Institute and Faculty of Actuaries

Pensions Automatic Enrolment

Evidence on the Lifetime ISA

IFoA response to the Work and Pensions Select Committee

17 April 2016

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Work and Pensions Committee
House of Commons
London
SW1A 0AA

17 April 2016

Dear Mr Field

IFoA response to Work and Pensions Committee's auto-enrolment inquiry – new evidence on Lifetime ISAs

1. The Institute and Faculty of Actuaries (IFoA) welcomes the extension of the Committee's inquiry into auto-enrolment (AE) in response to the Budget announcement to introduce a Lifetime ISA (LISA) from April 2017. We recognise the need for initiatives that encourage people to save more for their retirement. It is important that any initiative strengthens the overall retirement savings framework.

2. It is vital that the introduction of the LISA does not undermine AE's success in increasing the number of people saving into an occupational pension. The role of the employer in pensions is crucial as many employees regard their employer as a trusted source of information about their pension. Employer contributions also make contributing to a pension more attractive to employees.

3. Many members of the IFoA advise employers and trustees about pension schemes. Some of those members, and their employers, have completed initial analysis on the relative tax benefits of pension contributions and the LISA.

4. Our members' work found:
    a. Irrespective of an employee's tax position, the most tax efficient saving vehicle is a pension, owing to the tax treatment of employer contributions (although it may be more financially beneficial overall for the employee to repay any debt, including mortgage debt, before increasing savings in either the LISA or a pension).
    b. Once the employee has put the minimum contribution into their pension needed to secure the maximum employer contribution, the LISA offers a greater incentive for any additional saving if the person remains in the same tax rate in work and retirement.
    c. For those employees who are a higher rate tax payer in work, but a basic rate tax payer in retirement the pension remains the more tax efficient vehicle for any additional saving (up to the Lifetime Allowance and Annual Allowance).

    We therefore recommend that for those eligible for AE the primary focus is on maintaining the low opt-out rates as this will secure the employer contributions.

5. For those not eligible for AE, the LISA could be an important savings vehicle. We agree that the introduction of the LISA, with the receipt of a 'tax bonus', could act as an incentive to save amongst those individuals not eligible for AE.

6. Finally, we have focused our preliminary research on taxation and when considering our findings the Committee should note that we have only researched this factor. However, in considering whether the LISA or a pension is the most beneficial savings vehicle, there are a large number of other considerations. In particular, we note that expenses could have a

significant impact. We would encourage the Committee to undertake a further inquiry to conduct a comprehensive assessment of the two savings vehicles.

The taxation of pensions vs LISA

7. Figure 1 demonstrates the tax efficiency of employer and employee pension contributions in comparison to the LISA. This is based on the proportion of employer spend returned to the employee where the employer has made £100 available by:

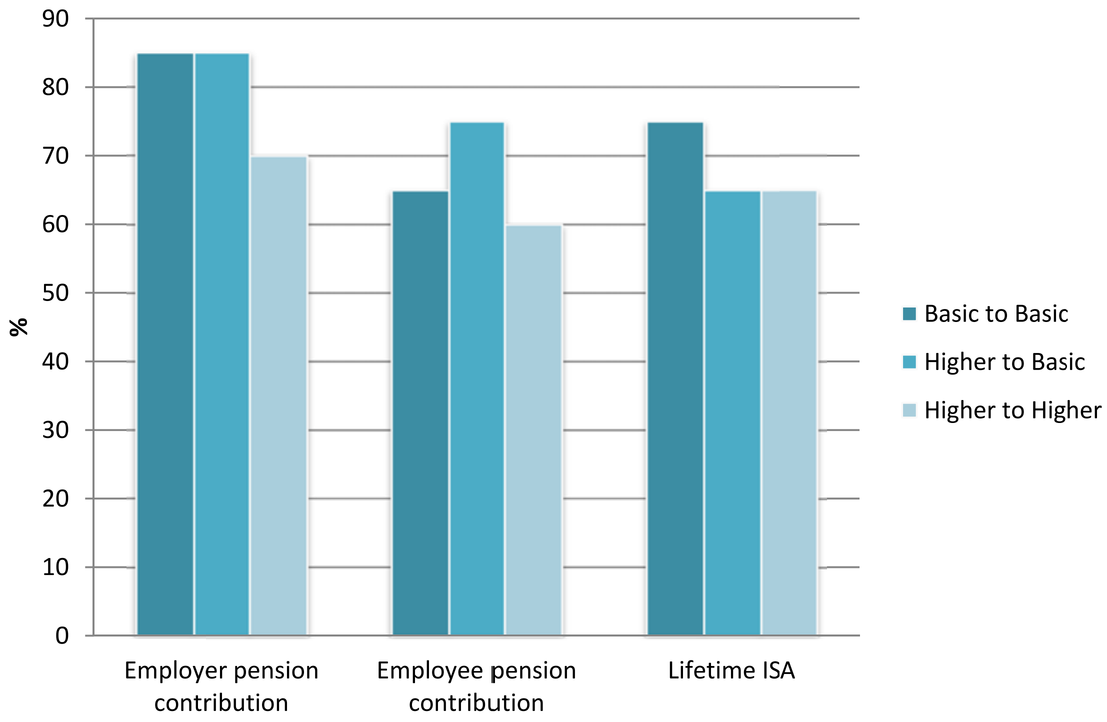
- Employer pension contribution
- Cash to employee to pay employee pension contribution
- Cash to the employee to pay into a LISA

To focus on the specific impact of taxation, it assumes identical charges and fund choices, which may not be the case in reality. The impact of these would be a useful area for further research and the IFoA could undertake further analysis if it were useful to the Committee.

8. This analysis looks at the impact of taxation for different tax brackets:

- Basic tax rate in both work and retirement
- Higher tax rate whilst working and moves to basic in retirement
- Higher tax rate in both work and retirement

Figure 1: Proportion of employer spend returned to employee



9. Figure 1 shows that for all tax rates the employer pension contribution is the most tax efficient savings vehicle. However, once the employee has contributed the minimum required to secure the employer contribution then for any additional savings:
   a. If someone is a higher tax rate payer during their working life, but becomes a basic rate taxpayer in retirement, the employee contribution is more tax efficient than the LISA.

b. Where the tax rate stays the same between work and retirement, the LISA is more tax efficient than employee pension contributions.

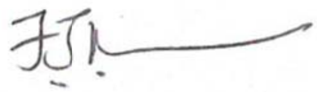
Pensions ISA

10. The LISA could act as an interim step towards the introduction of a Pensions ISA and a TEE tax framework. As it currently stands, the LISA does not offer an incentive to employers to contribute. We reiterate the important role that employers play in pension saving. The impact of a Pensions ISA would be significant for employers. The costs for employers, and ultimately scheme members, for introducing a new system must not be underestimated.

11. The IFoA would support the Committee in asking the Government to clarify whether it envisages future changes to pension tax relief akin to the Pensions ISA model and whether the Government could respond to the consultation ‘Strengthening the Incentive to Save’ as soon as possible to stop the ongoing uncertainty. Planning for retirement means taking a long-term focus and it is important that continual tinkering to the pensions framework does not undermine this.

Should you wish to discuss any of the points raised in further detail please contact Rebecca Deegan, Policy Analyst (rebecca.deegan@actuaries.org.uk / 02076322125) in the first instance.

Yours sincerely



Fiona Morrison
President, Institute and Faculty of Actuaries