06 February 2025

Treasury Select Committee
House of Commons
Westminster
London
SW1A 0AA

Dear Treasury Committee,

LIFETIME ISA: CALL FOR EVIDENCE

The Pensions and Lifetime Savings Association (PLSA) is the voice of workplace pensions and savings. 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 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs, and others who play an influential role in people's financial futures. We aim to help everyone achieve a better income in retirement.

We welcome the opportunity to respond the Committee's call for evidence on the Lifetime ISA. Our response is mainly focused on how the Lifetime ISA (LISA) is used as a retirement savings product, and whether it is a suitable substitute for a workplace pension. As a result, we have elected to only answer questions where we feel our remit allows us to contribute in a valuable way.

It is widely acknowledged that many UK savers are not saving enough for their retirement. PLSA modelling has suggested that on the current trajectory, more than 50% of savers will fail to meet the retirement income targets set by 2005 Pensions Commission and as many as 20% will fail to achieve the PLSA's Minimum Retirement Living Standard (RLS)[1]. This is despite the widely acknowledged success of Automatic Enrolment (AE). DWP analysis from 2023 showed that thanks to the rollout of AE, private pension participation had more than doubled from 42% in 2012 to 86% in 2021[2]. The PLSA have called for a number of reforms to AE (such as widening its scope and increasing the minimum contribution rate to 12%[3]) which are likely to have a significant positive impact on the number of people who are saving adequately for retirement.

Overall, the PLSA believes that the LISA can be a valuable vehicle to help savers reach an adequate level of retirement savings. Even when used for the other intended purpose of helping to save for a deposit on a first home, the LISA can help to improve retirement outcomes – as home ownership is positively associated with lower housing costs in retirement. However, the LISA should not be viewed by savers, nor the Government, as a replacement for a well-run occupational pension.

Comparing the two, the LISA has several significant limitations which mean if it is used as a substitute method of retirement saving, it could lead to a lower standard of living for pensioners. For this same reason, use of the LISA must not be restricted to those who have no access to a workplace pension. Recognising that the LISA holds merit if used appropriately, policymakers may wish to consider a number of reforms to the current design, including exploring how to make the LISA more accessible for people with tied-in housing, the house price cap, length of contributions and age for contributions.

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[1] https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2022/Research-report-supplement-to-Five-Steps-to-Better-Pensions.pdf
[2] https://publications.parliament.uk/pa/bills/cbill/58-03/0255/DWPImpactAssessmentMarch2023.pdf
[3] Five-Steps-to-Better-Pensions-Final-Report-Oct-2023.pdf

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In addition, given the Committee are currently examining the Lifetime ISA, it may be beneficial to examine the whole range of ISA products currently available with a view to simplifying the regime. Simplifying the overall suite of ISA products could promote saver engagement and understanding of the system and ensure that each specific product can best serve savers to meet their respective goals.

Is the Lifetime ISA fit for purpose in its current design, including as a combined product for house purchase and pension saving?

Given that the LISA is structured as a dual saving product both for retirement and property purchase, there is a risk that savers perceive from its design that it is appropriate to save for a property prior to saving for retirement, as opposed to saving for both concurrently.

Home ownership is recognised as a pillar of retirement income adequacy and building financial resilience. Owning a home has significant implications for living costs in later life. Analysis from the Pensions Policy Institute (PPI) estimates that fewer than one in five households aged 45 to 64 and renting privately today are likely to have sufficient pension income to rent even a modest one-bedroom flat through retirement[4]. People who were able to buy earlier in life are likely to have significantly reduced housing costs (they do not pay rent and have lower, if any, mortgage payments). Initiatives which encourage people to get onto the property ladder earlier can be conducive to retirement adequacy.

However, being both enrolled in a workplace pension and saving into a more flexible, non-workplace pension like a LISA could create competing demands. This risk may be acute for Millennials where over a third (35%) say they prioritise saving for a deposit on a home instead of their retirement and nearly a fifth (19%) say saving to buy a house is the main reason they don't save into their pension[5]. The design of the LISA could be perceived as reinforcing this philosophy of 'housing first' when saving any disposable income and could be at the expense of engagement with, and contribution to, a workplace pension.

Of course, for most people, contributing to a workplace pension is the best way to save towards retirement. Those savers who choose to forego contributing to a workplace pension in favour of a LISA will miss out on the associated benefits of employer contributions, long term investment returns and tax relief.

The average age of a first-time buyer is now 34; this could leave those savers who access their funds for property purchase with relatively few years of working life remaining to build up their pension savings and benefit from the effects of compound interest had they began their retirement saving sooner. This could have serious consequences for their overall retirement prospects, especially as no additional contributions to a LISA can be made past age 50.

All of this is not to say that the LISA does not have a place: but relying mainly on house purchase for future financial security is riskier than saving persistently in a pension, with all the associated benefits.

How well do consumers transition between using the Lifetime ISA as a product for house purchase, to then a product for pension saving?

Data regarding how people access their LISA is not readily available, though it appears most people have so far intended to use their LISA to purchase a first home, and it is not yet clear how many have a LISA purely as a vehicle for retirement purposes. Research suggests that around one in six first-time buyers in the past year used a LISA when purchasing their first home.

[4] 20241127-the-uk-pensions-framework-2024-final.pdf

[5] TrulyIFA, *Consumer Intelligence conducted an independent online survey for Prudential between 20 and 21 June 2018 among 1,178 UK adults*

Moreover, the maximum age cap for contributions to be made to a LISA is 50 years old. With the average age of first-time buyers now being 34, this leaves on average around seventeen contributing years into the LISA to accumulate a retirement income after buying a house (assuming the total LISA sum is withdrawn to pay for a property). In the best-case scenario of maximum contributions, currently set at £4,000 per year, past the point of property purchase, and assuming an interest rate of 5% AER year on year, this would result in a retirement pot of £130,518.89 – significantly below the sum needed for an adequate income in retirement.

More data is needed to be able to accurately indicate whether consumers are well able to transition between using a LISA as a product for house purchase and then to a product for pension saving.

Is the Lifetime ISA a suitable pension savings product?

Whilst the advent of automatic enrolment (AE) in 2012 has been hugely successful in bringing more savers into pension saving, too many are still excluded such as the self-employed and gig economy workers. For these savers who are excluded from AE, the LISA does provide one route into pension saving. However, these savers could be better served by being brought into the scope of automatic enrolment. This is because despite the government bonus on contributions, LISA savers don't benefit from the compounding benefits of tax relief or employer contributions. Workplace pension schemes also often benefit from stronger governance than non-workplace alternatives. Research from Canada has shown that schemes with good standards of governance (self-assessed by schemes and with size of scheme controlled for) added 1-2% per annum in investment performance when compared to less-well governed schemes[6].

When comparing the benefits that a saver can accrue when contributing to an occupational pension scheme, and those provided by the LISA, occupational pension schemes can offer greater value (as illustrated in the table below[7]):

	LIFETIME ISA	OCCUPATIONAL PENSION
Employee annual contribution/deposit (based on the median UK Salary of £37,430[8])	£1,497.20 (4% of the median UK salary)	£1497.20 (4% of the median UK salary)
Employer annual contribution	£0	£1,122.90 (3% of salary)
Tax relief	£0	£374.30 (1% of salary)
Government bonus	£374.30 (25% of contribution)	£0
Total annual savings if employee puts in 4%	***£1,871.50***	***£2,994.40***
Annual contribution allowance (before loss of benefits)	£4,000 (government bonus not received on deposits made over this amount)	£60,000 (tax relief not applied on amounts over this

Not only do the potential benefits have greater value in an occupational pension scheme, the amount which savers can contribute before losing them is also much higher. In addition, many employers choose to offer contribution rates of higher than 3% (which is the statutory minimum), with some

[6] https://www.pensionspolicyinstitute.org.uk/media/t2djkxca/201702-bn89-db-the-role-of-governance.pdf

[7] The table focuses on the design benefits of each product and as such does not account for the investment returns generated through a pension or the interest which is accrued in a LISA.

[8] Employee earnings in the UK - Office for National Statistics

choosing to match employee contributions up to a certain amount. This is compared to the LISA, which caps the bonus at £1,000 per year.

Another significant limitation of the Lifetime ISA when compared to an occupational pension is that savings made into a LISA are included in the calculations for the means tested benefits Universal Credit and Housing Benefit. Universal Credit claimants with savings between £6,000 and £16,000 will have reduced payments (and no payments above £16k). Similarly, Housing Benefit claimants with savings of over £16,000 are not entitled to payments, and at the lower limit, savings up to £10,000 will be disregarded in calculations for claimants who are above pension credit age (the lower limit is £6,000 for people of working age). LISAs are included in means testing calculations despite the intended purpose of these savings to be house deposits or retirement funds (and not for living expenses). On the other hand, workplace pension savings are only included in means testing calculations once retirees begin to access their pension as income. This means that for savers who are on lower incomes, Automatic Enrolment saving is the more attractive option, as saving into a LISA for retirement purposes could reduce or completely disqualify them from benefit entitlement. Furthermore, being disqualified from receiving means tested benefits can make savers more likely to need to access their savings in case of an emergency, for which in the case of LISAs they will be subject to a 25% withdrawal penalty – again making the LISA the less attractive option.

The maximum annual saving limit allowed under the LISA regulations could also send a strong 'anchoring' message to consumers that a contribution rate of no more than £4,000 per annum is sufficient to provide individuals with an adequate retirement income. Such a savings rate is unlikely to afford a saver even the Minimum Retirement Living Standard, therefore risking poverty in retirement. We also recognise that the government policy of setting a workplace pension contribution rate of 8% minimum has largely had the same effect, hence the PLSA's continued call to raise the minimum contribution level to 12%. For the reasons outlined above (tax relief and employer contributions) a workplace pension provides better outcomes for retirement adequacy than a LISA even when only contributing at 8%.

Indeed, prior to its introduction in 2017, the Work and Pensions Select Committee highlighted that "whatever the attractions of the LISA, it must not be presented as a direct alternative to AE. Savings under AE carry an employer contribution, which will not be available in the LISA. Opting out of AE to save for retirement in a LISA will leave people worse off.[9]"

Finally, where a LISA acts to help people in buying a home of their own, there are particular challenges for those in tied housing provided by their employer. Under the current rules, these employees are unable to use a LISA to buy a property that they will need to eventually move into but may need to rent out in the meantime while undertaking their role. As a first-time buyer must intend to live in a property purchased as their primary residence, this disproportionally affects people in roles who are serving their communities in some way, whether in education, military or in a faith ministry who often receive tied housing as part of their employment terms.

Remaining in tied housing for a number of years delays the point in which those employees are able to purchase a home with their LISA, possibly until the point of retirement. As highlighted above, home ownership can have significant positive impacts in retirement. People who were able to buy earlier in life are likely to have significantly reduced housing costs (no rent payments and lower, if any, mortgage payments).

As the rules currently prevent these people from being able to purchase a home until later in life, once their employment ceases, they are more likely to end up renting in retirement which comes with a significant burden on their retirement incomes and may also increase their dependency on state

[9] Work and Pensions Select Committee, Eleventh Report of Session 2015 – 16, Automatic Enrolment, HC 579. https://publications.parliament.uk/pa/cm201516/cmselect/cmworpen/579/579.pdf

benefits. Furthermore, if these people only purchase a property at the point of retirement when their employment ends, they are likely to face significantly higher mortgage costs compared with those in conventional employment who were able to purchase a property many years prior.

For this specific group of people, allowing them to purchase a home earlier, even if not as a primary residence, would positively impact their retirement prospects and may be worth exploring further to ensure that they are not disproportionately excluded from home ownership.

Should the Lifetime ISA be abolished?

We do not believe that the Lifetime ISA should be abolished. A place for the LISA exists as an addition to the range of products available to savers, although not as an appropriate replacement for a well-run and good value occupational pension scheme.

Should the Lifetime ISA be restricted to those with no access to a workplace pension?

We would not support restricting access to a LISA for those without access to a workplace pension. Groups who have no access to a workplace pension include the self-employed, multiple job holders and gig economy workers. Offering only these groups, which include many low earners, 'exclusive' access to the Lifetime ISA would reinforce the behavioural and 'anchoring' difficulties described earlier in this response – normalising saving for a house first; pension second; and saving at relatively low levels. Rather than restricting the LISA to those with no access to a workplace pension, the PLSA have highlighted that there are a number of policy solutions that policymakers could consider that would improve access to workplace pension saving. These include reducing the barriers to Master Trusts offering pensions to the self-employed, a re-evaluation of the £10,000 earnings trigger mechanism and inclusion of gig economy workers within the scope of AE[10].

With respect to the self-employed, it is important to stress that they are not a homogenous group and work in a wide range of industries beyond the skilled trades such as education, communication sectors and technical information. Due to the diverse nature of self -employed people, pensions will be suitable for a significant portion of self-employed workers but may not be the most suitable long-term savings vehicle for all of these workers.

Whilst it is true that in these cases, the LISA may be a more appropriate vehicle for long term savings than a pension, we would encourage the Government to look at this in more detail as part of the second phase of the pensions review. As highlighted in the PLSA's response to the Saving for Later Life Inquiry in 2022[11], "The success of automatic enrolment has been underpinned by the power of inertia and the government could look to leverage inertia by designing solutions integrated with the tax system but into a private pension/long term savings product. There is also a case for making pensions more attractive for self-employed people by allowing salary sacrifice."

Recognising that the LISA is a valuable savings product, though not a replacement for a workplace pension, we believe it should remain accessible to everyone, especially as this will help some into home ownership, which as we have said is a key element of achieving retirement adequacy.

Should the Lifetime ISA house price cap be raised in line with inflation, or removed and should the annual Lifetime ISA limit be raised from £4,000?

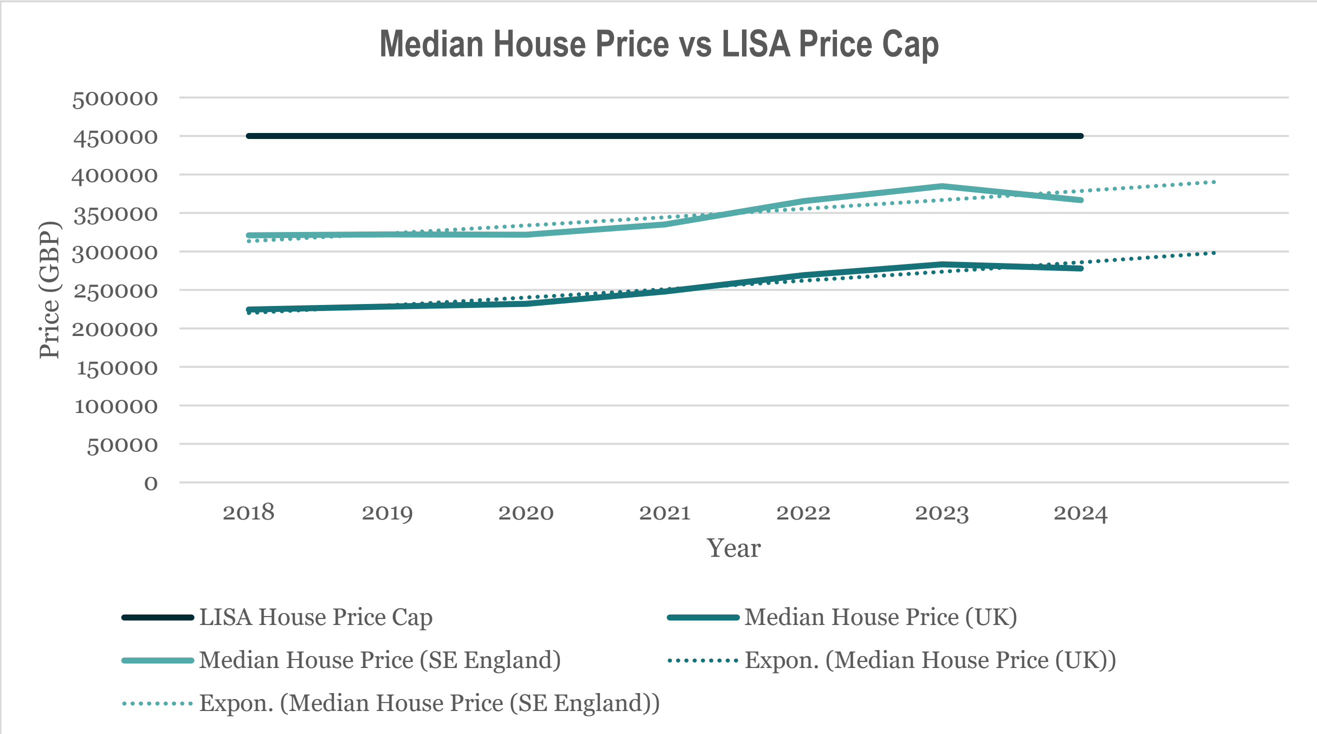
A modest increase to the annual LISA limit, to adjust for inflation since 2016, would be merited. However, a constant or annual inflationary uprating may have unintended consequences by making the LISA appear as a suitable substitute for a workplace pension which as highlighted

[10] Five Steps to Better Pensions: Final Report

[11] WPSC Call for Evidence: Saving for later life (2022)

above, we do not believe that it is. To ensure that workplace pensions remain as attractive as possible to savers it is also imperative that contributions under automatic enrolment should rise over the next decade.

Additionally, there may be merit in allowing for regional flexibility in the LISA house cap given that there is a significant variance in median house prices across the UK. Not increasing the house price cap could have preventative impacts on home ownership for those in more expensive areas (e.g. the southeast of England). An inflationary adjustment mechanism to the house price cap could also be beneficial considering the consistent increase in house prices over recent years. Whilst median property prices have remained well below the price cap, the below diagram illustrates that price trends over the next decade could potentially push above the house price cap which would render the purpose of the LISA ineffective for home ownership.



Source: HM Land Registry, UK House Price Index, prices as of January each year

Should the Lifetime ISA be reformed in any other way?

There are a number of reforms which could be made to the current LISA regime which could be beneficial to savers and help more people to be able to get onto the property ladder and by extension, support greater adequacy in retirement outcomes. Namely: -

- Reforming the LISA to be more workable for those who live in tied housing. Current LISA rules require that the funds used to purchase a home can only be used toward a property which will be the purchaser's primary residence. Given that those in receipt of tied housing with their employment are unable to move directly into their purchased property, adding flexibility so that these people can buy without the need to move in immediately may be worth exploring. The concept of tied housing is well established in tax treatments from HMRC and taken together with a contract of employment (or equivalent) should be sufficient to ensure that this exception is applied fairly and correctly. In the absence of this amendment to the rules, it is important that these people are made aware of the practical limitations of the LISA before opening lest they make contributions under the pretence that they will be able to use it to purchase a house only to face a 25% withdrawal penalty on their funds at a later date.

- Whilst putting down a deposit for a home is often the largest expense associated with home purchasing, there are a number of large ancillary costs associated which home ownership such as solicitors' fees, surveys etc. Amending the permissible purposes of accessing the LISA to include these associated costs could make the LISA better suited to helping people onto the housing ladder, thereby supporting the affordability of their lifestyle in later life.
- Given the wide variance of house prices across the UK, it is worth re-examining the price limits on eligible properties so that savers aren't turned away from using the LISA because they won't be able to afford to buy in certain areas which may be necessary for employment or family reasons. Such localities are also the most expensive areas to rent and therefore where people will be at a greater risk of having an inadequate income in retirement if they are unable to purchase a property.
- Given that LISAs are included in the means testing calculations for Universal Credit and Housing Benefit, we believe the 25% early withdrawal penalty is unfair. A harsh withdrawal penalty essentially renders these savings as illiquid, meaning that most people are unlikely to be accessing their LISA savings when they need emergency cash. We support retaining the penalty in order to encourage savers not access their retirement savings prematurely but also argue that LISA savings should not be included in means testing calculations and should be treated in the same way that pension savings are (i.e. only included in these calculations once withdrawn).
- There may be a case for further 'selling' the benefits of the Lifetime ISA to those under 40 and also for increasing the age limits associated with opening and paying into a LISA. Allowing people to open a LISA later and pay into it for longer i.e. past the current maximum contribution age of 50, could significantly boost the retirement incomes of those using the LISA as their main savings vehicle, especially against the backdrop of the increase in the state pension age.

To summarise the PLSA's position on the future of the LISA, we are keen to stress that saving for a house and saving towards retirement must not be seen as mutually exclusive ambitions. Whilst we believe that there is a place for the LISA, and that it shouldn't be abolished - it should not be seen as a suitable replacement for a workplace pension and certainly should not be restricted to those without access to a workplace pension. However, policymakers may wish to explore reforms to the current LISA structure with respect to the house price cap, length of contributions and age for contributions to be made to ensure that it is still succeeding in achieving its stated objectives.

The PLSA would be happy to provide further information to the committee on any of the points raised above. Should this be of interest, please contact Katy Little (Katy.little@plsa.co.uk) Head of Parliamentary and Stakeholder Affairs in the first instance.

Yours sincerely,

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