Inquiry Response

Pensions automatic enrolment – Lifetime ISAs

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About Age UK

Age UK is the country's largest charity dedicated to helping everyone make the most of later life. The Age UK network comprises of around 165 local Age UKs reaching most of England. Each year we provide Information and Advice to around 4.5 million through web based and written materials and individual enquires by telephone, letters, emails and face to face sessions. We work closely with Age UK Cymru, Age UK NI and Age UK Scotland.

Key points and recommendations

- We do not believe that the Lifetime ISA (LISA) as proposed represents a serious threat to pension saving, but we do anticipate some negative effect on opt-out rates and potentially reduced pension saving by some individuals.
- The risk to pension saving would be increased if the Government were to extend the 'life events' which the funds can be used for without a penalty. This might encourage more people to opt-out of or reduce contributions to their workplace pension in order to save into a LISA instead.
- We would also be extremely concerned if the LISA were to be a precursor to a move to an ISA model for pension saving more generally as our research suggests this would lead to worse outcomes. Our response to the 'Strengthening Incentives to Save' consultation provides more detail on our views.[i]
- With this in mind, we believe the Government must exercise caution in the introduction of the LISA, resist the temptation to make it any more flexible than currently proposed, and carefully monitor uptake and the impact on pension saving.
- We do not believe it is necessary or desirable to combine saving for later life and buying a first home. The timescales for saving and appetite for risk are so different for the two objectives that it would difficult for the ISA to develop an investment strategy to suit both needs.
- We are concerned that most ISAs are held in cash alone,[ii] which does not represent a suitable long-term investment strategy.
- Groups that might benefit from a LISA that we can identify are the eligible self-employed and low-paid workers whose employer operates a net-pay payroll system. However, 44 per cent of the self-employed are aged 50+, and so would be ineligible for a LISA. LISAs are not going to solve the lack of pension saving among this group. In addition, there are much simpler and fairer ways of solving the 'net-pay' problem.
- Guidance that emphasises the need for long-term saving, and the benefits of different options, is essential.

1. Introduction

1.1 Securing a sufficient private income in later life is challenging for everyone regardless of age. For many younger people, retirement can seem a long way off, and the motivation to save into a pension can be somewhat reduced. We recognise that many young people face a range of financial challenges, and that saving into a pension can seem like a lesser priority than other uses for their income.

1.2 However, in order to ensure income adequacy in retirement, pension saving needs to take place across working life.[iii] There is a danger that if the LISA becomes a substitute (wholly or partially) for pension saving, future cohorts could experience lower levels of income in later life.

1.3 The roll out of auto-enrolment (AE) is not yet complete, and the effect on AE should be carefully considered before making any significant changes to savings policy. Auto-enrolment has had a very successful start and must not be undermined.

1.4 LISAs may well be a good initiative for younger people, if they help people get on the housing ladder and foster a culture of saving – however if this is at the cost of reduced pension saving then we question whether it is a price worth paying.

2. LISAs and pension saving

2.1 As set out in the Budget, Lifetime ISAs are unlikely to have a severely detrimental impact on automatic enrolment. However, they are likely to have some effect on opt-out rates, the level of contributions, and employer attitudes, and these effects could be increased if the rules around withdrawing funds and penalties were to be slackened.

2.2 The flexibility of the LISA as a savings vehicle is likely to draw people towards it. This could have a positive effect on overall savings levels but we would be concerned if the outcome was at the expense of pension saving. If the 'other specific life events' that allow penalty-free withdrawal were broadened to include other issues, for example having a first child or buying a second home, then the relative attractiveness compared to pensions would significantly increase, which could serve only to undermine auto enrolment. The possible extension of these flexibilities is the biggest threat to pension saving.

2.3 Similarly, if the 5 per cent penalty for early withdrawal were removed and/or the saver allowed to retain the government's contribution from a younger age, the flexibility would be increased and LISAs would appear more attractive to savers.

2.4 While the default option remains to auto enrol people into a pension fund, we suspect that the power of inertia is likely to carry a greater weight. In a survey by Now Pensions, only 9.4 per cent of under 40s said they would stop saving into a pension and save into a LISA instead.[iv] This is encouraging, although it is arguably still 9.4 per cent too much, and would impact on auto enrolment opt-out rates. We are also concerned that even if opt-rates are not affected, pension savers who also take out a LISA could be less likely to increase their level of pension contributions.

2.5 It is particularly worrying that 41 per cent of people surveyed said they would like their employer contributions to go into a LISA instead of a pension. That LISAs require no employer contributions may incentivise employers to encourage employees to save into this vehicle instead – even though this would arguably breach the 'employer duty' under auto-enrolment.

2.6 Overall, we are concerned that the LISA could be the start of a move to a wider ISA-based approach to pension saving which will not be the right option for many young savers, and will leave them considerably worse off in retirement. Most ISAs are held in cash, which over the longer term is likely to be a sub-optimal investment choice that will have a negative impact on income adequacy in retirement.

2.7 A LISA might be a better alternative for low earners saving into a pension under a net pay system. If people do not pay income tax and their employer uses this system, they do not receive the government tax relief element. Savers using a LISA would at least receive some Government contribution. However using LISAs to tackle this issue is like using a sledgehammer to crack a nut – as the Pensions Minister has suggested, the focus should be on ensuring that all savers receive their due tax relief.

2.8 As there is no tax advantage for the LISA over a pension in most cases, and it is less flexible for withdrawing in later life – withdrawals must wait until age 60 rather than 55 – it is difficult to identify other groups for whom it would be preferable as a means of encouraging retirement saving.

2.9 We do not believe it is necessary or desirable to combine saving for later life and buying a first home. The timescales for saving and appetite for risk are so different for the two objectives that it would difficult for the ISA to develop an investment strategy to suit both needs. Pension saving requires a longer-term outlook with an investment strategy geared up to meeting the specific needs of the consumer at the time when they access their savings; whereas saving for home is very much for the shorter term. The appetites for risk are very different, with short-term fluctuations in investments likely to have a greater impact on house buying. It would difficult for the ISA to develop an investment strategy to suit both needs.

3. LISAs and self-employment

3.1 LISAs may be attractive to some people who are self-employed as a means of getting a Government contribution to their saving. However they are far from being a magic bullet for improving income in later life.

3.2 For example, self-employment increases with age – in July-September 2015, 44.1 per cent of the self-employed population were aged over 50. This age group will be ineligible to save into a LISA which will have an upper age limit of 40, so claims it will rescue pension saving for the self-employed are overstated.[v]

4. Guidance

4.1 As already mentioned, if pension saving were switched to an ISA-based system this would lead to worse outcomes for consumers, particularly younger cohorts. LISA guidance should reflect the longer-term benefits of pension saving and compensate for the well-documented short-term bias among savers.

4.2 We support the idea of re-branding pensions tax relief as a 'government match' or 'bonus' (following behavioural testing of different options). Consumers do not typically understand pension tax relief, with many failing to realise it is a Government contribution to their pension saving. As the Government contribution to LISAs are being billed as a 'bonus', this may lead to consumers finding LISAs superficially more attractive, even though a 25 per cent post-tax 'bonus' is identical to a 20 per cent pre-tax 'relief'. This should be explained up-front in all forms of engagement with pensions and LISAs, alongside a clear indication of how a pension might benefit the individual over the longer-term.

4.3 To make pensions tax relief easier to understand, we believe that (in addition to re-branding) it should be available at a flat-rate to all savers, regardless of the income tax bracket they fall under. This should be set at a cost-neutral level – redeploying the savings made from higher rate taxpayers to benefit saving for basic rate taxpayers.

5. Conclusion

5.1 We accept that the flexibility of a lifetime ISA may be attractive but this must not come at the cost of a proper pension in later life. At the time the Lifetime ISA is due to be introduced, the roll-out of auto-enrolment will not yet have finished. It is crucial that the Government acts to sustain the attraction of pension saving and continues to give policy priority to automatic enrolment into workplace pensions. With this in mind, we believe the Government must exercise caution in the introduction of the LISA, resist the temptation to make it any more flexible than currently proposed, and carefully monitor uptake and the impact on pension saving.

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[i] Available at: http://www.ageuk.org.uk/Documents/EN-GB/For-professionals/Money-and-benefits/Pensions%20tax%20relief%20(Sept%202015).pdf?dtrk=true
[ii] HMRC (2015), ISA statistics
[iii] See Pensions Policy Institute (2013), What level of pension contribution is needed to obtain an adequate retirement income?
[iv] http://www.nowpensions.com/press-release/majority-of-lifetime-isa-savers-plan-to-use-money-for-retirement/
[v] Office for National Statistics (December 2015)