AGENDA ITEM No. 8

NORTH LANARKSHIRE COUNCIL REPORT

To:	Policy & Resources (Finance & Customer Services) Sub-Committee	Subject:	"Strengthening the Incentive to Save: a consultation on pensions tax relief"
From:	Head of Revenue Services		
Date:	15 November 2015	Ref:	BC /

1 Introduction

1.1 HM Treasury issued a consultation paper "Strengthening the Incentive to Save: a consultation on pensions tax relief" which had a closing date for responses of 30th September.

2 Background

2.1 The government considers that increased life expectancy and the shift towards Defined Contributions (DC) pensions means that it is appropriate to consider whether the tax relief system is properly incentivising people to save for their retirement.

2.2 The current system is founded on the principle that contributions made to your pension during your working life are tax free at the point of contribution, any tax liability is paid when taking pension benefits.

2.3 The government has recently reviewed the pension area with amendments to the lifetime & annual allowance levels, and changes to state pension age.

3 Consultation Paper

3.1 For many years the government has endeavoured to reform the pension landscape with the intent to increase the individual's responsibility to save for their retirement, increase their scope to choose how to take their pension benefits, balanced with the provision of support from the state.

3.2 The pensions landscape has been changed and continues to change as highlighted by:

- Increased life expectancy – creating a longer period for pension benefits to be provided
- Increased use of DC schemes – pension benefits are dependent on the performance of the underlying assets that the pension fund has been invested in
- Decline in the proportion of employees with a workplace pension – increased burden on the state in the future

3.3 With the introduction of Auto-enrolment there has been an increase recently in the number of employees now in pension schemes. The majority (72%) of these are being enrolled into DC scheme.

3.4 The main differences between Defined Benefits (DB) and Defined Contributions (DC) schemes are:

3.4.1 Defined Benefits (DB) – The pension paid to the employee is based on a formula (generally related to length of Service and final salary). The funding of the pensions to be paid comes from employee, employer and market returns. It is the employer contributions that require to be changed if there is any projected shortfall. Consequently the pension paid is not directly linked to the employee's contributions over their working life.

3.4.2 Defined Contributions (DC) - The pension paid to the employee is based on the returns on the investments. The funding of the pensions to be paid comes from employee, employer and market returns. It is the employee contributions that require to be changed if there is any projected shortfall. Consequently the pension paid is directly linked to the employee's contributions over their working life.

3.5 Whilst both DB & DC pension schemes are affected by market returns the difference is who picks up the shortfall. With the rise in the use of DC schemes it is important that employees ensure that they monitor the value of their fund and save enough throughout their career to provide the necessary / desired level of pension benefits in retirement.

3.6 The consultation paper sought responses to 8 specific questions which were grouped on 4 main areas:

3.6.1 Simplicity & Transparency – Does the current system confuse people and should consider whether the current operation of tax incentives is positively or negatively affecting individuals decisions to save for their retirement. Could changing the current position so that pension contributions are made from taxed income and pension benefits are tax-free on receipt, engender more people to save for their retirement.

3.6.2 Personal Responsibility – Can the system be improved to incentivize individuals to be more responsible for their retirement and save the correct amount through their working life.

3.6.3 Automatic Enrolment – Can any changes work alongside the operation of auto-enrolment and helps to reinforce the success that this has had in increasing the numbers of people saving for retirement.

3.6.4 Sustainability – Consider how to ensure that any changes are sustainable and aligned with the government's fiscal strategy. Would changes need to be phased in and, if so, over what period.

3.7 The Council's response has been discussed with the Convener prior to submission for the 30th September and is attached as Appendix 1.

4 Recommendation

The Committee is asked to

4.1 Note the report

Head of Revenue Services

Members seeking further information on the contents of this report are asked to contact Mr. Brian Cook, Head of Revenue Services on 01698 403929

Appendix 1

Summary of questions

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

Response

As indicated in the foreword the underlying principle of the current system is that savings into pensions is tax-free and tax is only payable when you receive the benefits.

The complexity of the current system is mostly around the factors affecting high-earners. There is a high proportion of employees who are members of our own pension fund and who are on higher salary scales. Generally there is a higher proportion of lower earning employees who are not members of the pension fund and it is more likely to be affordability issues rather than any perceived complexity that is the issue for them.

If savings into pensions were to be taxed then this is more likely to act as a disincentive to membership as the employee would have a lower net income.

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

Response

The suggested complexity of the current system is more an issue for the higher earners, of which there are relatively small numbers, and the number of changes that have been introduced to the pension legalisation and industry over the last 5-10 years.

The pension system would benefit from a prolonged period of stability allowing decisions by employees to be made about savings for their pensions under the same rules today as would apply in the future.

The current system is relatively simple in its application for the majority of employees and, as shown in Chart 1C & 1D, the % of employees choosing to have pensions generally fell over the last decade. It would seem that given the choice employees chose not to save to pensions. As indicated in Q1 above this may be more to do with affordability rather than any perception of complexity.

3 Would an alternative system allow individuals to take greater personal responsibility for saving an adequate amount for retirement, particularly in the context of the shift to defined contribution pensions?

Response

The DC pension schemes bring an added risk to the pension payable for the employee as the level of pension depends on investment returns (market rates etc). Clearly it has been difficult enough to get people to save for their pensions without them also having to save the "right" amount.

The improvement in the membership of pension funds shown in Chart 1C & 1D aligns with the introduction of auto-enrolment and could infer that membership by compulsion is a better method of ensuring saving to pensions than choice. There may be scope to improve the current system to provide greater incentive to the lower paid to ensure a greater proportion opt to save.

If the tax advantages of pensions savings were removed at the point of saving then this would be a massive disincentive for employees, particularly the low paid, to make pension savings.

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

Response

Generally no, the pension systems should be designed to provide a level of return (pension and /or Lump sum) and it is the absolute value / amount which is of importance to the saver. Clearly with DC pension scheme the individual needs to consider the level of their savings and projected returns periodically to ensure that there will be sufficient income in retirement. Stability within the pension system is likely to be of better benefit to individuals in planning their retirement, albeit that a greater flexibility in taking pension or lump sum may aid the retirement planning.

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

Response

Generally with DB schemes the risk of funding the benefits falls to the employer (employee contribution is a set %, market rates are volatile, the gap is funded by the employer), with DC schemes the risk of funding the benefits generally falls to the employee. Consequently the government could look to incentivise the employer for DB schemes and the employee for DC schemes.

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

Response

From our own fund's experience the greater proportion of individuals that are not choosing to be in the fund are the lower paid, As such any system change which introduced tax at the point of contributing would increase the disincentive to save, if they can't afford it when there is a tax advantage they won't afford it when it costs more at the point of saving.

Auto enrolment has brought significant increases in the number of individuals in pension funds. Any change should be focussed on incentivising the remaining individuals to save to pension funds with a particular emphasis on rewarding the lower paid.

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

Response

For the DB schemes within the public sector the changes to the NI regime mean there is no longer any financial incentive for employers to promote and support membership of the pension scheme. If this were reversed then the employer would again benefit from a lower employers' NI rate. In the public sector the employer bears the cost of ensuring that the pension payout is met (employees pay a set %, the market returns are volatile, leaving the employer to make the necessary contribution). The employer contributions should be incentivised as they were with a lower employer NI, to reward the employer for bearing the risk of funding the pension scheme and so reducing any future burden on the State.

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

Response

It is for the Government to ensure that any changes to the pension system are sustainable and strike the right balance between individual, employer and government support to employees who opt to save for their pension income. The Government would need to recognise that the State may carry a burden to support individuals who don't save any or enough for their retirement and provide the right environment to encourage individuals to save for their pension. Individuals are more likely to save when it is affordable and when they are confident that the conditions under which they have elected to save will persist through to their retirement – any changes to the pension system should be made with the intention that there are no further changes and provide certainty for individuals to make decisions about their future pensions.