PENSIONS AND LIFETIME SAVINGS ASSOCIATION

10 September 2024

The Rt Hon. Rachel Reeves MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
SW1A 2HQ

Dear Ms Reeves,

RE: PLSA 2024 AUTUMN BUDGET/SPENDING REVIEW REPRESENTATION

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

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

Achieving economic growth has been the defining mission of this Government so far. It is clear that the pensions sector will play a leading role in this ambition, evidenced by the Pensions Review that was launched in August and subsequent Pension Schemes Bill confirmed in the King's Speech.

Our Budget submission covers four key areas including the role of pensions in encouraging UK growth, pensions tax relief, pensions adequacy and the State Pension. Crucially, all the measures put forward in the submission aim to ensure that pension investment takes place in the interests of savers and that everyone should be able to expect an adequate standard of living when they come to retire.

The role of pensions in encouraging UK growth

In August, the Government announced it would conduct a Pensions Review, aimed at boosting growth. The first stage of the Pensions Review will examine actions to support greater productive investment and better retirement outcomes.

Pension funds already invest over £1 trillion in the UK economy through ownership of shares, corporate bonds, government bonds, and alternative investment assets such as property, unlisted equity and unlisted debt. They are open to investing more in UK growth, provided the assets have the right risk / return characteristics and they offer appropriate diversification of investment risk. When investing pension fund assets, it is essential that the investments meet the needs of pension scheme members who rely on them for their retirement income. This is why we believe that Government should not mandate or direct the investment of pension funds. However, we do want to help the Government identify all the other actions needed to achieve the goal of greater UK investment.

As the Government is aware, investing in productive finance is best suited to open DC and open DB schemes (private sector or funded public sector), which have long investment time horizons, rather than to closed DB pension schemes which need investment assets that are not liable to sudden fluctuations in value.

PLSA believes the right way to quickly encourage pension funds to invest in UK growth is for the Government to undertake the following reforms:

- **Pipeline of Assets**: Ensure there is a stream of high-quality investment assets suitable for pension fund needs. We welcome news that the National Infrastructure Bank and British Business Bank will help identify UK productive finance assets for pensions schemes through the creation of a National Wealth Fund. It is important this should not only include unlisted equities but, also other related assets such as unlisted debt and infrastructure. In our latest report, **Pensions & Growth: Creating a Pipeline of Investible UK Opportunities** we identify the funding needs of four key areas – climate change, infrastructure, social and community growth funds and life sciences and AI – and the actions by Government and the pension sector to make them more investible.

- **DB Regulation**: The funding regulations that apply to DB pension funds must allow sufficient flexibility over their investments. We welcome recent DWP regulations and the related TPR DB Funding Code which allow open DB pension funds, and closed DB pension funds with long investment time horizons, to take more investment risk (appropriate to protecting member benefits). The Government may also want to consider policies that will facilitate greater surplus sharing – particularly given 80% of DB schemes are in surplus.

- **Taxation:** Fiscal incentives should be introduced that make investing in UK growth more attractive than competing assets. We would like the Chancellor to make the following changes: allow tax free dividends on investment by pension funds in UK companies, and provide additional tax incentives, like the LIFTS initiative, in UK start-ups and companies requiring late-stage growth capital.

- **Consolidation**: Larger schemes, for example, those with more than £25 bn of assets tend to have considerable governance capability and find it easier to invest directly, or alongside others, in “productive finance”. However, it is important to remember that such assets can be made accessible to much smaller pension funds via the products offered by the asset management industry, e.g. LTAFs, or by Government initiated entities such as the British Business Bank. Nevertheless, there are measures that Government can take to encourage and support further consolidation. We welcome news that superfunds will be put on a legislative footing in the Pensions Schemes Bill. We broadly support the current consolidation of LGPS assets in England and Wales into eight asset pools where it is in the interests of scheme members and the assets have the necessary risk, return and cost components. We have, however, previously cautioned against the deadline of March 2025, as it may pose investment risks and operational challenges. We believe that a careful and well-governed transition process is crucial to ensure the preservation of value and the long-term sustainability of the scheme.

- **Market for DC Under Automatic Enrolment**: The operation of the market in which employers and trustees select their DC pension funds for automatic enrolment purposes must be reformed so that there is less focus on cost and more on performance. In addition to the action already being taken by the Government on introducing Value for Money (VFM) tests we believe that the duty on employers, and the advice by corporate IFAs and Investment Consultants to employers on pension schemes should focus more on performance rather than cost.

- **Raising Pension Contributions**: Increase the future flow of assets into pensions by gradually increasing the level of pension contributions under automatic enrolment from today's 8% of a band of earnings to 12% of all earnings starting in the mid-2020s and finishing in the mid-2030s. This action will also significantly increase the volume of saving in UK shares and other growth assets.

Pensions tax relief: Five principles for reform

The Government has said that it will have to raise taxes at the next Budget and may be considering reforming pensions tax relief as a source of additional revenue. We understand that this is a difficult economic time, and that the Government is looking to safeguard the UK's finances. Many people, however, are not saving enough for their retirement and tax relief acts as an important incentive to help people save.

If the Government does choose to introduce a reform, we urge you to consider our 'Five Principles for Pensions Taxation' report and to consult extensively to avoid unintended consequences. The five principles are:

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

In our report, **Pensions Tax Relief: Implications for Savers** we applied these tests to a range of potential tax relief reforms and concluded that while none met all the objectives, the worst option would be a move from EET (Exempt, Exempt, Tax) to TEE (Tax, Exempt, Exempt). This would shift to taxing contributions but income in retirement being tax-free. In essence, a change of this kind would result in pensions being taxed in the same way as ISAs but with the additional, perceived downside of not having access to the money until retirement. Because the benefit of the tax-free cash would be lost, the individuals modelled in the report, with the exception of some non-taxpayers, would lose out under a TEE regime. Basic rate taxpayers would lose around 20% of the value of their private pension while higher rate taxpayers could lose up to 38%.

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

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

In 2021, the PLSA estimated that the removal of higher rate tax relief on pension contributions could result in around 3-4 million taxpayers each paying an average of £2,000 more tax each year. These are likely to arise particularly in the case of highly skilled workers who have good pension schemes, such as those commonly used in the public sector, such as for the NHS and education. Given the freezing of tax thresholds since then, and the increasing in earnings in response to inflation, we believe even more would be affected now. Some reports in the media suggest that over siz million people would be affected in this way by the end of this Parliament.

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

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

Lifetime Allowance

The Government has previously confirmed that it would not reintroduce the Lifetime Allowance that was abolished in the 2023 Budget. However, the regulations introduced to support implementation of the policy were flawed and have needed multiple amendments since. This has resulted in significant issues and is causing industry concern. We ask the Government and HMRC to rectify these errors in full for schemes to allow them to undertake the necessary administrative work needed to support savers. Pensions tax relief is a highly complex area and changes, particularly when rushed, create unintended consequences for schemes and schemes members.

Continued support for automatic enrolment (AE)

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

However, our research finds that without reform more than 50% of savers will fail to meet the retirement income targets set by the 2005 Pensions Commission and around a fifth will not achieve the minimum level of the **Retirement Living Standards**. Without further policy intervention, most people in the UK will retire with an inadequate pension income.

Over the last year, progress has been made to address this shortfall, in particular, by introducing legislative reforms to the AE regime so that people will save from the first pound of pension saving and from age 18 rather than age 22. This is very welcome, and we would encourage the Government to implement these changes as soon as possible. Retirement living expectations need to be supported by Government reforms so that people will not fall into poverty when they reach retirement.

The Government should also look to set out a roadmap to extend AE over the next decade so that contributions are balanced equally between employers and employees, and rise gradually from 8% to 12%, as part of the second stage of the Pensions Review. This is a key recommendation from our **5 steps to better pensions report** which sets out policy recommendations to help people achieve better incomes in retirement. The five steps are:

- Set new goals for the UK pensions framework: adequate, affordable and fair.
- The State Pension should protect everyone from poverty and its value should be maintained by keeping the Triple Lock until such time as the State Pension fully achieves the objectives Government chooses to set for it.
- More people should be saving into a workplace pension and at higher contribution levels. Over the next decade contributions should rise gradually from 8% to 12%. While employees should

only be required to put in 1% extra, we believe employers should put in 3% extra, with the result that by the mid-2030s each will be paying 6%, totalling 12%.
- Additional help should be given to under-pensioned groups such as women, the self-employed, gig economy workers and others. Some of these will require changes to automatic enrolment or other policy interventions.
- The pensions industry and employers should take action to help people engage with pensions, receive higher contributions, or get better pension outcomes. This includes initiatives such as the **Retirement Living Standards** and the **Pay Your Pension Some Attention campaign**.

If all our proposals are implemented, and the State Pension Triple Lock maintained, people on all income levels will have an improved income in retirement. If someone were to work for a full working life without career breaks, the projected retirement income for a median earner would increase for men from £17,672 to £20,609 and for women from £17,177 to £19,825.

State Pension

The Labour manifesto committed to retaining the Triple Lock policy. We welcomed this commitment and hope that the Government will re-affirm this in the upcoming Budget. The State Pension currently provides the majority of most people's retirement provision. For the least well off in society it is often all of their retirement income. The new State Pension, at £11,502 per year, is currently approximately 20% short of our minimum Retirement Living Standard for a single person. **The Triple Lock therefore plays a vital role in helping everyone – today's pensioners and future pensioners – towards achieving an adequate pension throughout their retirement.**

The media has speculated that the Government might consider raising the age at which people can receive the State Pension as a way to reduce government spending. An increase from 66 to 67 is already scheduled to take place by 2028. A further increase, to 68, is currently due to happen between 2044 and 2046 and will affect people born after April 1977. Data from the ONS on Healthy Life expectancy between 2018- 2020 shows both a regional disparity and a downward trend in most regions of the UK. The gap in life expectancy at birth between local areas of the UK was 11.3 years for males and 8.7 years for females in 2017 to 2019. Longevity tends to be higher in prosperous areas and lower in poorer areas of the country. Any further increases in the State Pension age would disproportionately affect disadvantaged groups and exacerbate regional disparities.

Moreover, the UK will already have one of the highest State Pension ages in the OECD when it reaches 67 in four years' time. The average state pension age in the OECD will not reach this level until between 2044 and 2046. There is compelling evidence that increasing the State Pension age leads to an increase in poverty, with the Institute for Fiscal Studies finding that the recent rise in State Pension age from 65 to 66 led to income poverty rates amongst 65-year olds more than doubling. **Given the evidence of how increasing the State Pension age increases poverty levels and has a very unequal impact on people from disadvantaged areas, we do not believe the Government should bring forward the date at which the State Pension age increases to 68 unless there are increases in healthy life expectancy across all income groups.**

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

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

Yours Sincerely,

Nigel Peaple

Chief Policy Counsel