Ground Floor, 16 Crucifix Lane
London SE1 3JW | 020 7403 7800

ShareAction's response to HM Treasury consultation: "Strengthening the incentive to save: a consultation on pensions tax relief"

ShareAction is pleased to respond to HM Treasury's consultation. ShareAction is a registered charity established to promote transparency and responsible investment practices by pension funds and other institutional investors. We are a member organisation and count amongst our members a growing number of NGOs and charitable foundations, as well as over 35,000 individual supporters.

The consultation paper makes many valid points about the current state of pension savings in the UK. The paper focuses on how changes to tax relief could improve incentives for pension saving. It may be that the tax system relating to pensions needs to be changed, but we have set out below our doubts about whether such changes will on their own incentivise greater saving. If the Government wishes to improve incentives, there are other issues to be addressed and steps which could be taken which should be of higher priority. In particular, treating the tax question in isolation from wider questions around the governance of pension schemes, member engagement and involvement and scheme scale misses an opportunity to consider all the levers available to Government to improve the pensions system and to incentivise people to save more.

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

We understand this question to be addressed to the complexity of the current *tax* system for pensions. For some savers, tax incentives will encourage greater saving. This is most likely true of higher paid and/or more financially literate savers. However, to address the issue of the major shortfall awaiting many savers in defined contribution schemes, the Government needs to look at savers across the social spectrum. It is not clear that for the majority of "ordinary" savers (those on middle and lower incomes) the tax treatment of pensions plays a significant role in their decision to save. Evidence to support this includes:

a. A study carried out by Aviva on 2,000 working people found that two thirds had little or no understanding of how the pension tax system works or how it affects their savings and 1 in 10 had never heard of pension tax relief[1].

[1] http://www.aviva.co.uk/media-centre/story/17526/two-thirds-of-people-in-the-dark-over-pension-tax-/

b. A meta-study by Bristol University of research into how individuals understand pensions and investment concluded that "*qualitative and quantitative research in the UK consistently shows that people's knowledge and understanding of pensions is generally poor… Many participants in a recent qualitative study were unaware that pension funds were invested on the stock market, and instead tended to view them as long-term savings accounts*" [2].

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?

The consultation paper is correct in saying that people are disengaged from pension saving. But many of the reasons for this arise before the question of the tax arises. Much of ShareAction's work focuses on helping people to engage with their pension savings. Barriers to this engagement include the following:

a. People will not engage with things they do not understand. As flagged above, many people have a limited understanding of how pensions work. Despite this high level of ignorance, the information people receive from their pension providers is complex and technical. The Work and Pensions Committee found that this is not, as is often claimed by providers, a *necessary* result of regulatory rules[3]. Providers could do much more to reach out to savers, including through employers where necessary, in a way which helps them to understand their savings[4].

b. One of the barriers to better communication and understanding may be the fact that the pension sector is heavily over-intermediated. Professor Kay recognised this as a problem in his review of short-termism in UK equity markets[5]. Intermediation not only adds costs (which diminish pension pots), it also adds barriers to the transfer of information and accountability along the investment "chain" to the ultimate saver. In ShareAction's experience, when savers do contact their pension providers they may be told that the information is unavailable because it sits with an agent. This is a disincentive to further engagement.

c. Related to the above point, savers have very limited *rights* to know how their money is being invested and the rights attached to it are being used. Lord German proposed an amendment to the Pension Schemes Bill in January 2015 which set out improved rights for savers to know how their money is used. Coupled with better understanding by savers and better communication by pension providers, such rights would go a significant way to enabling engagement and encouraging people to take responsibility.

[2] Para. 2.1: http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/investment-consultation-research-report,PDF.pdf

[3] See para. 90: http://www.publications.parliament.uk/pa/cm201213/cmselect/cmworpen/768/76808.htm

[4] See ShareAction's report on what industry could do: http://www.shareaction.org/sites/default/files/uploaded_files/investorresources/OMOB.pdf

[5] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf

d. As ShareAction's recent report "Realigning Interests, Reducing Regulation" explored, pension provision in the UK has shifted away from governance structures which provide strong protection for savers[6]. This is true on a financial basis, with the move from defined benefit to defined contribution pensions, and it is also true on the basis of protection of savers' interests. The move away from trust-based provision, with fiduciary duties, to contract-based provision has reduced protection for the saver. Contract-based provision erroneously treats the saver as an informed consumer. It is governed by contract law and regulatory rules which provide much weaker protection for the saver.

   This trend contradicts evidence from other jurisdictions that trust-based provision and / or structures which allow greater saver involvement perform much better[7]. ShareAction is concerned that discussion of reforms to the way in which pensions are taxed is not being coupled with discussions about the best business models to use for pension provision.

e. Pension performance in the UK has been poor. It is therefore perfectly rational for those savers who *do* understand pensions to opt not to save more. The Danish Pension system has been judged to be the best in the world and according to Better Finance EU delivered real average annual returns of +4.7% over a 12 year period. In stark contrast, UK savers received -0.7%[8].

   These "returns" are also impacted by the high level of fees and charges extracted from saving pots in the UK. The same research found that the Danish system had the lowest costs. High costs signal that the market is failing, one of the reasons the Government intervened with charge caps. As suggested above, adjusting tax incentives may only have limited impact on incentives to save. Of far greater importance is taking action to address the flaws in the system that prevent it from delivering, in a responsible and transparent way, good returns for savers, thus making it an attractive way to save.

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 DC pensions?

We are not sure that an alternative tax system would have an effect on savers' sense of personal responsibility. In ShareAction's view, of far greater importance is equipping savers with a better understanding of the way in which their money is invested in the real economy. Indeed, it is difficult to see how people can reasonably be expected to take responsibility without clear, comparable and digestible information about their money.

[6] http://action.shareaction.org/page/-/ReducingRegulationReport.pdf
[7] See ShareAction's analysis of Dutch, Danish and Australian pensions in our latest research – see ftn 6 above
[8] Better Finance For All, 'Pension Savings: The Real Return. 2014 Edition', 2014

Savers' understanding is hampered by the fact that they have very limited rights to know where their money is invested and how the rights attached to it are being used. In our response to Q.2 above we mentioned Lord German's amendment to the Pension Schemes Bill. Lord German withdrew that amendment on the promise by Lord Bourne (Cons) that the Government would consult on giving savers greater rights. DWP has since mentioned this proposed consultation in other papers it has issued[9], but the promised consultation has not materialised. We urge the Government to honour the promise to consult.

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

We do not have a strong view on this question, other than to say that part of planning for retirement is having a clear idea of how much money you will have. This may be achieved better by savers seeing their pension pot net of tax. It would also be facilitated by clear reporting on all the fees and charges (presented as a single figure) taken by providers and their agents.

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

We do not have a strong view on this question, other than to flag that savers in defined contribution pensions are most vulnerable to the vagaries of investment decisions made outside their control. They therefore need greater protection and clear information from providers.

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

We do not have a strong view on this question.

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

We do not have a strong view on this question.

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

ShareAction urges the Government to make sure that it does not look at the issue of tax reform independently of the wider systems for governance and regulation of pension provision.

[9] See para. 15: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/407937/Condoc_27_02_15_to_DWP.pdf