Written evidence from LCP (APS0065)

We were grateful for the opportunity for Laura Myers to contribute to the Committee's thinking at the oral evidence session on 21st July. As the Chair kindly invited further submissions we thought it might be helpful to provide this further short note. This covers two topics:

1. 'Decoupling' of tax-free cash – our response to the discussion with witnesses and concerns raised; and,

2. The risks of people using pension freedoms and inadvertently undermining their means-tested benefit position, a topic which Laura briefly touched on.

1. Decoupling of tax-free cash

As we noted in our previous submission, the idea of allowing people to take 25% of their pot tax free whilst leaving the rest 'behind' being invested in a pension was mooted by the FCA a few years ago. We have looked into the latest evidence on how people are using pension freedoms and are increasingly convinced that real harm is being done to savers from the present regime. We think that allowing people to access the part they are most interested in, but seamlessly leave the rest behind, would greatly reduce the risk of them cashing out in full, which is by far the most common use of small pension pots at present. If 'de-coupling' is not adopted, what is the solution to this problem?

a) *Would there need to be a law change?*

The Committee asked if the law would need to change to facilitate 'de-coupling', and one of the witnesses said that 'you can do this in any case', and therefore implied no need to change anything.

Our understanding is that the way this works at present is slightly different for the two main types of pension – occupational (trust-based) pensions and personal (contract-based) pensions.

As Laura mentioned in her oral evidence, we advise a number of occupational pension schemes who have been told that, under current tax rules, they cannot simply allow members to access 25% tax free cash and leave the rest behind. We believe that HMRC would therefore need at the very least to provide clarification that this was acceptable or, more likely, adjust tax law to make it possible.

With personal pensions or group personal pensions, in principle (as Rachel Vahey pointed out in oral evidence this morning) you can in effect take your 25% and leave the rest invested by putting the balance in a drawdown product. However, at the end of the market we are focused on, relatively few people who want to get their hands on tax free cash are sitting down to consider moving the balance of their funds to an

investment platform. Even if they do go into drawdown, they risk paying 'retail' charge levels (as Laura mentioned in her evidence) compared with the much lower 'wholesale' charges that they are currently paying in their pension.

But more likely they will simply take the lot, because that is just the easiest thing to do. For behavioural reasons, as much as legal reasons, if we don't make it as easy as possible to take the tax-free cash but leave the rest behind, people will continue to take the route of 'least resistance' and take the lot. This not only leads to lower investment returns (as the 'other 75%' may end up in cash), but they also risk triggering the 'Money Purchase Annual Allowance' unnecessarily, potentially jeopardising their potential for future pension saving.

Even for those who take 25% tax free and move the rest into drawdown, there is still a risk of worse outcomes, as the 'retail' charge levels applied to their investment in drawdown are likely to be higher than the 'wholesale' charge levels applied to their investments while still in their workplace scheme.

In short, there is clear evidence of adverse consumer outcomes currently happening every day. No solution is perfect, but we believe that 'de-coupling' would make it far easier for people to leave the balance of their funds invested in a low cost and well governed environment.

b) Would this encourage early access?

One concern raised in oral evidence was that if we make it easy for people to take tax-free cash, then they will do so at the earliest opportunity, typically 55.

However, it is already the case that many schemes report a spike in withdrawals at age 55. The problem is that under current rules it is not 25% which people are withdrawing, it is 100%.

In other words, we are not comparing with a perfect world where people don't touch their pensions until they retire and then make optimal choices. We are trying to mend a system where large numbers of people *already* take their money well before state pension age and take far more than they need to because this is the easiest thing to do or because they don't trust pensions. If a change to the rules resulted in *some* people taking 25% earlier than they would otherwise do, this would not be ideal, but this would have to be weighed against the much greater good of having far more people *only* taking 25% rather than 100%, and dumping the balance in a cash ISA for years.

2. Adverse outcomes for savers on means-tested benefits from using pension freedoms

An issue which has been neglected to date and which the Committee could usefully highlight is the risk that people on low incomes who access their pensions under pension freedoms could unwittingly damage their benefit position.

In brief, the benefits system was designed for a world where there is a set of people in work who get 'working age' benefits alongside their wages, and a set of people in retirement who get 'pension age' benefits alongside their pensions. But pension freedoms blur that distinction by creating large numbers of 'working age' people who have started to draw on their pensions. And the rules of working age benefits were not really designed with that scenario in mind.

To give a simple example, Universal Credit has a capital limit of £16,000. Anyone with capital above this limit is disqualified from UC entirely. This means someone on universal credit who, for example, took a £20,000 pot in full (including some tax free cash) could end up with £17,000 net and immediately lose all their benefits. If they spent the money at once – for example on paying down debts – the authorities may well turn a blind eye. But if that money stayed on deposit, any benefit reassessment could result in them losing benefit and possibly facing action for recovery of benefit overpayment.

The rules around local authority help with council tax bills (at least in England) are even more stringent with most local authorities removing all help for those with capital over £6,000.

Very little thought has so far been given to the 'customer journey' in these cases, and with well over one million people aged 55-65 on means-tested benefits, this could be an increasingly important issue.

At present, the only safeguards are:

a) Pension Wise, although take-up is low, especially among those with small pots. In addition, Pension Wise will mainly signpost to benefits calculators; these are fine for someone willing to answer dozens of questions to work out if they might be eligible for benefit in the first place, but they are unlikely to help someone answer a 'what if' question about how a potential future pension withdrawal might affect their benefit, especially if they want to compare taking their pension as a lump sum, as drawdown or a mixture of the two;

b) Schemes and providers – in theory, when a customer rings up, the providers or schemes could ask if they are on benefits and could signpost guidance services or Citizen's Advice etc. However, it is pretty clear that providers are not experts on the benefits system, and scheme members who simply want

the cash are unlikely to go to a lot of trouble to seek out the information they need to make an informed choice.

We have prepared a fuller report on this issue, a pre-publication draft of which is attached for the Committee's information. We are talking to regulators, guidance providers and pension providers to see what more can be done, but we would welcome a recommendation from the Committee that DWP, FCA, TPR and MAPS work together with schemes and providers to investigate the scale of this problem and recommend a 'consumer journey' which would protect lower income savers from potentially catastrophic outcomes.

August 2021