions. COPNI, in a submission to the Committee of the Northern Ireland Assembly welcomed the driving aims behind the introduction of the single tier State Pension, including making the system simpler and fairer, but said that there was a need for:

- More Northern Ireland specific analysis of the current situation of pensioner poverty, levels of pension credit uptake and income levels for older people.
- Analysis of how high above the level of the Pensions Credit Guarantee the new State Pension should be, supporting the position that it should be at least 5% above.
- Greater safeguards for those who may not meet the minimum 10 years of National Insurance payments or who only attain a low number of qualifying years due to caring responsibilities. COPNI also made the point that government should explore the feasibility of using Real Time Information PAYE to aggregate part time work.
- The Northern Ireland Executive needs to have a clear commitment in place to ending Pensioner Poverty.
- Ensure the phasing out of Assessed Income Periods for individuals between 65 and 75 will not produce excessive intrusion and burden upon individual older people.
- An appropriate publicity campaign should be developed to explain the changes to the system in a timely way.

COPNI also responded to the Equality Impact Assessment on the Consultation about the proposed Pension Schemes Bill which is presently going through the Northern Ireland Assembly. The Commissioner expressed support for the objective of the Bill to encourage greater risk sharing in private pension arrangements and to allow for new types of pension arrangements based on the extent of risk borne by scheme members. She also made it clear that this change needed to be accompanied by a commitment to providing adequate guarantees that individuals will be properly informed about the change, and that the products should be transparent about how risk would be split between the provider and the buyer.

COPNI welcomes that workplace pensions membership levels in the private sector have risen since the start of automatic enrolment.

Pensions Tax Relief

COPNI understands that there are different arguments about which tax relief systems are most effective at encouraging sufficient Pension contributions to leave today's and tomorrow's older people comfortable in retirement. The Commissioner has followed the debate with interest, including proposals for flat rate relief, Government top ups, and reversing relief so it applies on pension withdrawal. COPNI believes that any move away from the current 'Exempt-Exempt-Taxed' system could bring with it complications and must be considered very carefully. COPNI recognises that the system should be fair, with as the consultation states, over two thirds of pensions tax relief going to higher and additional rate taxpayers, although this is reducing through capping introduced by Lifetime Allowances.

Principles for Reform

COPNI broadly agrees with the Government's stated principles that any reform should be:

- Simple and transparent
- Allow individuals to take personal responsibility for ensuring they have adequate savings for retirement
- Build on the success of automatic enrolment in encouraging new people to save more.
- Be sustainable and in line with the Government's long term fiscal strategy.

COPNI would comment that the first three principles are paramount. The fourth principle, while desirable and necessary, must not be allowed to compromise the first three principles. The Commissioner believes that the fourth principle could undermine recent steps the government has made in giving more people the opportunity to save for retirement. Any reform that did achieve the first three principles would be of particular relevance to Northern Ireland, given the lower levels of Pension saving. Simplicity and transparency would allow older people especially to have a more accurate picture of what they need for an adequate retirement, which Northern Ireland Pension pots do not have on average at the present time. Encouraging more people to save more would also create a stronger Pension system in Northern Ireland.

The Northern Ireland Context

In Northern Ireland, the broad trend of a move from Defined Benefit to Defined Contribution Pensions is similar to UK averages. The numbers with defined benefit pensions have declined from 40% to 30% in the last decade. In 2014 85% of public sector employees and 36% of private sector employees were members of a workplace pension scheme. This includes 61% of full time employees and 33% of part time employees. Those in professional occupations are most likely to have a pension. ¹

The phenomenon we have seen across the UK of declining numbers belonging to a workplace Pension scheme being reversed by auto enrolment has also occurred in Northern Ireland. 2012, when auto enrolment was introduced, marked a low point in workplace scheme membership, with 44% of all employees being members of a workplace Pension scheme. By 2014 this had increased to 51% of all employees. ²

COPNI is concerned any reforms could prejudice the Northern Ireland position on saving for retirement, which is already behind UK averages. COPNI would encourage government to introduce policies to help improve this situation here. Northern Ireland has the lowest rate of contributors to personal pensions in the UK – 7% of the adult population compared to 11% in England and Scotland. The level of ‘pot’ created via these contributions is also an area of concern. In 2014 figures showed that Northern Ireland had smaller pension pots – an average of £44,392 compared to a UK average of £72,134 and £97,156 in London (the region with the largest pots). Surveys have shown that Northern Ireland’s lower pension pots mean people are on average further away from generating an income that could be defined as ‘adequate’ in retirement. ³

Northern Ireland is experiencing some of the same trends in Pensions as the rest of the UK, but has a poorer record of getting people to contribute, and lower amounts in pension pots at present. COPNI would welcome any new reforms to the system which could help turn around the position here.

¹ DFP, ‘Northern Ireland Annual Survey of Hours and Earnings 2014: Pension Results’.

² DFP, ‘Northern Ireland Annual Survey of Hours and Earnings 2014: Pension Results’.

³ True Potential, ‘Savings Gap Campaign’.

Simplicity and Transparency

- **To what extent does the complexity of the current system undermine the incentive for individuals to save into a pension?**

COPNI believes that the complexity of the present system can undermine the incentives for individuals to save into a pension and think there are opportunities to make it less complex and 'distant', especially in terms of making people more aware of what the tax benefits of doing so are, and what their contributions would entitle them to.

Older people who have engaged with COPNI on this topic have commented that they are confused about what they will get from their pensions, and what benefits there are to continuing to make contributions. Unless older people have more clarity about what their contributions are actually leading to, the tax incentives may just be 'catching' those who are already in the savings habit and mindset already, and growing Pension saving which is what Northern Ireland especially needs.⁴

- **Do respondents believe that a simpler system is likely to result in greater engagement with pension saving. If so, how could the system be simplified to strengthen the incentive for individuals to save into a pension?**

COPNI would like to see consideration of:

- Explicitly listing the amount of tax relief (from personal and employer taxes) received in payslips and annual statements from HMRC so people who are pension saving (and those who are not) can 'see' what there is to be gained from better Pension saving. Combined with real time information about what percentage of salary needs to be saved for a target/adequate income in retirement along with information about concepts like compound interest, could further incentivise more individuals to pension save.
- An exploration of the incentivising effects of 'flat rate' relief at around 33% on lower earners.
- Exploration of the incentivising effects of rebranding the tax relief as a 'Government Matching contribution' or similar phrasing.
- Exploration of such changes would fulfil two requirements for simplicity. Firstly it would not substantially change the concept of a system that has undergone

⁴ Center for Retirement Research at Boston College, 'Subsidies Vs. Nudges: Which Policies Increase Saving the Most?'

substantial change recently. Secondly, by making things clearer to Pension savers, it would have the potential to incentivise saving.

Personal Responsibility

- **Would an alternative system allow individuals to take greater personal responsibility for saving an adequate amount for retirement, particularly in the context of the shift to Defined Contribution Pensions?**

COPNI agrees with the position that the shift towards defined contribution pensions, reflected in Northern Ireland, has increased the importance of individuals needing to contribute 'enough', and COPNI would emphasise the importance of individuals knowing what they have to contribute to achieve their desired income. COPNI believes that clarity on this point is crucial to encouraging the largest amount of pension saving, and believes there is no benefit to changing the essential EET tax relief structure which presently exists. There is little evidence that this would encourage people to save more for retirement, and a major change like this may actually put people off saving for retirement.

- **Would an alternative system allow individuals to plan better for how they use their savings in retirement?**

Again COPNI believes that planning and information is key to addressing this issue. It is important that the existing system is better explained, but clear explanation needs to be accompanied by no change to the basic EET structure. Firstly, further change would create confusion among older people approaching retirement age and undermine the incentive for some to keep contributing to a pension. Secondly, if the tax relief was reversed to occur on pension payout, it would introduce an extra element of uncertainty for individuals planning how to use savings, as some may not be confident there would be no tax subsequently levied on payout. Introducing levels of uncertainty into the Northern Ireland system is not sustainable when Pension saving is already so low here. We cannot afford to introduce any measure that could further deter people from making Pension savings. It would be particularly hard on older people who would have further renewed uncertainty just when they should be undertaking detailed planning for their retirement.

- **Should the Government consider differential treatment for defined benefit and defined contribution pensions? If so, how should each be treated?**

This is not an area where the Commissioner's office has sufficient expertise to make valid comment.

Automatic Enrolment

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

COPNI welcome the Government indication in this consultation that any reforms should work alongside automatic enrolment, and build upon existing processes that have been developed. Any substantial reform to the existing EET structure of tax relief would introduce administrative complications and costs, and would raise questions for older people, especially those at the lower end of the age range which the Commissioner represents. A number of outstanding questions and queries remain: Would they switch over to the new system, and would this be combined with a one off payment to guarantee tax free withdrawals? Would they have separate pensions that would pay out under the old and new systems? What would be the age ranges at which individuals would be switched over? And would any closure to new entrants by 'old system' Pension funds harm their viability? The Commissioner is of the view that the confusion this could engender among older people would be a barrier to reform achieving the objectives that the Government has set out.

- **How should employer pension contributions be treated under any reform of pensions tax relief?**

If the point at which tax relief occurs was to be reversed, then it disrupts the 'relative simplicity' of tax relief at the point of contribution being applied to employer National Insurance contributions and employer contributions. If tax relief was granted on withdrawals there is no clear answer to this question of what would happen to Tax Relief on employer contributions, and COPNI would be concerned that this tax relief could fall through the gaps in this reform. If so, then this could further reduce the size of what are already relatively small pension pots in Northern Ireland. It would also reduce the size of pension funds which are a big driver of investment and capital allocation in the economy. There is a need for Northern Ireland specific analysis of the potential effects.

- **How can the Government make sure that any reform of pensions tax relief is sustainable for the future?**

COPNI recognises that at a time of budgetary restraint the Government needs to have budgetary sustainability as a key priority. However, there needs to be a distinction drawn between short term and long term budgetary sustainability. It is undeniable from the figures presented in the consultation documents and elsewhere that reversing the point at which tax relief occurs would in the short term bring the government budget closer to balance.

In the long term however this would be balanced out by increasing tax receipts foregone on withdrawals. But there is a bigger question which goes to the heart of the matter. If a change to the tax treatment of pensions reduces incentives to save in pensions or creates confusion which puts people off pensions saving, then this will ultimately directly reduce the level of tax the government receives, as well as harming the wider benefits pension income provides. Pensions provide a large source of investment for the economy, more security and sustainability for older people in retirement, and more income to start other activities, such the increase in self employment among older people happening in Northern Ireland. It is important that the medium and longer term options are balanced.

Conclusions

Following on from the recent high profile and major changes to public and private pensions systems, and the emerging effects of auto enrolment, COPNI is of the opinion that a change to the tax treatment of pensions would create confusion and scepticism among older people just when these reforms should be bedding down in their minds and attitudes. It is this scepticism which could depress the fiscal sustainability of the pensions system in the longer term.

Feedback to this office from older people indicates existing confusion with regard to the volume of Pension changes, and individuals not being aware of key aspects of the reforms. Improving this situation should be the main priority for now, not introducing another big change when it is not clear whether it will bring positive or negative impacts. COPNI believes that changes to tax relief should be limited to changes that better represent the benefits of tax relief, accompanied by better information, and exploration of what a fair rate of relief should be.