Pensions: a vision for the future

Michael Johnson

SMF Social Market Foundation

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ABOUT THE AUTHOR

Michael Johnson

Michael Johnson is one of Britain's leading authorities on pensions policy and taxation. After training at JP Morgan in New York, he worked in investment banking for more than 20 years before joining Tillinghast, the actuarial consultants. He has advised several leading politicians on economic policy and is occasionally called to give expert evidence to Parliamentary select committees.

Michael has written some 40 think tank policy papers, predominately concerning pensions. Some of his proposals have been implemented, including the introduction of the Junior and Lifetime ISAs. He was an early advocate of pensions freedoms, accompanied by default Auto-Protection at 60 (yet to be implemented).

EXECUTIVE SUMMARY

This paper proposes a vision for a simpler, fairer and more sustainable pensions landscape. It is presented as one coherent package incorporating all three pillars of State Pension, workplace provision and personal provision, and considers both pre-retirement saving and the taking of post-retirement income.

The focus is on defined contribution (DC) pensions; private sector defined benefit (DB) is withering naturally, and the politically toxic arena of public sector pensions is ducked (albeit that I have written about it elsewhere[i]).

Saving incentives, risk sharing, and addressing the proliferation of small (and lost) pots (the existing stock and, separately, the ongoing flow) are discussed in detail, along with the importance of a dashboard *with utility* (i.e. the ability to use it to actually consolidate pots rather than merely to look at them).

This paper assimilates some of the actionable proposals made in more than 40 policy papers written over the last 14 years. More detail is provided in individual papers; where relevant, these are referenced in footnotes.

Summary of the proposed architecture: four key components

(1) A larger, but later, State Pension ("Senior Citizen's Pension"), supplemented by Income Support (being replaced by Universal Credit by end-2024) extended beyond State Pension age (SPA).

(2) "Auto-protection" for DC pot decumulation, with two distinct components, both introduced by default (each with the right to opt out):

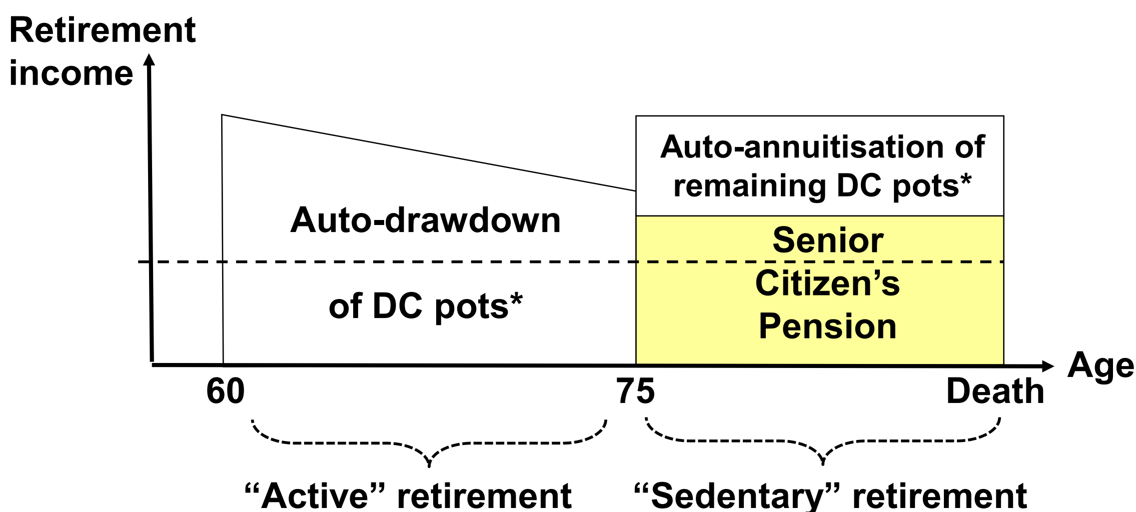
   i. "auto-drawdown" over a finite 15 year period (60 to 75), in the form of an income drawdown default of between 4% and 6% of pot assets per annum, dependent upon pot size, paid weekly or monthly.

   ii. "auto-annuitisation" of residual pots, at the age of 75. This would facilitate the collective hedging of individuals' exposure to the unquantifiable risks of longevity. It would also remove later-life exposure to investment markets risks and, through indexation, cost of living inflation.

Figure 1 shows how auto-protection and the Senior Citizen's Pension could combine chronologically.

[i] *Self-sufficiency is the key; addressing the public sector pensions challenge*; CPS. The paper is backed by Conservative and Labour peers.

Figure 1: Auto-protection combined with a Senior Citizen's Pension



Source: Illustration by Michael Johnson

(3) Bonuses, not tax relief, paid on all contributions to pension pots.

(4) An enhanced automatic enrolment (AE) framework, to broaden participation. Members of workplace pension schemes should be given the right to choose the pension scheme into which their employee and employer contributions are paid ("member choice"), subject to the recipient pot meeting AE's qualifying criteria. In addition, two new AE-eligible ISAs are proposed, a Workplace ISA and a Self-employed ISA. Alternatively, the Lifetime ISA could be brought into the AE framework, enhanced to provide the same capabilities as the two proposed new ISAs.

Destination; a Senior Citizen's Pension alongside one pot for life

In the 2023 Autumn Statement, the Chancellor announced a call for evidence on a lifetime provider model for DC pension schemes. Given that the purpose of consolidation is to create fewer, larger pots, the logical policy destination is ultimately a system in which individuals would have a single pension pot at one provider, for life. They would of course be entitled to move it to a different provider, should they so wish (and pot mobility would help keep the market competitive).

The exercise of "member choice" (discussed below) would provide a mechanism to help achieve this. In addition, because member choice is focused on arresting the ongoing flow of new pots, it would neatly complement the Government's proposed multiple default consolidator model to reduce the existing stock of small, deferred pots.

Together, these two initiatives would dramatically simplify the pensions market and boost engagement with pensions. In addition, they would heighten provider competition for pots, thereby improving value for money for savers. Meanwhile, the distinction between DC work-derived and personal pension savings continues to blur; a single (pension) pot for life looks inevitable, facilitated by common sense and digital capability.

But why stop at pensions? For millions of people, ISAs are an increasingly significant source of retirement income. Once today's five ISAs are pulled together into a Universal ISA, the pensions and ISA regimes should be harmonised within a single bonus-fuelled framework. Consumer-centric simplicity to the fore.

Guiding principles

- The pensions system should:
  - be designed to ensure a dignified retirement for all ("adequacy"); and
  - embrace accountability, fairness, simplicity, sustainability and transparency (not least to ease the communication challenges).
- When reviewing the state, workplace and private sources of retirement income, they should be considered as a single coherent framework. Policy should be made systematically, not piecemeal.
- State provision should be long-term financially sustainable, reflecting the costs associated with the (post-war) rise in life expectancy and the deleterious economic consequences of an ageing population.
- The state is best placed to absorb life expectancy tail risk (particularly given the decline in voluntary annuitisation).
- Providers of private and workplace retirement saving products should be consumer-focused; their customers' interests should not be subordinate to the industry's.
- Personalisation encourages engagement with saving, and hence awareness about the pension system. Workplace-derived savings should be considered as an extension of private provision, they should be portable and as personal as a bank account (thereby reinforcing automatic enrolment).
- Treasury-funded saving incentives should be structured progressively to maximise their effectiveness. Today's tax relief arrangement is regressive.
- Defaults work; they should be employed in the decumulation phase to facilitate a more collective approach to post-retirement risk sharing.
- Pensions' unjust structural prejudices against the low paid (predominately women) should be rectified.
- The paucity of retirement saving by the self-employed can no longer be ignored.
- The role of ISAs in the retirement saving arena should be formalised, given that they are now widely considered to be a core part of retirement savings.

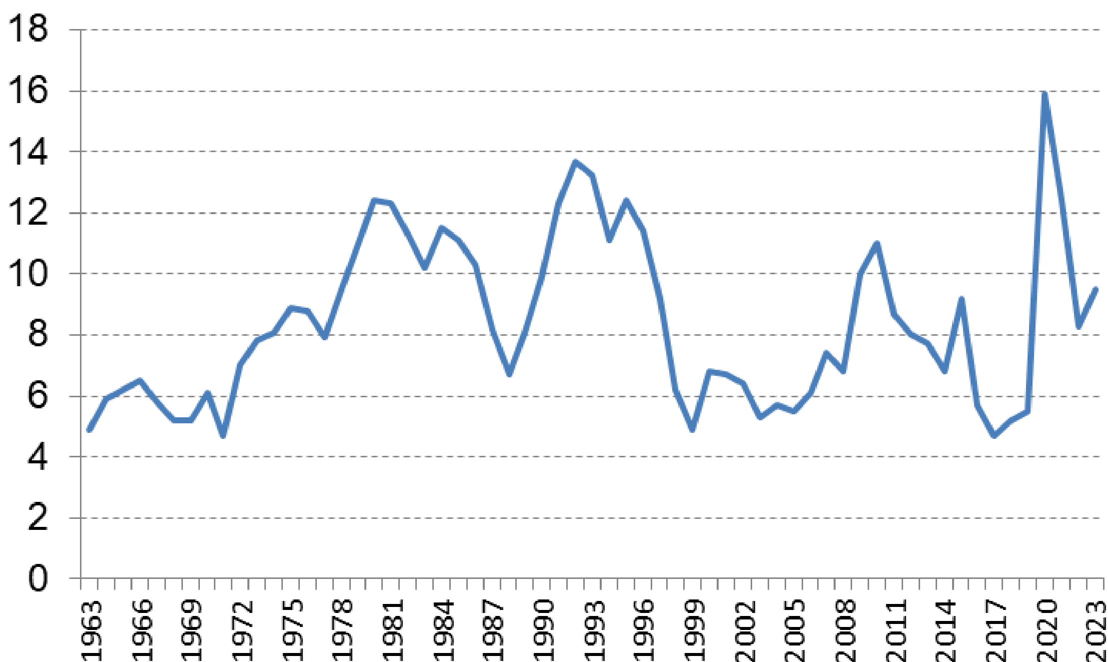
INTRODUCTION

Growing international competition for capital

The UK is increasingly dependent on imported capital, and competition for it is rising, particularly from other developed nations with ageing populations. Consequently, we need to catalyse a *broad-based* savings culture, i.e. more people saving more (as opposed to just the wealthy saving more), not least because the SPA is in retreat.

Figure 2 illustrates the history of the household savings ratio which has, since 1963, averaged 8.4%. We should ignore the short-term data noise (the ratio was 5.6% in Q4 2019…and 26.8% in Q2 2020); policy should be shaped by the long-term data signal which is indicating, since the early 1990s, a decline in saving. We should aspire to increasing the ratio to, say, the 1990s average of 11%, and not be distracted by the pandemic-induced temporary savings surge.

Figure 2: UK Households' saving ratio, %, 1963 to 2023



Source: ONS data series DGD8 (which commenced in 1963)

Using the OECD's measure of net household saving[ii], the UK's rate in 2022 was 2.0%, far lower than almost all our competitor (developed) countries. By comparison, Australia's was 13%, France and Germany were both at 11%, Ireland 8%, Netherlands 13%, Spain 10% and the USA 12%. The rate for the European Union (collectively) was almost 6%, and 7% for the Euro area.

[ii] Defined as the total amount of net saving as a percentage of net household disposable income. It thus shows how much households are saving out of current income and also how much income they have added to their net wealth. All OECD countries compile their data according to the 2008 System of National Accounts (SNA). https://data.oecd.org/hha/household-savings.htm.

Boosting the savings rate on a long-term basis requires a strategy that will produce behavioural, and then cultural change in attitudes towards saving… which will not be achieved by continuing to tinker with our ludicrously complex pensions' framework.

Pensions policy should deliver on two objectives: decent pensions in retirement, and a more dynamic economy, both fuelled by domestic pools of (long-term) retirement savings. Australia, for example, takes this so seriously that it is currently seeking to enshrine the objectives of their superannuation (i.e. pensions) system in law, in an attempt to ensure that any policy changes are aligned with the core purposes of the system.[1] It has long been recognised that haphazard or inconsistent changes in pensions policy inevitably produce an incoherent, fragmented pension system. They also risk undermining trust in the system: the UK should take note.

Pension freedoms: implications

In 2010 I outlined to the Chancellor (Osborne) some proposals that led to the decision to end the pension pot annuitisation requirement. My letter was subsequently published as a policy paper *Simplification is the Key* (CPS, 2010), de-politicised through public backing from Conservative and Labour peers.[iii]

The so-called "pension freedoms" eventually materialised in 2015, rapidly followed by a 90% reduction in the purchase of annuities. During 2019-20, of the 674,000 pension plans accessed for the first time, only 10% involved the purchase of an annuity[2], and while recent higher interest rates have increased demand, annuities sales remain relatively subdued; the flexibility of drawdown is immensely popular.

Policy considerations: two fundamental questions

(1) What is a pension?

Most people respond to this question with something along the lines of "income which is certain until the day I die". The word "annuity" very rarely gets mentioned, but what people are actually describing is indeed a lifetime annuity. But with almost all (private sector) DB schemes now shut to new members, retirement incomes are increasingly being sourced from DC pension pots which, unless annuitised, do not provide any certainty of income until death. Consequently, the number of people who will enjoy what is conventionally understood to be "a pension" will only diminish.

(2) National identity: are we a nation of individuals, or a collective?

Pension freedoms appeared without an important feature that I requested in my original letter to the then Chancellor: a mechanism to protect people both from themselves (i.e. against the risk of running down savings too quickly and then falling back on the state) and the vagaries of markets. Given the attendant implications for identity, this debate quickly becomes politically polarised.

[iii] Notably Lord Norman Blackwell (C) and Baroness Patricia Hollis (L).

CHAPTER ONE – A LARGER, BUT LATER, STATE PENSION, SUPPLEMENTED BY AGE-EXTENDED INCOME SUPPORT[iv]

1.1 Background

i. Today's State Pension is unsustainable

If the State Pension were fully funded, actuarially speaking, then its long-term affordability would not be debated. The affordability question arises through a combination of its unfunded status; rising longevity and, very different, our ageing population; the triple lock; and years of weak economic growth (partly due to low productivity growth).

Yes, the SPA is being sent into retreat, but far too slowly. Consequently, total annual expenditure on the State Pension has, for years, been growing at a rate that exceeds the growth rate of our economy. In 2012-13 it cost £79.8 billion, a decade later £109.7 billion (2022-23), and next year alone it is forecast to rise by £15 billion to £124.7 billion…and three years later by another £20 billion.[3]

Inflation is, of course, partly responsible for driving up the cost, but consider the OBR's Fiscal Risks and Sustainability Report (FRR, July 2022):

> *…every assessment we have published over the past decade having shown debt on an unsustainable path over the next 50 years as a result of these [emergent geopolitical and energy] pressures.*[4]

The OBR's projections are for state spending on payments to pensioners to rise from 5.6% to 9.6% of national income over the next 50 years, an increase equivalent to £100 billion a year in today's terms.

Unless economic growth accelerates significantly, one or a combination of spending cuts and higher taxes surely beckon. Meanwhile, the National Insurance Fund remains an accounting chimera, notionally invested in gilts. It serves as a barometer for the sustainability of the State Pension, and has required periodic topping up by Treasury grants to ward off exhaustion. According to the Government Actuary, the Fund will be exhausted by the mid-2030's, so unless the State Pension is addressed within the next few years, fiscal calamity beckons.

ii. Entitlement to the State Pension through NICs is unfair

Given the ongoing bifurcation (i.e. widening) in life expectancy between the wealthy and the poor, policymakers should be very wary of the word "average" in the context of life expectancy.

At the age of 65, the typical Chelsea male resident can expect to live to 88; he will receive the State Pension for 22 years (commencing at age 66). Conversely, Tottenham Green man is, on average, expected to die at 71, thereby receiving the State Pension for only five years. Tottenham Green man's return on his National

[iv] Note that Income Support is gradually being replaced by Universal Credit through a process of invitation, with completion expected by end-2024.

Insurance contributions (NICs) and NI credits, in the form of his State Pension is, on average (yes, a dangerous word), only about a quarter of that of Chelsea man's.

In addition, the gap in *healthy* life expectancy (at birth) between the most- and least-deprived areas is almost two decades, double the gap in total life expectancy.[5] Furthermore, socio-economic inequalities in life expectancy are increasing as a result of greater gains in life expectancy in the least-deprived populations.

Given that entitlement to the State Pension is established on a common basis, NICs provides terrible "value for money" for those who can least afford it, and a (retreating) universal SPA is increasingly unjust. The poorest in society are hugely subsidising the State Pensions of the wealthiest.

Means-tested tiering of access to the State Pension (by age) has been suggested, but it would come at the price of immense operational complexity. Other approaches (such as a post code-determined access age) would be too crude, and risks inviting moral hazard.

iii. The State Pension is opaque, and widely misunderstood

Contrary to widespread belief, the State Pension is *not* a contractual obligation arising from the payment of NICs. A judgement delivered by Lord Hoffman makes it clear that the State Pension is not a "property right": *National Insurance contributions has no exclusive link to retirement pensions...in fact the link was a rather tenuous one.*[v]

Essentially, National Insurance is to "insure" people against the risk of not being able to work, by providing an income until either they are able to work, or they die. Old age is just one of a number of insured risks, which include unemployment, sickness, maternity and bereavement. NICs also partially fund the NHS. In short, National Insurance is not a pension scheme.[vi] It is really a work-related tax, akin to Income Tax, albeit loosely hypothecated (via the National Insurance Fund) to pay the State Pension, i.e. an inter-generational transfer of cash from workers to pensioners.

State Pension payments are dependent upon certain conditions being satisfied. These include past NICs and NI credits, but they do not give rise to a specific value of State Pension: witness how indexation rules have changed over the years (and the single-tier State Pension is different from its predecessor). The age of eligibility is defined in legislation, but this could be, *in extremis*, changed at any time through primary legislation.[vii] Consequently, the State Pension does not appear in the National Accounts, nor even the (more transparent) Whole of Government Accounts' balance sheet.[viii]

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[v] House of Lords judgment, May 2005, dismissing a discrimination claim made by a pensioner living in South Africa who was not receiving the same pension increments as those paid to pensioners living in the UK. For more detail, see Frances Coppola's *Coppola Comment, State pensions: property right or benefit?* 20 October 2016.

[vi] Ibid.

[vii] E.G. as per the Pension Acts 1995, 2007, 2011 and 2014.

[viii] If the State Pension were to be included in the WGA, the UK's net liability per household would more than treble.

In summary, the State Pension is technically and legally a contributory social security benefit[ix] which could be removed tomorrow (the retreating SPA does this subtly). This is not widely appreciated, because the true status of the State Pension has long been shrouded behind politically convenient ambiguity.

1.2 State Pension: proposals

i. Communicate: be honest about State Pension entitlement

Any responsible government should be clear about the true nature of State Pension entitlement; ultimately, transparency is a virtue (notwithstanding the political challenges)…and a crucial prerequisite for effecting significant change. Start early and maintain message consistency.

ii. Merge NICs and Income Tax[6]

For decades, voices across the political spectrum have proposed the merger of NICs and Income Tax, the virtues being simplification, transparency and fairness. The 2016 introduction of the residency-based, single-tier State Pension terminated the last vestiges of the contributions-based principle for benefits entitlement. Subsequently, NICs have been unambiguously part of the broader tax take.

To its credit, in recent months the current government has commenced NICs' demise by reducing the rate of employees' Class 1 NICs from 12% to 8%, with the self-employed Class 4 rate falling from 9% to 6% from April 2024.

The revenue gap arising with the end of NICs could be closed with the introduction of a single Earnings Tax (essentially aggregating the tiers of Employee NICs and Income Tax). Employer NICs receipts could be replaced primarily by higher Corporation Tax.

iii. Demise the State Pension

The State Pension should be put into "run-off" so that from 2026, say, no further entitlements would be created. Existing State Pension "rights" (garnered through NICs and NI credits) should be preserved (as the "legacy" State Pension[x]), with the caveat that they would be potentially subject to means testing along Australian lines, along with the whole gamut of other pensioner benefits.

[ix] The word 'benefit' is used as a general term to encompass all State-issued payments, and from the time of the 1946 National Insurance Act, which applied from the inception of the National Insurance scheme, retirement pension (now known as State Pension) has always been classified in law as a "benefit", defined in section 122(1) of the Social Security Contributions and Benefits Act 1992.

[x] The legacy SPA would rise to 67 between 2026 and 2028, as scheduled for today's State Pension.

iv. A "Senior Citizen's Pension" to replace the State Pension

A new residency-based "Senior Citizen's Pension" should be introduced, commencing at age 75, say, coinciding with the termination of "rights" accruing to the current State Pension.[xi] Like the State Pension, the Senior Citizen's Pension would socialise longevity risk by providing certainty of income until death, but it should be substantially larger than today's State Pension (by 40%, say).

A Senior Citizen's Pension set at an amount adequate to live on from the age of 75 would encourage retirees to concentrate decumulation of their DC pension pots and other savings into a finite 15 year window between the age of 60 and 75. DC pots would then go much further (i.e. produce higher incomes) because, with the removal of the life expectancy "tail risk", annuity pricing over that period would improve, substantially.[xii] Similarly, drawdown incomes over a finite 15 year period could then be higher.

1.3 Bridging the 60 to 75 income gap...through extended Income Support

Following the introduction of a Senior Citizen's Pension, retirement income between the ages of 60 and 75 would be derived from one or a combination of:

- defined contribution (DC) personal and workplace pension pot decumulation;
- final salary / defined benefit (DB) pensions (diminishing over time);
- drawings from ISAs and other savings; and
- legacy State Pension rights (diminishing over time).

Clearly, those without meaningful savings would need additional state support. In addition, we know that the rising SPA is already posing difficulties for many, through a combination of ill-health and fewer work opportunities for those in their late-60s. Furthermore, working-age benefits are less generous than the support available for pensioners.[xiii]

Consequently, Income Support should be extended beyond SPA to form an integral part of the post-retirement benefits framework, and also enhanced to fill the 60-75 income gap. Pension Credit would then be superfluous (a simplification measure).[xiv]

1.4 State retirement income provision: summary

The combination of a residency-based Senior Citizen's Pension and age-extended Income Support would provide universal coverage beyond the age of 75 until death.

[xi] The rationale for a later, but larger, SCP is detailed in a policy paper, *The State Pension: no longer fit for purpose*; Michael Johnson, CPS, 2016.

[xii] Having long lobbied for the state to assume the tail risk, the annuity industry would welcome this structure.

[xiii] For example, the increase in SPA from 65 to 66 led to a more than doubling of the income poverty rate for 65-year-olds. IFS; *A blueprint for a better tax treatment of pensions, 2023*.

[xiv] Pension Credit provides additional money to help pensioners on a low income.

As for the very long term, given that the contributions-based principle no longer applies, perhaps we should consider a further simplification by combining any form of state pension (past "rights" honoured) with an Income Support framework, delivered as one single residency-based benefit?

1.5 A Royal Commission to opine

Given the State Pension's political toxicity, a Royal Commission should be invited to conduct a review of the State Pension's future financial sustainability. Ideally, inter-generational fairness should be a major consideration (not least because of the deteriorating worker-pensioner dependency ratio).

The Commission should be invited to comment on the aforementioned specific proposals to merge NICs and Income Tax, and to replace the State Pension with a "Senior Citizen's Pension", combined with age-extended Income Support. It should also be asked to appraise the future of the triple lock[xv], particularly in light of recent inflation, as well as the introduction of means testing of today's State Pension. Australia, for example, aggressively means-tests its Old Age Pension (OAP) above pretty modest asset *and* income thresholds. A home-owning couple with net assets (including property) in excess of A$419,000 (£228,000) see their OAP gradually reduced, and if net assets exceed A$954,000 (£519,000) *they get nothing*.[xvi] The income test is similarly draconian. If, for example, a couple's *combined* income exceeds A$336 (£183) per fortnight, they lose 40 cents in OAP for each dollar over A$336 (for singles the threshold is A$190).

One subtler approach that could be considered for the UK is to introduce means testing for only a few years immediately following SPA. It would, however, be open to accusations of being the thin end of the wedge, i.e. that is would only be a matter of time before means testing were extended through until death.

1.6 Implementation

Clearly, implementation of the Senior Citizen's Pension would take decades to complete. The legacy State Pension would disappear only very slowly, and payments of the Senior Citizen's Pension would only commence once those who were at SPA when the SCP were introduced reach the age of 75. Prior to this, they would receive an (age-dependent) combination of the legacy State Pension and Income Support.

Detailed cost modelling would be required, with variables including demographic "shape"; the maximum size of the Senior Citizen's Pension, its indexation and eligibility criteria; the parameters for any means testing of the legacy State Pension; and the exact structure of the (age-extended) Income Support.

A separate paper details how the proposed Senior Citizen's Pension could be implemented; see *The State Pension: no longer fit for purpose* (CPS, 2016).

[xv] The maximum of earnings, prices and 2.5%. See *The State Pension: no longer fit for purpose*; Michael Johnson, CPS, 2016.

[xvi] For non-homeowning couples, these figures are $634,750 and $1,178,500, respectively.

CHAPTER TWO – AUTO-PROTECTION DEFAULT FOR DC POTS DECUMULATION

> *"By providing financial protection against the major 18th and 19th century risk of dying too soon, life insurance became the biggest financial industry of that century...Providing financial protection against the new risk of not dying soon enough may well become the next century's major and most profitable financial industry".*
>
> **Peter Drucker, "Innovate or die", The Economist, 25 September 1999**

2.1 Overview

Following the introduction of "pension freedoms" in 2015, ending the annuitisation requirement, many retirees risk wallowing in indecision when pondering the complexities of how to decumulate their workplace and personal DC pensions pots.

Consequently, upon retirement, more than 80% of DC workplace scheme members are making full cash withdrawals, rather than electing to remain invested.[xvii] Given that retirement often exceeds twenty years, this is unlikely to be in retirees' best interests. Meanwhile, uncertain life expectancy exposes retirees to downside financial risks in later life, notably the premature exhaustion of savings.

Notwithstanding years of product development, the pensions industry has failed to create a risk-equivalent alternative to annuitisation. This is unsurprising: complex DC pot drawdown schemes cannot compete with the lifetime annuity.

Outlined below is a proposal termed "auto-protection", an idea first floated in 2015 and updated in subsequently papers.[7] It harnesses two successive defaults (with opt outs) to accommodate individualism (consistent with pension freedoms), collective investing (to harness economies of scale), and the socialisation of later life longevity risk (which, for most people, is best managed collectively).

(1) **Auto-drawdown" over a finite 15 year period** (60 to 75), in the form of an income drawdown default of between 4% and 6% of pot assets per annum, dependent upon pot size, paid weekly or monthly. This would substantially reduce both the "risk of ruin", and exposure to pot conversion fraud. Providers would be encouraged to provide a low cost, diversified default fund for undrawn assets, with economies of scale helping to deliver larger retirement incomes than otherwise. Pension pots below a threshold size could be exempted.

(2) **"Auto-annuitisation" of residual pots, at the age of 75.** This would facilitate the collective hedging of individuals' exposure to the unquantifiable risks of longevity. It would also remove later-life exposure to investment markets risks and, through indexation, cost of living inflation.

[xvii] Corporate Adviser's *Workplace Pensions Into Retirement Report (2023).* As pot size diminishes, cash-in rates typically rise, whereas scheme members with pots exceeding £30,000 are more likely to remain invested.

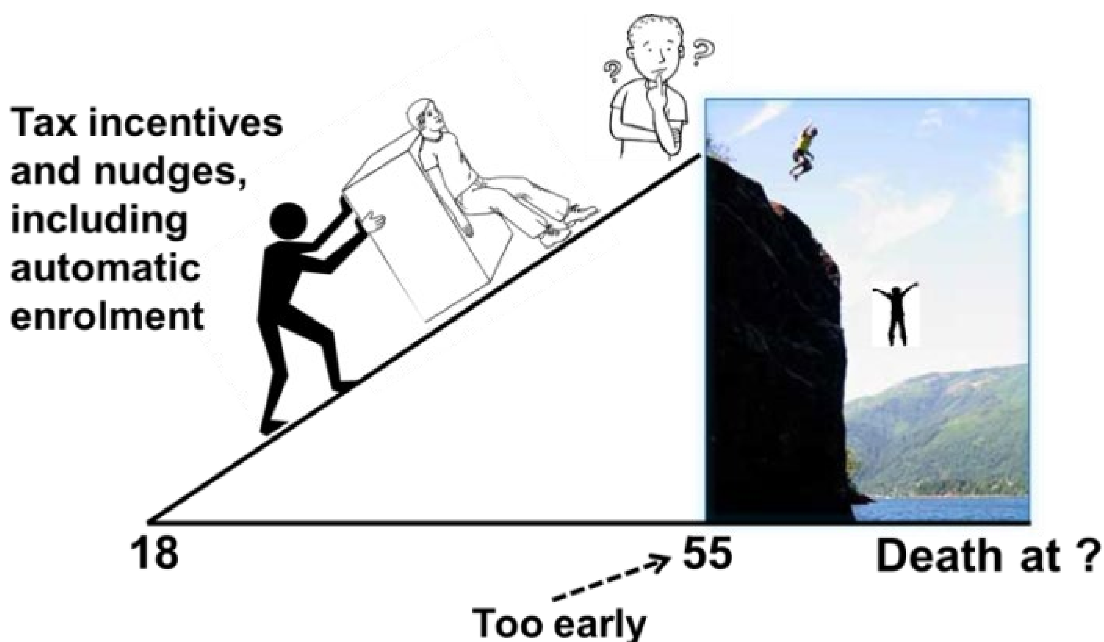
We know from our experience with automatic enrolment that defaults (combined with inertia) can be highly effective, particularly for the less financially aware (i.e. most people). That said, to be clear, there is no desire to prevent people from doing what they want with their own savings. Everyone should be free to opt out of one or both auto-protection defaults to pursue alternatives, consistent with 2015's liberalisations.

Indeed, such is the wide variety of different personal circumstances as people approach retirement (health, home ownership, marital status, spouse's circumstances, non-pensions wealth, etc.) that a single default will not accommodate everyone. Consequently, auto-protection could be considered as a useful default "backstop". In addition, in respect of auto-annuitisation, some people do not like annuities because of the loss of control of their capital; they will probably opt out.

2.2 Observations

The introduction of auto-protection should be presented as a logical extension of the auto-enrolment framework, and would address a major policy inconsistency. Today, the state nudges and incentivises people to accumulate retirement savings, only to desert them at private pension age. Auto-protection would substantially reduce financial risk in later life, thereby helping to protect both the individual and the state.

Figure 3: From 55 you are on your own



Source: Illustration by Michael Johnson

Auto-drawdown's default drawdown rate is for debate. Table 1 shows the pot size at age 75 expressed as a proportion of the pot size at age 60, for a range of different annual drawdown and asset growth rates.

Table 1: Pot size at age 75 as a percentage of pot size at age 60

	Asset growth rate % p.a				
Drawdown rate, % p.a.	**0%**	**1%**	**2%**	**3%**	**4%**
4%	54%	63%	74%	86%	100%
5%	46%	54%	63%	74%	86%
6%	39%	46%	54%	63%	74%
7%	34%	39%	46%	54%	63%

Source: Calculation by Michael Johnson

Thus, at age 75, some 54% of the original pot size at age 60 would be available for (auto) annuitisation, assuming a 2% asset growth rate and an annual drawdown of 6% of the start-of-year pot size. Clearly, at age 75, the remaining pot size would be larger with a higher asset growth rate, and smaller with a larger annual drawdown rate.

This should leave a meaningful pot size for auto-annuitisation. Variations on this structure include drawing down larger pots (at age 60) at a faster rate than smaller pots, but this comes at the price of added complexity. Also for debate is whether the auto-protection framework should provide an automatic tax-free cash sum at age 60.

Auto-protection places individuals' longevity risk where it can be most efficiently managed: with annuity providers and the state (subsumed within the proposed Senior Citizen's Pension). In addition, the combination of default funds and investment collectivisation (within annuity books) would facilitate an extended post-retirement investment horizon. This would accommodate larger allocations to (potentially) higher yielding, longer-term illiquid and private market (i.e. unlisted) investments.

One alternative to auto-protection, supported by Labour's Baroness Jeannie Drake, for example, would be to reintroduce a minimum income requirement (MIR) before being able to gain unlimited drawdown access to pension funds. However, drawdown is immensely popular; pension freedoms would be politically tough to reverse.

2.3 A national auction house for annuities

If auto-protection were to be implemented as described, then demand for annuities could be expected to rocket. In addition to auto-annuitisation, auto-drawdown's finite timeframe between the age of 60 and 75 invites "opting out" to purchase 15 year fixed term annuities, which the industry would of course welcome.

The industry should be encouraged to establish a not-for-profit national annuities auction house to automate the process of shopping around, adding to pricing tension and transparency. All aspiring annuity providers would be required to participate: this would be akin to making the exercise of the Open Market Option mandatory for aspiring annuitants. Initially, perhaps only a limited number of standardised single- and joint-life, inflation-protected lifetime and deferred annuity contracts would be

listed. Pre-auction aggregation of small pots by the auction house would encourage stronger bids.

2.4 Timing...private pension age: raise it to 60

To be effective, auto-protection should commence at the private pension age; any later and it would be too late for inertia (facilitated through the default mechanism) to play its role (pots having already been accessed). It should also be attached to the timing of the vesting of life policies (and when other retirement benefits commence).

But today's private pension age of 55 (scheduled to rise to 57 in 2028) is an anachronism, out of step with post-war improvements in life expectancy. Access to pension pots at 55 encourages people to leave the workforce early (potentially leaving them short of savings later in life), at a time when we need to encourage working for longer.

Consequently, prior to introducing auto-protection, the private pension age should be raised to 60 as quickly as practicable (by a year every two years?). Note that a private pension age of 60 would be consistent with the commencement of penalty-free access to Lifetime ISA savings.

CHAPTER THREE – BONUSES, NOT TAX RELIEF, ON CONTRIBUTIONS

3.1 Overview

Last year (2022-23), the Treasury is estimated to have provided £44 billion in Income Tax relief on pensions contributions, and a further £28 billion in National Insurance contribution (NIC) rebates on employer contributions. Outcome? The UK has one of the lowest household savings ratios in the developed world. Tax relief and NIC rebates are an ineffective use of scarce Treasury resource.

Not only is tax relief expensive, it is inevitably regressive, and therefore iniquitously distributed. Most of it goes to those in least need of an incentive to save, with nearly 60% being harvested by higher- and additional-rate taxpayers, i.e. only 14% of all taxpayers.[8] In addition, the language of tax relief is incomprehensible to more than half of all adults, and employer NICs rebates are invisible to employees. Consequently, many people are unmoved by the Treasury's largesse.

From the Treasury's perspective, an equally serious issue concerns Income Tax "band shifting" whereby high-earning workers become basic-rate taxpayers upon retirement. Recipients of higher- and additional-rate tax relief pay an average tax rate of less than 17% on their pension incomes (and 39% of basic-rate taxpaying workers become non-taxpayers in retirement).[9] This fiscal gap is only going to widen as the population ages (leaving the UK with fewer tax-paying workers per pensioner).

We need to catalyse a *broad-based* savings culture, i.e. more people saving more (as opposed to just the wealthy saving more). One solution is to detach the incentive to save from tax-paying status, through the introduction of contributions-based bonuses. Meanwhile, pensions-related tax-based incentives are amongst the lowest hanging fruit in Whitehall.

3.2 Pension freedoms: at odds with tax relief

Historically, there has been a (tacit) arrangement between the Treasury and the people, summarised by the Treasury[10]:

> *"The fundamental reason for giving tax relief is to provide a pension income. Therefore when an individual comes to take their pension benefits they can take up to 25 per cent of the pension fund as a tax-free lump sum; the remainder must be converted into a pension – or in other words annuitised.*

Lord Turner's Pensions Commission report[11] made the same point:

> *"Since the whole objective of either compelling or encouraging people to save, and of providing tax relief as an incentive, is to ensure people make adequate provision, it is reasonable to require that pensions savings is turned into regular pension income at some time."*

The arrival of "pensions freedoms" (2015) put an end to the annuitisation requirement, and with it the main mechanism through which the Treasury is repaid for its earlier (tax relief) incentive (i.e. via annuities taxed at the marginal rate).

In addition, gone is the concept that tax relief is reward for making a (long) term commitment to saving. Today one can contribute to a pension pot just before reaching the age of 55, receive tax relief, and shortly thereafter limit annual pot drawdowns to less than the Personal Allowance, thereby paying no Income Tax. In addition, the 25% tax-free lump sum is available and, furthermore, each year £10,000 of pension pot drawings can be recycled back into the pot to secure more tax relief.[12]

All this makes no sense from a Treasury perspective, providing strong justification for a significant redeployment of incentives to boost their effectiveness *and* efficiency.[xviii]

3.3 A single tax regime for ISAs and pensions

In the Treasury Select Committee's response to the 2014 Budget, which introduced pensions freedoms, it commented that in light of pensions' improved flexibility, ISAs and pensions will become *increasingly interchangeable in their effect.* It went on to suggest that the government should work towards a single tax regime to reflect this.[13] The Committee chairman, Andrew Tyrie MP, was clear:

> *in particular, there may be scope in the long term for bringing the tax treatment of savings and pensions together to create a "single savings" vehicle that can be used – with additions and withdrawals – throughout working life and retirement. This would be a great prize.*

This coincided with my proposal for the Lifetime ISA, with a bonus incentive disconnected from tax-paying status.[14]

3.4 Proposal: replace all pensions tax relief and NICs rebates with bonuses[15]

We should replace all tax relief and NICs rebates with a simple bonus, detached from tax-paying status. Bonuses would be paid on individual and employer (post-tax) contributions, capped at £2,500 per year, say. A bonus rate of 25% would facilitate an incentivised annual savings capacity of up to £10,000, more than adequate for 95% of all adults. Alternatively, to encourage those who find it hardest to save anything at all, a more aggressively progressive approach would be to pay a 50% bonus on the first £2,000 saved, say, and 25% thereafter (making for an incentivised annual savings capacity of £8,000).

A five year "roll up" of unused incentivised capacity could be introduced to accommodate those with less regular annual incomes.

3.5 Observations

- Replacing tax relief with bonuses (i.e. disconnecting the incentive to save from tax-paying status) would put an end to many tax-related pensions complexities. This would provide a huge simplification of the savings arena:

[xviii] Effectiveness concerns outcomes, whereas efficiency concerns the use of (finite) resources.

there would, for example, no longer be a need for the high earners' annual allowance taper.[xix]

- The word "bonus" is a much-needed reframing of the incentives language.
- An incentivised annual savings capacity of £10,000 would adversely impact a tiny minority of the population (a few percent). Only the very highly paid are in a position to save more than this in a single year (and they do not need to be incentivised to do so).
- An alternative incentive structure of a 50% bonus on the first £2,000, and 25% on the next £6,000, would be significantly redistributive (i.e. highly progressive). It would also be **politically very attractive** because, on the first £2,000 saved, **it would double the rate of savings incentive for basic rate taxpayers** (84% of working adults).
- The annual allowance (£60,000 from April 2023) would become redundant.
- NICs rebates on employer contributions (some £28 billion last year) directly benefit company shareholders. Invisible to employees, they are an ineffective incentive to save and have long been considered for abolition. The seminal Mirrlees Review[xx], for example, suggested *"ending the excessively generous treatment of employer contributions".* A more effective use of Treasury resource would be to redeploy NICs rebates within a budget for savings bonuses on employer contributions, paid directly into pension pots, where they would be visible…and therefore more engaging.
- In addition, scrapping NICs rebates would put an end to salary sacrifice schemes, a tax arbitrage at the Treasury's expense (costing roughly £4 billion per year). Such schemes are unfair because they are only available to those with an employer-sponsor (thereby excluding, for example, the self-employed).[xxi]
- Bonuses, as envisaged, would help low earners because, unlike tax relief, they would now be eligible for bonuses, even if total annual income (from one or multiple jobs) fell below the Personal Allowance[16]. This would help promote gender equality because pensioner poverty is far more prevalent among women than men.
- The "net pay" debacle, which disadvantages over 500,000 workers (epitomising the damaging complexity of today's tax relief-based incentive

[xix] However, the impenetrable jargon associated with pension pot decumulation, such as Uncrystallised Fund Pension Lump Sum, would remain.

[xx] The Mirrlees Review (2010, chaired by Nobel laureate Sir James Mirrlees) was set up to identify what makes a good tax system for an open economy in the 21st century, and to suggest how the UK tax system could be reformed to move in that direction. See *Tax by Design, Chapter 14, Reforming the Taxation of Savings*, September 2011.

[xxi] Unlike employer contributions, employee contributions do not attract NICs relief. Consequently, employees accept a salary cut in return for a larger pension contribution from the employer, so that both parties save on NICs (which can be recycled into the additional contribution).

framework), would be immediately extinguished, tax-paying status having become irrelevant for incentive calculation purposes.[xxii]

- Moving from tax relief to a simple bonus-based saving incentive would provide the Treasury with scope to realise a net saving of at least £10 billion per year, depending upon the precise bonus structure. This arises because of the significant reduction in the incentive that would be available to those on high incomes.
- Substantially reducing the savings incentive for the wealthy would water down the case to reintroduce the Lifetime Allowance (LTA). Abolishing the LTA (from April 2024) provides a much-welcomed simplification of today's complex pensions framework, albeit at a modest opportunity cost to the Treasury. The move has been criticised as benefiting those with large pension pots, but there are other, far simpler ways of raising additional revenue from the wealthy, which would not deter senior NHS staff, for example, from working into their 60's.

3.6 Tax relief; conclusion

Pensions' tax relief is expensive, inequitable, illogical, incomprehensible to many, and incompatible with the end of the annuitisation requirement (due to "round tripping" risks). Consequently, it is an ineffective incentive to encourage saving, and therefore an inefficient use of scarce Treasury resources.

Replacing tax relief with a bonus-based framework disconnected from tax-paying status makes eminent sense, particularly for the low-paid and the self-employed. This would boost the effectiveness of the Treasury-funded incentive to save (i.e. more people saving more, particularly amongst the low paid). The consequences for the world of defined benefit pensions are discussed in a separate paper.[17]

3.7 Other tax considerations

(a) Private pension assets; apply Inheritance Tax (IHT)

Following the end of the annuitisation requirement, financial advisers almost always advise their clients to access their pension pots last, particularly only after exhausting any ISA assets. Consequently, the wealthy are increasingly treating private pension pots as the vehicle of choice for minimising IHT, rather than as a vehicle to fund their retirement.

Post-death, assets residing within a pensions wrapper should be taxed in the same away that other savings (including ISAs). They should not be exempt from IHT, not least because contributions are likely to have received up-front tax relief (and, furthermore, any unutilised capital growth and income would have been untaxed).

[xxii] People in "net pay" arrangements who earn between the auto-enrolment threshold (£10,000) and the Personal Allowance (£12,500) do not receive any tax relief, whereas employees in "relief at source" schemes do (albeit that they do not actually pay any Income Tax). Clearly, all low-paid employees should be in "relief at source" schemes, but reconfiguring a "net pay" payroll system is potentially complex and expensive.

(b) Pension pots' tax-free lump sum: expensive, inequitable and ineffective

The tax-free lump sum is hugely regressive: 2% of lump sums are worth £150,000 or more, yet they attract 32% of all lump sum tax relief. It is also expensive (over £5 billion per year, a figure that is rapidly rising with the decline in annuitisation) and, as an incentive for long-term saving, it is wholly ineffective. Note that without the lump sum, retirement incomes (as annuities) would be up to 33% larger. The Mirrlees Review proposed *"replacing the tax-free lump sum with an incentive better targeted at the behaviour we want to encourage"*.

Some have suggested capping the tax-free lump sum (including the Pensions Policy Institute and, more recently, the IFS) at, say, £40,000. This has the merit of simplicity, and would not impinge upon 75% of savers, yet would save the Treasury over £2 billion per year. Indeed, the 2023 Budget did introduce a cap, at £268,275 (as 25% of the LTA in 2022-23) but, given that recipients will have already received up-front tax relief on their contributions, entirely scrapping the tax-free element would be perfectly justifiable…but politically challenging to implement.

CHAPTER FOUR – NEXT STEPS FOR THE AUTOMATIC ENROLMENT FRAMEWORK

Outlined below are three proposals which, if implemented, would bring many more people into automatic enrolment's embrace. Beneficiaries would include those on low incomes, perhaps in one or more part time jobs (predominately women), and the self-employed.

4.1 Introduce member choice to cull small pots, and stimulate engagement[18]

(a) A Ten-Minute Rule bill

In March 2023 Anthony Browne MP introduced a Ten-Minute Rule bill to give members of workplace pension schemes the right to choose the pension scheme (and provider) into which their employee and employer contributions are paid.

Potential recipient schemes could include other auto-enrolment qualifying schemes (including master trusts, life insurers and platforms) as well as group personal pensions (GPPs) and group Self-invested Personal Pensions (SIPPs).[xxiii]

Some non-workplace (i.e. private) pension pots could also be potential member choice recipients, subject to:

(1) the receiving provider having agreements in place under which the employer and employee meet AE's minimum contribution requirements;
(2) contributions being paid via payroll (which imposes contribution monitoring obligations upon the provider); and
(3) the availability of a default investment fund that is subject to the Financial Conduct Authority's (FCA) charge cap.

Note that, subject to employer approval[xxiv], auto-enrolled contributions can already be paid into a non-qualifying personal pension, or even a non-pension product, chosen by the employee. Any employee exercising member choice would need to opt out of the employer's AE qualifying scheme, and the employer would still need to automatically re-enrol the employee every three years.

(b) The 2023 Autumn Statement

The 2023 Autumn Statement confirmed the Government's interest in member choice by announcing a call for evidence on a lifetime provider model for DC pension schemes. The exercise of member choice would provide a significant mechanism for realising a single pension pot for life.

[xxiii] Note that in respect of employers making payroll contributions into a personal pension scheme for two or more workers, then it would be under the remit of an Independent Governance Committee (IGC) or a Governance Advisory Arrangement.

[xxiv] The employer would have to be sure that TPR did not consider that the employee was being induced to give up membership of a qualifying pension scheme.

(c) Protections and standards: no watering down

The destination pots of employees who exercise choice, but do not choose their own investments, should benefit from the same protections as the pots of auto-enrolled members of workplace pension schemes. In addition, they should continue to benefit from the same employer duties and safeguards.[xxv]

Furthermore, financial services firms offering eligible destination pots should be required to comply with the FCA's Consumer Duty, a recently introduced higher standard of consumer protection. This encompasses the management of long term investments found within pension products.[xxvi]

Operationally, the exercise of member choice should not be permitted to inhibit employers' ability to perform their Employer Duties, and meet the employer safeguards (in place to protect the rights of individuals), as specified in the automatic enrolment legislation.

In the meantime, the DWP could introduce a simple nudge; P45s should include employees' most recent active workplace savings pot. This should help encourage those moving jobs to ask their new employer to pay contributions to the last active pot (which would otherwise become deferred, then potentially forgotten about, and ultimately lost).

(d) A BACs-style clearing house to avoid an additional employer burden

There is currently no infrastructure in place that could receive a single (bulk) monthly payment from an employer, and then divide it up for onward distribution to multiple individuals' pots.

It is important that the exercise of member choice does not create a significant additional burden for payroll operations. A BACs-style clearing house could facilitate payroll contributions, and it could also serve to confirm to employers that their contributions were destined for qualifying schemes (evidencing that they were satisfying their auto-enrolment obligations). Pension providers would assume contribution monitoring obligations; any necessary communication with employers could be via the clearing house.

The DWP has already identified the need for a clearing house to facilitate pot consolidation; the same infrastructure could facilitate the exercise of member choice (perhaps developed in tandem with the ongoing dashboard project). A clearing house could, in time, act as a multi-faceted vehicle to: connect pension schemes; enable individuals to identify, view and consolidate their pensions; and facilitate widespread engagement in, and ownership of, pensions.

[xxv] These requirements are triggered by receiving payroll contributions or agreeing that the pension is a qualifying scheme, rather than conditions which need to be met before payroll contributions can be received.

[xxvi] The three elements of the FCA's Consumer Duty require firms to take all reasonable steps to (i) avoid causing foreseeable harm to customers; (ii) enable customers to pursue their financial objectives, and (iii) act in good faith.

(e) The benefits of member choice

i. Reinforcing auto-enrolment through personalisation

It is striking how many people talk about "my ISA" and "my SIPP", but depersonalise their membership of pension schemes facilitated by their employer. Inevitably people do not feel in control of their workplace savings when they are compelled to accept having their savings invested in an arrangement not of their choosing.[xxvii]

Workplace-derived savings should be considered as an extension of private provision; they should be portable and as personal as a bank account. Accounts should bear the name of the individual to engender a sense of ownership; being in control is closely allied to being motivated. The exercise of member choice would require, and encourage, decision-making, thereby driving engagement with the pension system.

ii. Far fewer small pots, faster

The automatic enrolment of employees into workplace pension schemes is widely regarded as a policy success, with one major caveat; it is producing a Niagara of small deferred pension pots (i.e. no longer receiving contributions). Many people have multiple pots, thereby missing out on economies of scale and, in addition, small pots are expensive to administer (relative to their size); in respect of sub-£1,000 pots, the industry's net loss is estimated to be up to £225 million per year.[19] The consequences are smaller retirement incomes than otherwise, and a less efficient and less profitable industry.

The 2023 Autumn Statement confirmed the Government's intention to introduce a multiple default consolidator model to reduce the existing stock of small deferred pots. But every year over one million new sub-£1,000 pots are created.[xxviii] Furthermore, this is primed to accelerate with the passing of the Pensions Extension of Automatic Enrolment Act, which reduces the age for automatic enrolment from 22 years to 18 years of age. The introduction of member choice would neatly complement consolidation by materially arresting the ongoing flow of new pots. The DWP would therefore achieve its objective of culling the small pots' population far more quickly than otherwise. In addition, with fewer new small pots being created, the number that subsequently became lost would be significantly reduced.[xxix]

[xxvii] An extraordinary 39% of auto-enrolled scheme members are unaware that they are a member of a workplace pension scheme; 95% have never tried to change their fund; 91% do not know where their funds were invested; 80% do not know how much is in their pension pot; and 34% do not know who their pension provider is. And very few have identified a beneficiary, should they die. *Decision Technology survey, 2017*. Response of 938 auto-enrolled scheme members.

[xxviii] DWP; *Ending the proliferation of deferred small pots, Table 2, July 2023.* Today there are roughly 20 million deferred pots containing less than £10,000, and 12 million of these hold less than £1,000. Deferred pots in the master trust market are projected to grow to around 27 million by 2035 if no changes are made to address the problem.

[xxix] The Pensions Policy Institute; *Briefing Note 134: Lost Pensions; what's the scale and impact?* 2022. Within each year's new cohort of small pots is a sizeable number that we know will get forgotten about. Over 2.8 million pots are considered lost (some 9% of all pots), an increase

iii. Better value for money

Today, the workplace DC market is focused on the employer as the "buyer" of DC pensions; the individual saver is essentially invisible. Consequently, the market usually views value through an employer lens, prioritising lower costs over improved saver outcomes.

If significant numbers of employees were to exercise member choice, the competitive landscape for workplace-derived pension contributions could be transformed. Individuals, rather than corporate HR departments, would finally be acknowledged as the customer, and traditional workplace pensions providers would have to adopt a more retail focus to gain (and retain) new business (partly through a forensic examination of fund management fees). Saver outcomes should subsequently improve.

iv. A role for all qualifying scheme providers

The introduction of member choice would create an opportunity for those qualifying scheme providers who are likely to miss out on consolidator status; many would be keen to act as "pot for life" providers. With an alternative role, some of the provider opposition to consolidation would wane, greatly helping in the implementation of the DWP's proposal for default consolidators.

v. Fewer transfers

Member choice will slow the production rate of future deferred small pots. Consequently the number of transfers required in the consolidation process would be reduced, reducing operational risk, and saving the industry time and money.

vi. Countering inertia

The current workplace pensions system encourages inertia, as would the DWP's proposed consolidation approach; everything is done for the employee. Inertia can be harnessed positively (automatic enrolment!) but there are also adverse consequences, notably the widespread lack of engagement with workplace pensions. The availability of member choice would help counter this.

vii. Larger pots at retirement

The introduction of member choice is intended to stimulate the accumulation of savings, as well as helping to arrest the creation of small pots. Bigger pots at retirement will produce larger retirement incomes, be they taken through annuities or drawdown, but member choice is not a decumulation phase retirement solution.

(f) Member choice; legal overview

i. Phased implementation

The introduction of member choice could be implemented in two stages. First, individuals could be given the right to choose where their contributions are paid by their current employer, subject to the receiving pots being afforded the

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of 75% over the last four years. Estimated to contain £27 billion of assets, they hold nearly 5% of total uncrystallised DC pot assets.

aforementioned protections. Subsequently, individuals' chosen provider could become their default (i.e. automatic) arrangement.

ii. Stage 1: The right to choose. No new Pensions Act required

The introduction of member choice could be introduced by regulations rather than through a new Pensions Act because the exercise of member choice could be conducted within auto-enrolment's legal architecture.[xxx] A few amendments to existing regulations would suffice, to:

- give engaged employees the right to choose the destination of their pension contributions[xxxi];
- confirm that employees who exercised choice would (still) be deemed to be meeting the requirements for active membership of their employer's scheme; and
- ensure that employees continued to benefit from "default arrangements",[xxxii] including access to a charge-capped default investment option (a qualifying scheme requirement).[20] However, if a member were to choose his own investments, then charge cap protection would fall out of the scope of default arrangements.

Employers would be obliged to (continue to) make "prescribed arrangements" for those employees who exercised choice, as per the auto-enrolment legislation, including the provision of "enrolment information". They would still be able to exercise postponement periods (in respect of new employees), and would need to exercise re-enrolment every three years (should an individual opt out of AE contributions altogether, or cease to contribute to their "member choice" scheme). In addition, members exercising choice should be able to continue to benefit from any available salary sacrifice arrangements.

Alongside the changes to the existing regulations, enabling legislation would be required to give the Secretary of State the power to place new obligations on employers to require them to implement an individual's exercise of choice. The relevant legislation could be introduced by way of a Private Members Bill similar in form to The Pensions (Extension of Automatic Enrolment) Act 2023 which received Royal Assent on 18 September 2023.

[xxx] The main building blocks of the auto-enrolment regime are the Pensions Act 2008, Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010, Employers' Duties (Implementation) Regulations 2010 and Employers' Duties (Registration and Compliance) Regulations 2010.

[xxxi] Regulation 6 of the Auto-Enrolment Regulations 2010 (SI2010/772) would have to be amended to oblige employers to pay their pension contributions to a pot of the employee's choosing, rather than being automatically enrolled into the employer's default pension scheme. Sections 3 and 143 of Pensions Act 2008 does give the DWP the power to use a Statutory Instrument (SI) to amend regulation 6. As regulations have already been made, the SI could be made using the negative procedure.

[xxxii] *FCA Handbook*; "default arrangement" is an arrangement expressly provided by an operator of a qualifying scheme for the purpose of investing the workplace pension contributions of employees who have expressed no choice in relation to the investment of such contributions.

iii. **Stage 2: Member choice as the default; primary legislation required**

Currently, members join their employer's scheme automatically, i.e. by default. Member choice is intended to allow engaged members to request that contributions are sent to a different qualifying scheme. A more substantial and impactful development would be for member choice to be made the default, so that where an individual changes jobs their new employer is required to automatically enrol them into their chosen scheme, without the individual needing to take any action. This would require structural change to today's auto-enrolment architecture, effected through primary legislation.

(g) Member choice; conclusion

The introduction of member choice would be an enhancement to, and natural evolution of, the auto-enrolment regime. It would provide a rare policy "win-win-win". Not only would it accelerate the reduction in the number of small deferred and lost pots, and therefore the number of future transfers, but it would present employees with an opportunity to exercise greater control over their workplace-derived savings.

This would set in train a mechanism to encourage more people to engage with their retirement savings, which would incentivise providers to treat them as individuals rather than anonymous members of workplace schemes. In addition, it would provide the DWP with a way to appease those providers who are likely to miss out on consolidator status.

The industry is now debating the proposals for a lifetime provider/pot for life; a recent paper attempts to answer some of the questions being raised.[21]

4.2 Liberate automatic enrolment from its limiting rules

The recent removal of the lower earnings threshold used in determining AE contributions is welcomed; contributions will be larger, albeit at the risk of a higher opt-out rate[xxxiii]. However, one participation-limiting structural absurdity remains, and it particularly conspires against the low paid (predominately women[xxxiv]).

AE's £10,000 minimum earnings threshold, combined with the inability to aggregate multiple incomes for AE contribution purposes, means that anyone with one or multiple small incomes (each paying less than £10,000) entirely misses out on employer AE contributions, as well as receiving tax relief on their own AE contributions. Large numbers of part time workers are entirely excluded from AE's embrace (notwithstanding how tough it is for many to save anything at all). The £10,000 threshold should be scrapped.

[xxxiii] Pensions (Extension of Automatic Enrolment) bill received Royal Assent in September 2023. AE's minimum contribution is now 8% of total income, capped at the upper earnings limit (£50,270), rather than being 8% of a qualifying earnings band.

[xxxiv] Women traditionally earn less than men during their working lives. Consequently pensioner poverty is more prevalent among women than men.

Note that if the aforementioned proposal to replace all tax relief with a simple contributions-based bonus were implemented, then the multiple small incomes problem associated with tax relief would be immediately addressed.

4.3 Two new bonus-eligible ISAs within automatic enrolment[22]

Outlined below are proposals for two new ISAs, both to be incorporated within the existing automatic enrolment (AE) legislative framework, with the same AE scheme qualifying criteria, and the same consumer protections as workplace DC pensions products. The new ISAs should be excluded for means testing purposes.

(a) A new bonus-eligible Workplace ISA

Assets in pension pots are completely locked up until, for millennials, the age of 57. This inflexibility is, for many people, a huge deterrent to commencing retirement saving early, particularly given their more immediate, competing, financial needs. The Lifetime ISA (LISA)[23] was introduced in 2017 to provide a unique savings vehicle that offers a 25% upfront bonus (not tax relief) *and* a degree of ready access, notably for the financial purpose that most of Generation Y care most about: home ownership.[xxxv]

A bonus-eligible Workplace ISA should be introduced to house employer and employee contributions in respect of workplace retirement saving, as an integral part of the automatic enrolment legal framework.

Employer contributions (paid net of tax through standard payroll systems) and bonuses would be locked in until the age of 60. Employees, however, would be able to access their own contributions (and bonuses) prior to 60 for the specific purpose of funding what many prioritise ahead of retirement saving: the purchase of their first home (as per the Lifetime ISA). Such flexibility would discourage workers from opting out of automatic enrolment.

(b) A new bonus-eligible Self-employed ISA[24]

i. The self-employed: ignored for too long

Thanks to automatic enrolment, the private sector workplace pension participation rate has, over the last decade, increased from 32% to 75% (and from 47% to 79% if the public sector is included).[25] But the self-employed, roughly 4.3 million people (and nearly 5 million pre-pandemic), remain entirely excluded from auto-enrolment, and many are saving little or nothing for retirement.

DWP analysis shows that in 2019-20 only about 16% of the self-employed were saving into a private pension, down from 48% in 1998. A minority will, no doubt, realise value from their businesses, some have workplace pensions from previous employment, and others hope to rely on equity in their homes to fund their retirement. But, clearly, many of today's self-employed (perhaps millions) will

[xxxv] Generation Y (aka "millennials") were born between 1981 and 1996; today they are aged between 27 and 42, approximately.

experience poverty in later life and, unless action is taken, they will inevitably fall back on the state.

ii. The self-employed do not like pension pots' inflexibility

In 2022 the All-Party Parliamentary Group (APPG) for Financial Resilience recommended that automatic enrolment be introduced for the self-employed. This is welcomed, but the APPG's focus on pension products is misplaced; many of the self-employed have no empathy for the inflexible pension savings product, its mind-numbing complexity and impenetrable jargon. In addition, tax relief is an ineffective incentive and there is no employer contribution to motivate the self-employed.

iii. An ISA for the self-employed, with a default NICs-based contribution

Automatically enrolling the self-employed is confronted by the perennial problem of the absence of an "employer" contribution. The opportunity to be creative arises because the self-employed enjoy access to the same benefits as the employed (including the State Pension), but pay 2% less in NICs.[xxxvi]

Payers of Class 4 NICs could be defaulted into a "Self-employed ISA" with a minimum 2% (Class 4 NICs-band-based[xxxvii]) contribution requirement, which would attract a 25% bonus (as per the Lifetime ISA). A (racier) alternative would be to offer a 100% bonus on the first £500 saved, and 50% thereafter, capped at £1,000, say (at an estimated cost to the Treasury of less than £2 billion annually).

If the opt out were exercised, there would be an additional 2% Class 4 NICs charge. So, save it or lose it. Ideally, few would opt out to then see cash go to HMRC rather than into a savings vehicle bearing their name, as well as losing the bonus. That said, communicating how the default would operate would require careful thought, not least to minimise the risk of any misunderstanding.

Any contributions made after the age of 50 should perhaps be locked in for at least 10 years, with allied bonuses, to ensure a term commitment to saving in return for the bonuses (unlike today's pensions tax framework). Contributions could be ramped up in the style of AE, increasing in 1% annual increments spread over two years, say, with additional contributions attracting additional bonuses, up to an annual limit.

Self-employed ISAs should be available from the age of 18 with tax-free access to funds from the age of 60. Crucially, however, savers should be able to withdraw funds before the age of 60 when purchasing their first home (and perhaps also in the event of ill-health), subject to a 20% charge (economically identical to losing the initial 25% bonuses (i.e. penalty-free on a net basis).

[xxxvi] For tax year 2024 to 2025, the Class 1A employee NICs rate is 8% of earnings between the Primary Threshold (£12,570) and the Upper Earnings Limit (£50,270) and 2% on higher earnings. The Class 4 (self-employed) rate is 6% on profits between the Lower and Upper Profits Limits (£12,570 and £50,270, respectively) and 2% on higher profits.

[xxxvii] Note that, unfortunately, the Lower Earnings Limit of automatic enrolment's Qualifying Earnings Band, £6,240 for 2024-25, is not the same as NICs' Lower Earnings Limit (£6,396).

Providers of Self-employed ISAs should be encouraged to offer a low-cost, diversified default fund (with an opt out).

iv. Self-employed ISA delivery: a clear role for NEST

David Bennett's independent review of NEST for DWP appears to confirm that NEST is well placed to develop and implement a savings product for the self-employed.[26] His review *"recommends that NEST uses the opportunity of its member engagement strategy refresh to identify learnings/insights to inform and maximise effective engagement strategies with self-employed members. Given NEST's size, there is a role for NEST to play in innovation in this area."*

In addition, NEST's Public Service Obligation states that *"the trustee must also accept those who are not eligible for auto-enrolment but nonetheless wish to save, such as self-employed individuals and those whose earnings are below the minimum eligibility level."*[27]

Article 19 of the NEST Order already allows NEST to admit workers in certain circumstances where AE obligations do not apply, which includes the self-employed (NEST has around 15,800 such members).

Bennett also refers to the paucity of saving amongst the self-employed, saying that *"this is partly because pensions can be seen as inflexible, and other saving products are more appropriate"*. In addition, the self-employed do not have the benefit of an employer's HR department to guide them through all the jargon and paraphernalia of pension pots.

NEST should be tasked to produce proposals to offer individual Self-employed ISAs to the self-employed, to include a default NEST-managed fund. This would be a logical extension of NEST's existing AE role and culturally consistent with NEST's current membership (concentrated in the low to moderate income segment), as well as being aligned with its Public Service Obligation. Subsequently, delivery of a Self-employed ISA should be open to private sector competition, as per the broader AE framework.

v. The politics of a Self-employed ISA

This proposed structure should pass a "reasonableness" test of public opinion, not least because the contents of the ISA would belong to the saver. There is a world of difference between this proposal (a strong nudge; shove?), which leaves the individual in control, and Philip Hammond's ill-fated 2017 attempt to increase NICs for the self-employed.[xxxviii] Indeed, having implemented a rise in NICs rates from April, the government has already crossed the Rubicon in respect of the 2019 manifesto guarantee ruling out tax rises. It should now not balk at increasing employers' NIC cost to help finance much-needed retirement saving for the self-employed.

Given the cost of living crisis, it is a tough time to promote saving, but the combination of a default structure, the opt-out penalty, bonuses, flexible access and personalisation should make for an attractive proposition.

[xxxviii] The very sensible intention was to prevent the tax base being eroded as self-employment became more widespread.

4.4 An alternative approach: enhance the Lifetime ISA

Instead of introducing two new ISAs, the Lifetime ISA (LISA)[28] (already popular with the self-employed) could be used to provide the same facilities by making the following improvements to it.

(1) Include the LISA within automatic enrolment legislation's definition of a "qualifying" scheme, so that it would be eligible to receive employer and (post-tax) employee contributions, attracting the 25% bonus, and serve as the default savings vehicle for the self-employed.

(2) Remove the LISA's contributions age ceiling (which serves no customer purpose), with the caveat that any contributions made after the age of 50 would be locked in for at least ten years (with allied bonuses).

(3) Incorporate within the LISA the necessary operational capabilities to facilitate Class 4 NICs-band-based contributions and bonuses for the self-employed.

There are two other improvements that should be made to the Lifetime ISA.

(4) The LISA contains a valuable free option; ready access when buying the first home, with accumulated bonuses then retained. This is, however, price capped at £450,000; it is unclear what behaviour this is trying to encourage (or discourage), or what consumer purpose it serves. The cap just adds to product complexity: it should be scrapped.

(5) One of the LISA's attributes is pre-retirement access to savings, particularly valuable when some 48% of households have less than £1,500 in savings. But the implicit 6.25% "penalty" on pre-60 withdrawals (other than when purchasing the first home) should be eliminated.xxxix It is not intuitive, is widely misunderstood, adds to complexity and serves no consumer purpose. Indeed, the Office of Tax Simplification (OTS) has acknowledged the penalty's scope to confuse, noting that it adds to the challenge on giving advice.[xl] A simply remedy would be to reduce the charge to 20% on pre-60 withdrawals; a 25% bonus and a 20% withdrawal charge are economically identical.[xli] Genuine penalty-free access to savings would encourage more people to save more, and it would be cost neutral to the Treasury.

Meanwhile, the LISA's tax treatment remains hugely attractive; for basic rate taxpayers (the marginal rate for over 90% of all workers under 40), LISA savings, if kept until 60, are effectively entirely tax-free. Ostensibly TEE, in reality the LISA effectively behaves as EEE for basic rate taxpayers.[xlii] This is not widely appreciated.

[xxxix] £100 saved attracts a £25 bonus to equal £125. On withdrawal, £125 x 25% charge = £31.25p, i.e. £6.25p more than the bonus received on the £100 saved. There is no charge in respect of purchasing the first home and on any post-60 withdrawals.

[xl] *Savings income: routes to simplification*; Office of Tax Simplification, HM Treasury, May 2018. The OTS concluded that the Government should revisit the rules on early withdrawals from the Lifetime ISA, not least to ensure that the LISA rules work effectively for unadvised retail savers.

[xli] £125 x 20% charge = £100.

[xlii] Retirement savings products are codified chronologically for tax purposes. ISAs are "TEE", i.e. Taxed (contributions are made post-tax), Exempt (income and capital gains are untaxed,

Conversely, the effective tax rate of pension pot assets is 15% for basic rate taxpayers (after taking the 25% tax-free lump sum into account). Consequently, for basic rate taxpayers, the Lifetime ISA will produce a significantly larger post-tax retirement income than a pension pot.

The LISA has the potential to help catalyse a much more broad-based savings culture, but it is unnecessarily complex. Simplification, and a role for it within automatic enrolment, could nudge the industry to engage with it more assertively. The industry could then be rewarded with a much broader customer base. Meanwhile, the LISA trumps saving in a personal pension pot (such as a SIPP) in two fundamental respects: tax treatment and flexibility of access. Generation Y is discovering that pension pots cannot compete with this.

bar 10p on dividends), and Exempt (capital withdrawals are not taxable). The LISA's 25% bonus effectively reimburses 20% Income Tax, leaving the LISA akin to EEE.

CHAPTER FIVE – AND WHAT OF THE PENSIONS DASHBOARD?

5.1 Endless delay

The DWP's Pensions Dashboards Programme (PDP) has the potential to transform the retail pensions market, and help drive small pot consolidation. It could become the ultimate disruptor of incumbent industry providers, but a decade has been lost to vested interests being allowed to (successfully) stymy progress. Some life companies potentially have a lot to lose from the transparency that a dashboard would bring, including a reduction in assets under management, notwithstanding the cost savings that some may make from small pot consolidation (which the dashboard would encourage).

In summer 2023 a further delay was announced in the delivery of the PDP, and the National Audit Office (NAO) has subsequently investigated as to why. It concluded that capacity and capability issues, including a lack of digital skills and ineffective governance, have contributed to delays. Consequently the cost of PDP implementation has increased by 23%, from £235 million in 2020 to £289 million in 2023. The first dashboard connections between pension providers (and schemes) and the government digital architecture that supports dashboards are not now planned until October 2026.

Meanwhile, the private sector is moving ahead; Standard Life has announced the launch of a (commercial) pensions dashboard for its four million customers, the first provider to do so.[xliii] It would appear that it will be far more capable than the dashboard envisaged by the PDP because, in addition to State Pension details, users will be able to see their bank accounts, credit cards, savings, property valuations, ISAs, loans, mortgages, and other financial products. Perhaps the DWP's dashboard risks redundancy before launch.

5.2 Utility is essential

Any dashboard which merely provides static information ("virtual aggregation") risks inviting limited engagement, at best. Witness how little of the industry's customer communications are digested and then acted upon. What is required is utility, the ability to use the dashboard to consolidate pots in a single location with a single provider; i.e. physical aggregation.[29]

5.3 Two DWP initiatives with a lot in common

There are strong parallels between the dashboard project and efforts to resolve the small pots problem. Both initiatives face technical and control challenges (i.e. security-related issues around identification), both are plagued by the lamentable quality of provider-held data (making it difficult to match people to pots), and both require standardisation (data format, file uploading process, etc.), unique identification numbers, and a central clearing platform.

[xliii] Standard Life will use Moneyhub's white label proposition for its own commercial dashboard, which will be embedded into its existing customer mobile app.

The DWP should seriously consider merging the dashboard and small pots initiatives, and draw upon Australia's experience in developing its MySuper framework. The Australians started by implementing a package of measures to enhance the "back office" (dubbed "SuperStream") highlighting the critical need to first get the admin up to scratch.[30] This was reiterated in a more recent report from the Small Pots Working Group (2020):

> *The evidence gathered through the Working Group and from international comparisons reveals that the core underlying administrative processes are fundamental to the successful delivery of high-volume, low-cost consolidation systems.*

The DWP should also consider the lessons learnt concerning the move to open banking and, before that, liberalisation in the telecoms market.[xliv]

It is a sad irony that had the dashboard been introduced a decade ago (with utility, as proposed[xlv]), the small pots problem would be relatively *de minimis* (automatic enrolment-generated flow having commenced in 2012). Meanwhile, millions of people will experience smaller retirement incomes than otherwise.

[xliv] The parallel with Open Banking is strong. The second Payment Services Directive' (PSD2) requires all UK-regulated banks to share customers' financial data with authorised providers offering budgeting apps, or other banks provided that the customer has expressly given permission to the new provider. The underlying objective is to bring more competition and innovation to financial services which, in turn, is hoped will lead to more and better products. It may be sensible to regulate information only and transactional dashboards differently with a more comprehensive regulatory package required for transactional services.

[xlv] See *Aggregation is the key*, Michael Johnson, CPS, 2013. In April 2016 I described to the Work and Pensions Committee why such little progress was being made: internecine warfare within the industry.

CHAPTER SIX – A SINGLE POT FOR LIFE BECKONS

6.1 Pensions

(a) Workplace and personal pots as one

A recent Minister for Pensions acknowledged the compelling logic behind a single "pot for life" and a "lifetime provider model":[31]

> *In the longer-term, a simpler system of workplace pension saving could emerge to deal with the fundamental issue that new pension pots are created each time someone starts a new job, for example, a lifetime provider model with each saver stapled to a 'pot for life'…*

Indeed, there is no consumer rationale to divide DC retirement savings into separate workplace and non-workplace pots. Combining them would simplify personal financial arrangements, generate economies of scale, raise engagement, and make it easier to plan for retirement.

(b) A clearing house

The clearing system proposed for small pots could also be used as the infrastructure to facilitate a pot for life; the system should be built with that in mind.

(c) Align the pensions regulators with the risks.[xlvi]

If a pot for life were to become commonplace then, ideally all DC schemes (i.e. contract-based DC and trust-based DC group personal pension arrangements) would be concentrated within the FCA's domain. Indeed, 77% of advisers think master trusts should be regulated by the FCA, not The Pensions Regulator (TPR).[32]

A merged Pension Protection Fund (PPF, overseeing DB schemes assumed from insolvent corporate sponsors) and TPR could then concentrate solely on defined benefit (DB) schemes, pooling their DB risk management modelling capabilities.

This would then leave us with a regulatory framework organised on the basis of risk (the risks in DC and DB schemes being very different); a DC-focused FCA and a DB-focused PPF / TPR.

6.2 And what of ISAs?

(a) Looking further ahead

For millions of people, ISAs are an increasingly significant source of retirement income. If the pensions and ISA regimes were harmonised into a single bonus-fuelled framework (as proposed; section 3.3), then ISAs could also become part of a single pot for life.

[xlvi] See *Pensions regulation: governance to the fore?* Michael Johnson, CPS, 2014. The risks within DC and DB schemes are very different, requiring very different risk management (and communication skills), but today's regulatory framework is not organised on the basis of risk.

(b) An interim step; ISA unification[33]

Today there are five types of ISA, with a combined annual contributions limit of £20,000.[xlvii] In this, the digital era, there is no reason why the attributes of today's panoply of ISAs should not be assimilated into one universal ISA, an all-purpose (personal and workplace) savings vehicle to serve from cradle to grave.

Implementation could start with merging the Cash ISA and Stocks and Shares ISA, and extending the Lifetime ISA age range from birth to death, with no access prior to age 18 (and why not add a £500 "starter" bonus, as per the old Child Trust funds?). The Junior ISA would then be redundant. In addition, the Innovative Finance ISA should simply be scrapped, not least to protect consumers from excessively risky investments. That aside, with only 17,000 subscribed accounts in 2021-22 (£144 million), it panders to a very narrow audience.[xlviii]

The final step would be to combined the merged Cash, Stocks and Shares ISA with the Lifetime ISA, with the latter's (digitally ring-fenced) bonuses available (with allied withdrawals) as per current rules. Today's £20,000 annual ISA subscription limit could then apply to the one remaining ISA; one ISA to serve from cradle to grave, ideally displayed on the dashboard.[34]

Conclusion

The proposals outlined herein would move the UK, over the next few decades, onto a funded model of retirement income provision, up until the age of 75. Thereafter, the (unfunded) Senior Citizen's Pension would provide the bedrock of retirement income for everyone. It should perhaps be set some 40% higher than today's full State Pension.

The introduction of auto-protection, with defaults commencing at the age of 60, would lead to a retirement income framework that combined individualism (through the right to opt out of defaults), and collectivism. The latter would emerge through widespread participation in default funds from 60 (harnessing economies of scale; lower costs would lead to larger retirement incomes), and substantially more socialisation of life expectancy risk through increased annuitisation.

The combination of dashboards, consolidation of the stock of small deferred pots, and the exercise of member choice in respect of live pots would provide a series of stepping stones towards arresting the proliferation of small pots. But implementation of the DWP's dashboard remains years away; other countries have already successfully implemented dashboards. And while anecdotes such as this are not science, considering Britain to be a leader in financial services looks increasingly delusional. This will only change once the industry puts its customers first.[35]

[xlvii] The Cash ISA, Stocks and Shares ISA, Innovative Finance ISA and Lifetime ISA, plus the Junior ISA for the under-18s.

[xlviii] Conversely, some 7.1 million Cash ISA accounts were subscribed to in 2021-22 (£31 billion), as were 3.9 million Stocks & Shares ISAs (£34 billion) and 662,000 Lifetime ISAs (£1.7 billion, plus 25% bonuses). *Individual Savings Account (ISA) Statistics;* HMRC, June 2023.

ENDNOTES

[1] *Legislating the objective of superannuation*; consultation paper, February 2023; Australian Government Treasury.

[2] *Retirement income market data 2019/20*; FCA, September 2020.

[3] DWP; *Autumn Statement 2022, Expenditure and Caseload forecasts*, Table 1a.

[4] OBR; *Fiscal risks and sustainability, July 2022*, page 13, para 19.

[5] What is happening to life expectancy in England? The King's Fund, December 2021.

[6] As detailed in *NICs: The end should be nigh*; Michael Johnson, CPS 2014.

[7] See *Auto-Protection;* Michael Johnson, CPS, 2017.

[8] IFS; A blueprint for a better tax treatment of pensions, page 32, 2023.

[9] *Ibid.* Table 5.1.

[10] HM Treasury (2006), *The Annuities Market*.

[11] *A New Pension Settlement for the Twenty-First Century: The second report of the Pensions Commission (2005), p 227;* The Pensions Commission (2005).

[12] The Money Purchase Annual Allowance (MPAA), increased from £4,000 in the March 2023 Budget.

[13] *Treasury Committee Budget 2014 Report, paragraph 205,* May 2014.

[14] *Introducing the Lifetime ISA;* Michael Johnson, CPS, 2014.

[15] Further discussed in *Retirement saving incentives: the end of tax relief and a new beginning* (CPS, 2014); *Time for TEE: the unification of pensions and ISAs* (CPS, 2015); *What of DB, in a TEE World?* (CPS, 2016); and *An ISA-centric framework beckons* (CPS, 2016).

[16] Further discussed in *Reinforcing automatic enrolment; a response to the DWP's consultation*; Michael Johnson, CPS, July 2017.

[17] *What of DB, in a TEE World?* Michael Johnson, CPS, 2016.

[18] Further detailed in *Member choice, to complement small pots' consolidation, culminating in a single pot for life*; Michael Johnson and Tom McPhail, Social Market Foundation, November 2023.

[19] The Pensions Policy Institute; *Briefing Note 134: Lost Pensions; what's the scale and impact? 2022, para. 76*.

[20] See Regulation 3 of the Charges and Governance Regulations 2015.

[21] *Member choice for pensions: Addressing some common questions*; Michael Johnson, Social Market Foundation, February 2024.

[22] See *The Workplace ISA; Reinforcing Auto-Enrolment*; Michael Johnson, CPS, 2016, and *Five proposals to simplify saving*; Michael Johnson, CPS, 2018.

[23] See *Introducing the Lifetime ISA*; Michael Johnson, CPS, 2014.

[24] See *FT Opinion Personal Finance Advice & Comment: How to close the pensions gap for the self-employed*, Michael Johnson, 19 July 2022, and 23 July's FT Money section https://on.ft.com/3okizjT

[25] *Employee workplace pensions in the UK: 2021 provisional and 2020 final results;* ONS, April 2022.

[26] *An independent review of the National Employment Savings Trust*; David Bennett, February 2022.

[27] Ref. 2010 EU commission State Aid letter.

[28] See *Introducing the Lifetime ISA*; Michael Johnson, CPS, 2014.

[29] See *The pensions dashboard: vital for UK plc;* Michael Johnson, CPS, 2016.

[30] Discussed in *Put the saver first,* Michael Johnson, CPS, 2012.

[31] *Ending the proliferation of deferred small pots, Ministerial Foreword (Laura Trott MP)*; DWP, November 2023.

[32] Corporate Adviser's *Workplace Pensions Into Retirement Report (2023).*

[33] See *An ISA-Centric Savings World,* Michael Johnson, CPS, 2015.

[34] For more detail, see *An ISA-centric savings world* (CPS, 2015); *An ISA-centric framework beckons* (CPS Briefing Note, 2016); *Five proposals to simplify saving* (CPS, 2018); and *The Lifetime ISA: enhance and simplify* (CPS, 2018).

[35] See *Put the Saver First*; Michael Johnson, CPS, 2012.