HM TREASURY

Early access to pension savings

December 2010

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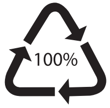

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Foreword

The Government is committed to fostering a culture of saving in the UK. Recent levels of individual saving have been too low. The Government is keen to encourage higher levels of saving by improving flexibility and promoting personal responsibility over financial choices.

It is vital to encourage individuals to save now in order to have a good income in older age. By 2051, nearly one in four individuals in the UK will be aged 65 or over.

Whilst the triple guarantee announced in the June Budget ensures an income for individuals in old age that will not be eroded over time by increases in prices or earnings, the state pension alone will not give individuals the income they may aspire to in retirement. Private pension saving will need to supplement this.

Automatic enrolment is a major step in boosting participation in private pension saving. But the Government wants to consider further ways to make pension saving more attractive to individuals.

Early access to pension savings is one such option. It could encourage more pension saving, or provide flexibility for individuals facing financial hardship. It could give more choice during the accumulation of pension savings, and so complement the reforms to remove unnecessary restrictions on accessing retirement savings in later life. However, early access also poses potential risks to retirement outcomes, and evidence on the likely impact of early access is currently limited.

I am therefore inviting all interested parties to submit further evidence or research on the potential of early access to boost pension saving, the risks and complexities it may involve, and whether any specific models of providing early access have particular merits.

The Government will carefully balance a consideration of the possible benefits of early access against potential risks to individuals' pension income in retirement, possible burdens on pension schemes and providers, and fiscal risks for the Exchequer.

I look forward to receiving your evidence, which will inform the Government's decision on whether to proceed with any reform in this area.

Mark Hoban MP

Financial Secretary to the Treasury

1 Introduction

The savings challenge

1.1 Recent levels of personal saving have been too low. Around a quarter of households in Great Britain have no savings and many of those who are saving are saving low amounts. Half of all households have net financial wealth of £5,200 or less.[1] The Government is therefore committed to encouraging people to save and invest by creating conditions for higher saving which will support a sustainable and balanced economic recovery, and foster a culture of personal responsibility.

1.2 This will require not only traditional saving incentives, mainly provided through the tax system, but also new approaches focused on changing behaviour and improving outcomes. New policies need to work with the grain of saving habits, creating new expectations of saving and responsible borrowing. The Government is also working with industry to ensure they provide simple, transparent, competitive and flexible products to help households.

1.1 Policies will be measured against the Government's three principles of freedom, fairness and responsibility, as well as the extent to which they provide lasting affordability and effective value for money. This will support the Government's aims of rewarding saving, supporting pensions, and helping vulnerable households to smooth their expenditure.

Demographic change and the importance of retirement savings

1.2 Saving for retirement is particularly important. The profile of the UK's population is changing. Individuals are living for longer, and as a result an increasing proportion of our population will consist of older individuals. While in 1981, a man aged 65 could expect to live for another 14 years on average, by 2008 this had risen to 21 years, and is expected to reach 25 years by 2051.[2] For women, the corresponding increase has been even higher.[3] As a result, between 2008 and 2051 the proportion of people aged 65 and over is expected to increase from 16 to 24 per cent.[4]

1.3 While longer life is clearly positive, it creates a challenge for the Government and individuals to ensure people have sufficient resources throughout later life to maintain a good standard of living. There is already evidence that people are not putting enough aside to achieve an adequate income in later life, with the Department for Work and Pensions (DWP) estimating that around 7 million people are under-saving across the working age population.

1.4 The Government is committed to providing a strong foundation to support pensioners throughout their life through the basic state pension and a minimum guarantee for pensioners' income. Individual saving must make up the difference between state provision and the income people aspire to have in retirement, which may be closer to their income during working life. Encouraging private pension saving by individuals is thus a key objective of the Government.

[1] Data from the Wealth and Assets Survey 2006-08. Net financial wealth includes any financial asset values minus the value of any financial liabilities.
[2] Office for National Statistics (ONS), Pensions Trends: Chapter 2: Population Change (April 2010).
[3] Women's life expectancy at 65 increased from 18 years in 1981, to over 23 years by 2008, and is projected to rise to nearly 28 years by 2051 (ONS).
[4] ONS.

Reforms to encourage private pension saving

1.5 The Government has taken early steps to promote pension saving. **Automatic enrolment** will commence from 2012 and will create a duty on all employers to auto-enrol qualifying employees into a minimum quality workplace pension scheme. Auto-enrolment will encourage millions of individuals to start saving or save more into a pension. The Government is also establishing the **National Employment Savings Trust (NEST)** to ensure employees on low and median incomes, and small employers, have a suitable, low cost pension scheme into which they can save with the introduction of auto-enrolment.

1.6 Tax relief is available on private pension saving to provide an incentive to save for retirement, and was worth £19.7bn (net) in 2009-10. In order to give individuals greater flexibility and choice in how they may use their tax-relieved pension savings, the Government has committed to **abolishing the effective requirement to annuitise by age 75 from April 2011**, as announced in the June Budget. This will remove any requirement to annuitise by a set age, simplify the tax treatment of income drawdown products, and allow more innovation in annuity products.

1.7 The Government is interested in exploring further steps that can encourage a broader culture of saving and make retirement saving more flexible and attractive. In particular, the Government is interested in exploring the potential to give people greater flexibility in accessing part of their private pension fund early, as stated in the Coalition Government Agreement.[5]

Exploring early access to private pension saving

1.8 Currently, individuals can only access savings in a registered pension scheme from age 55 at the earliest (except in cases of serious ill health or other limited circumstances). The Government is keen to consider whether enabling access to pension savings before this age would improve the flexibility and choice available to individuals in the earlier stages of pension saving, and therefore generate more saving overall and higher incomes in retirement. Early access may also have the potential to alleviate some instances of financial hardship.

1.9 According to the Wealth and Assets survey, 57 per cent of 35-44 year olds were members of a private pension scheme, rising to 58 per cent for those aged 45-54. The median private pensions wealth held by those *with* some form of pension savings in these age cohorts was £33,000 and £55,700 respectively.[6] This gives some indication as to the number of individuals who may immediately benefit from some form of early access.

1.10 Alongside early access, the Government is keen to consider whether any other pensions tax rules may be unnecessarily impeding choice and flexibility for pension savers. In particular, this paper seeks evidence on issues that may be affecting individuals with smaller pension pots, primarily focusing on the trivial commutation rules and possible barriers to transfers facing those with smaller fund values.

1.11 Chapter 2 outlines the existing UK pensions tax framework, and some of the potential benefits and risks of allowing early access. Chapter 3 summarises the different types of early access that have been suggested, the initial benefits and risks the Government perceives, and calls for evidence on each of these. This includes a brief summary of several international examples of where early access to pension savings is offered. Chapter 4 then sets out some remaining aspects of the pensions tax framework where there may be a case for enabling greater choice and flexibility in pension saving. The Government welcomes views and evidence from interested parties throughout, with the questions summarised at Annex A.

[5] The Coalition Government Agreement is available on the Cabinet Office website (http://www.cabinetoffice.gov.uk/media/409088/pfg_coalition.pdf).

[6] These figures are for men and women, and include both defined contribution (DC) and defined benefit (DB) membership and pensions wealth.

2 Early access as an incentive to save

The existing UK pensions tax regime

2.1 This Chapter sets out the key features of the UK pensions tax system, before examining the existing evidence on whether early access to pensions may boost retirement saving. Private pension saving in the UK is based on an 'Exempt, Exempt, Taxed' or 'EET' basis:

- Exempt: individual contributions into a registered pension scheme are given tax relief at an individual's marginal rate, and any employer contributions may also qualify for a deduction of corporation tax and relief on national insurance contributions (NICs);
- Exempt: investment growth of savings and disposal of investments in a registered pension scheme are exempt from tax;
- Taxed: subject to the option to take up to 25 per cent of a pension fund as a tax-free lump sum, when an individual receives an income from their pension they will be taxed according to their marginal rate.[1]

2.2 The generous tax treatment of pension saving is intended to encourage individuals to save for the long-term and provide them with an income in retirement. Private pensions tax relief had a net cost to the Exchequer of £19.7bn in 2009-10.

2.3 Reflecting the intended purpose of pension saving, the tax rules set a minimum age of 55 from which benefits from pension savings can be accessed.[2] From this age, the 25 per cent tax free lump sum can be taken, while the remainder of a pension pot must be used to secure an income in retirement, either by a scheme providing pension income to its member, or by an individual purchasing an annuity for life or entering an income drawdown arrangement.[3]

2.4 To improve flexibility over when and how an individual can take an income in retirement from their pension savings, the Government is removing the requirement to purchase an annuity by age 75. This retains the principle that tax-relieved pension savings are intended for use in retirement, but removes unnecessary and outdated rules and restrictions around annuitisation.

Early access reform

2.5 The Government is aware that a number of parties, including the pensions and savings industry, academics, and consumer groups, have examined the potential merits of allowing early access to pension savings. This debate has centred around two main arguments:

- early access could increase the overall number of individuals saving into a pension and encourage higher levels of contributions by those already saving, to the extent

[1] One variation of this general tax treatment is where an individual is between 60 and 75 with total pensions wealth of less than £18,000, when they can choose to take all their pension savings as a lump sum, with the first 25 per cent tax free and the remainder taxed as income in the year taken.

[2] Previously 50 years of age before April 2010 – some individuals may also retain protected rights that allow them to take benefits earlier than 55 depending on their individual scheme arrangements and rules.

[3] Income drawdown arrangements currently include unsecured pension arrangements (USPs) available before age 75, and alternatively secured pensions (ASPs), which are only applicable after age 75. Both are due to be abolished and replaced with new drawdown options from April 2011, following the announcement in the June Budget that the effective requirement to annuitise by age 75 will be removed.

that the increase in overall retirement saving outweighs the effects of any funds actually withdrawn before age 55; or

- early access may help alleviate specific instances of hardship by allowing access to funds in a pension scheme in particular circumstances, such as where an individual faces repossession of their home.

2.6 These possible advantages need to be balanced against potential risks, notably that individuals may prematurely deplete their pension savings and so experience worse outcomes in retirement.

2.7 The Government believes that any new flexibility should be considered in line with the following principles:

- the purpose of tax-relieved pension saving is to provide an income in retirement;
- any change to pensions tax rules should be affordable, sustainable and maximise the value for money of Exchequer tax relief, and should not create opportunities for tax avoidance;
- any changes to pensions tax rules should not add undue complexity or place disproportionate burdens on individuals, providers, schemes, including defined benefit (DB) schemes, HMRC or others.

Early access as an incentive to save

2.8 Early access would have a positive effect on pension saving if the incentive to save created by greater flexibility outweighed the impact of early withdrawals on future retirement funds. Evidence on the incentive effect is mixed. In a recent Association of British Insurers (ABI) survey, 28 per cent of respondents said an option to access part of their pension early would encourage them to save more, while 47 per cent stated it would make no difference, and 6 per cent said they would be less likely to save.[4] DWP evidence also suggests a lack of accessibility may be discouraging some private pension saving. Among those not currently saving into a pension, 34 per cent stated they would be more likely to do so if they could access savings before retirement, while 26 per cent of existing pension savers said they would be likely to save more if savings could be accessed pre-retirement.[5]

2.9 However in the same survey, 79 per cent stated they thought pensions were a good way of saving because they cannot be accessed until retirement. In another ABI survey, which asked why non-pension savers were not contributing into a pension, only 5 per cent stated the inability to access funds early as a reason.[6]

2.10 The Government is also interested in whether early access may have a more pronounced effect on encouraging groups traditionally less likely to save into a pension to start saving or save more – such as younger people, women, and low earners. It has been suggested that women in particular could benefit from early access to better smooth their incomes across their lives, as they may be more likely to prioritise other short-term needs, such as those of their children, over providing for their retirement.[7] A Scottish Widows survey suggested nearly 1 in 5 women may be encouraged to save more for the long-term if pension savings were more accessible.[8] Meanwhile, DWP survey evidence indicates that for individuals in the lowest income

[4] ABI quarterly survey (Q2, 2010).
[5] DWP, Attitudes to Pensions: The 2009 Survey (2010).
[6] ABI, 'State of the nation's savings' (2008). The majority, around 60 per cent, stated the main reason as the inability to afford contributions.
[7] Baroness Hollis, House of Lords, Hansard (volume 702), 23 June 2008, Columns 1273-1276.
[8] Scottish Widows, 'Women and Pensions Report: Pensions for Today and Tomorrow' (2009).

quartile, a lack of access to pension savings before retirement is more likely to mean they view pension saving negatively than compared to people in the highest income quartile.[9]

2.11 However, the existing evidence is limited and not conclusive, as other studies have noted. Therefore the Government seeks evidence or analysis from interested parties on the following questions:

- Is early access likely to have a net positive effect on retirement outcomes for individuals?
- Would early access have particular benefits or risks for groups who traditionally under-save, including those on low incomes?

Early access as a means to alleviate specific cases of hardship

2.12 Early access to pension savings has also been suggested as a way to help in specific cases of hardship. The Government is aware of proposals suggesting early access to pension saving could be offered where individuals face a financial crisis such as unemployment or repossession of their home, and have no other liquid savings. This could also include situations where long-term care becomes necessary, although the independent Commission on the Funding of Care and Support is currently examining the wider issues in this area.

2.13 A central factor to consider in these situations is the extent to which pension saving is correlated with other forms of saving. The Social Market Foundation (SMF) has recently published a study that suggests under-saving for retirement mirrors a wider problem of under-saving in general, and that there is a correlation of household wealth across different forms of saving.[10] In other words, individuals or households with no liquid savings to fall back on in the event of hardship, or a life event requiring access to a capital lump sum, are also more likely to have limited or no pension savings. This corresponds with a frequent survey response from non-pension savers when asked why they do not save, which is a lack of spare money.[11] It suggests early access to private pension savings may not be an effective policy to help the majority of individuals facing financial hardship.

2.14 The most frequent argument for permitting early access in specific circumstances is made in relation to helping people prevent repossession of their home. However the Government is not aware of any evidence or analysis that specifically examines whether pensions wealth may be available to households facing the threat of repossession.[12] DWP analysis, based on the Wealth and Assets Survey, shows that in 2006-08 around 1 per cent of working-age households with mortgages were in arrears, some of whom also had private pensions wealth. But, since mortgage arrears and repossessions are generally higher among younger people (under 30), who are also less likely to hold significant pensions wealth, early access to pension savings may have a limited effect for the majority of households facing repossession.

2.15 The Government would welcome further evidence on whether a reform linking pension savings to repossessions would have net benefit for individuals, especially considering the potential effect on their income in retirement, and any wider implications for the housing market and mortgage lending behaviour. An early access option limited to repossessions would create a potential transfer of personal assets from pensions into property. This could create further risks for individuals (e.g. losing pensions wealth and their home), and could potentially

[9] A quarter of those in the lowest income quartile stated they were not in favour of pension saving because they could not access funds until retirement, compared to 14 per cent of people in the highest income quartile. DWP, Attitudes to Pensions.

[10] Social Market Foundation (SMF), 'Early Access to Pension Saving' (March 2010).

[11] In the Wealth and Assets Survey (2006-08), 66 per cent of respondents stated a lack of spare money as a reason for not saving into a pension.

[12] The SMF conclude there is an evidence gap in assessing whether access to pensions wealth could have held off repossession in any of the 47,700 repossessions that occurred last year (repossession figures from the Council of Mortgage Lenders).

create distortions in the housing market. Individuals who are not home owners would not be able to benefit from this form of early access.

2.16 The Government is also open to considering whether early access to pensions wealth could promote fairness and intergenerational redistributions of wealth, allowing older family members to use pension savings earlier in life to help younger relatives in specific financial difficulties. Pensions wealth tends to be accumulated later in life, and is further skewed towards the current generation approaching retirement due to the earlier prevalence of more generous defined benefit occupational schemes, which are now in decline.[13] The flexible income drawdown option that will be introduced from April 2011 as part of the reforms removing the requirement to annuitise by age 75 would help those over 55 who wished to help relatives, since it allows unlimited withdrawals from defined contribution (DC) pension savings provided a minimum level of lifetime pension income is first secured. However, the argument for early access to pension savings to help relatives in financial need may undermine the principle that tax-relieved pension savings are primarily intended to provide individuals with an income in retirement.

2.17 On the assumption that this kind of early access would only be necessary for those under 55 (since the 25 per cent lump sum can be accessed at this age, and its use is not restricted), analysis suggests 40 per cent of households where the head is aged 40-54 have at least £90,000 of total pensions wealth.[14] If liquid savings are also considered, on the basis that accessing pension savings should be a last resort where liquid savings cannot be called upon, the proportion of people with a high degree of pensions wealth (over £100,000) but liquid savings of less than £10,000 represents 12 per cent of households aged 40-54. These figures would be lower if early access were not extended to defined benefit (DB) pension schemes, since DB pensions constitute a significant amount of the pension wealth held by households aged 40-54.

2.18 Overall, in considering the links between cases of hardship and allowing early access, there is limited evidence on which to base firm conclusions as to the likely scale of benefit it could achieve. On this basis, the Government welcomes further representations, supported by evidence, on the following questions:

- Would allowing early access to pension savings in situations of acute hardship, for example where individuals face repossession of their home, help a significant proportion of people in such circumstances?
- Is there an argument for early access as a way of promoting intergenerational redistribution of pensions wealth in cases where a pension saver's relatives face specific financial difficulties?
- Would this create more risks for an individual's income in retirement?

[13] By 2009, there were only 1 million members of open private sector occupational defined benefit schemes, compared to nearly 5 million in 1995. ONS *Occupational Pension Schemes Survey 2009* (October 2010).

[14] DWP analysis based on data from the Wealth and Assets Survey.

3 Possible models for early access to pension savings

3.1 Having considered the broad arguments and existing evidence on early access as an incentive to boost pension saving, or as a means to alleviate certain cases of hardship, the Government is also interested to consider how such a policy may be implemented in practice. The Government's view of the merits of any potential early access option must consider the administrative and compliance burdens any reform may create for pension schemes, providers, the Government, and others.

3.2 Several different forms of early access have been proposed, and each has potentially varied effects on the incentive to save into a pension, and net effects on incomes at retirement. They are also likely to involve varying administrative and compliance burdens for industry and HMRC, which could in turn increase costs to members through higher charges.

3.3 Four main options have been identified for allowing more flexible access to private pensions:

- **A loan model** allowing individuals to borrow from their pension fund;
- **A permanent withdrawal model**, allowing access to funds without repayment obligations –possibly in limited circumstances, such as in cases of hardship;
- **Early access to the 25 per cent tax-free lump sum** currently available from age 55;
- **A feeder-fund model**, creating a more flexible savings product linking liquid savings products, such as ISAs, and pension savings together into a single account.

3.4 The first two examples have been established in other countries, while the latter two build on existing features of the UK pensions system. The remainder of this chapter will summarise each early access model in turn, considering the initial advantages and disadvantages the Government perceives in each, and setting out the evidence sought from interested parties. Two frequently cited international examples are also briefly outlined in Box 3A below. However, it is difficult to draw direct parallels between the UK and other countries due to wider differences in state pension systems, occupational pension provision, and pensions tax treatment.

A brief overview of potential early access models

A loan and repayment model

3.5 Similar to the US 401(k) schemes summarised below (Box 3.A), this would allow individuals to borrow from their own pension fund, with a requirement to repay the loan with interest. It would provide individuals with access to a capital lump sum, at potentially lower rates than other forms of finance, while at least partly protecting the individual's final retirement fund size.

3.6 It has been suggested that this option could increase participation and contribution levels of pension saving. The Pensions Policy Institute (PPI), using evidence from US 401(k) studies and applied to hypothetical UK private pension savers, suggests UK participation rates could rise by between 0 and 6 per cent, and contribution levels by 0.6 to 3 per cent with a loan option.[1]

[1] Pensions Policy Institute (PPI), 'Would allowing early access to pension savings increase retirement incomes?' (November 2008).

However, risks of reduced pot sizes were noted if individuals ceased to make contributions while they were repaying loans, or if loans were not repaid.

3.7 The Government would be interested in considering further evidence around the loan option, including the level of appetite for offering it, and the impact it may have on levels of pension saving.[2] The Government is however wary of the potential complexity of incorporating a loan model into the UK pensions tax framework, and so also welcomes evidence on the benefits or burdens that it may create for individuals, providers, and schemes.

Permanent withdrawal

3.8 This would allow a lump sum to be taken from a pension with no repayment obligations. Like New Zealand's KiwiSaver, this would likely be limited to certain circumstances of hardship. A hardship requirement would need to be carefully set and assessed to limit the risks to individuals of making an ill-informed decision to withdraw their pension savings, at the cost of having significantly less in their pension pot at retirement.[3]

3.9 Assessing cases of hardship would create new administrative burdens for providers, schemes, individuals, and the Government. This option may be especially complex for DB schemes, due to difficulties in valuing an individual's fund and the effects on other scheme members of withdrawals, since funds are pooled. It would also be necessary to mitigate potential fiscal risks of this kind of access, for example recycling of tax relieved funds, by having appropriate tax charges. Permanent withdrawals create a potential tension within the UK's 'EET' pensions tax framework, since funds withdrawn early will not be used to provide an income in retirement, and therefore tax relief provided should be recovered.

Early access to the 25 per cent tax free lump sum

3.10 This would allow access to the existing tax-free lump sum option at any time, rather than limiting it to age 55. The simplest model would be to base the 25 per cent lump sum on fund value at the time (rather than a projected value). Once taken it would extinguish the later right to a commencement lump sum. It would have the advantage of offering more flexibility, while being relatively easy for individuals to understand and providers to implement, since it is based on current rules, and protects final retirement income by capping the withdrawal level.[4]

3.11 Potential disadvantages would be the loss of the lump sum option in later life if an individual chooses to take it prior to retirement. Basing the 25 per cent lump sum on a projected fund value, or allowing more than one lump sum withdrawal, would significantly increase the complexity of this option for providers and schemes, and introduce additional risk for the Government. In addition, since the 25 per cent tax-free lump sum could be recycled into further tax-relieved pension saving, rules would be needed to guard against this possibility, with a corresponding compliance burden.

A feeder-fund model

3.12 Several versions of this idea have been proposed, most involving the combination of ISAs and pensions under one product wrapper. This could include automatic triggers within the product, for example a liquid part of the account, treated like an ISA, up to a certain level (e.g. the existing cash ISA limit of £5,100), with any amounts saved above this then placed into the

[2] It is envisaged loans would be a permissive feature, if considered, rather than mandatory, with providers free to choose whether they offer the facility.

[3] PPI modelling on a permanent withdrawal option suggested the effect on individual pot sizes could vary widely, with withdrawals without any additional contributions potentially lowering pot sizes by over 50 per cent. PPI, 'Would allowing early access to pension savings increase retirement incomes?'

[4] The PPI research suggested pot sizes may vary from 15 per cent lower to 9 per cent higher by retirement with the 25 per cent tax free lump sum option, however this was based on slightly different access rules, and assumptions on what the incentive effects would be on contributions.

ring-fenced pension part of the account and provided with pensions tax relief.[5] It has been argued that individuals may find these products simpler to understand compared to the perceived complexity of pension products, and raise levels of saving or participation as a result.[6]

3.13 However, since the tax rules already allow savings to be placed into a pension at any time within the annual and lifetime allowance limits, including from an ISA, the Government is keen to understand whether and why this facility is currently under-used, and if there is a genuine market appetite for a combined ISA-pension product. Any product involving a trigger point above which pension savings are made also creates a potential risk that individuals who withdraw funds regularly may never make substantial pension contributions for their retirement.

3.14 The Government is open to considering alternative feeder fund options as a form of early access, and would welcome evidence on the extent to which they may encourage both liquid and pension savings, while not adding significantly to Exchequer tax relief costs.

Box 3.A: International examples

US 401(k) defined contribution schemes offered by employers are one of the most frequently cited examples of flexible access to pension savings. Core features include:

- employees can take out loans from their pension scheme and withdrawals are available in certain cases of hardship at the provider's discretion;[7]
- loans are limited to no more than 50 per cent of a pension pot or $50,000 (whichever is the lower), with interest charged and a maximum loan repayment period of 5 years;
- tax penalties apply to both permanent withdrawals and non-repayment of loans;
- 401(k) schemes have a take up of around 75 per cent among employees;
- in 2008, 18 per cent of all employees eligible for a loan had taken out the option, falling to 12 per cent for those with account balances of less than $10,000;
- the average outstanding loan amount was $7,191, and the median $3,889.[8]

One early study of 401(k) schemes showed employee participation to be around 6 per cent higher, and contribution levels up to 35 per cent greater, in schemes that offered a loan option compared to similar plans without a loan option.[9] But recent studies of 401(k) schemes have suggested more limited effects.[10]

New Zealand's KiwiSaver was introduced in 2007, and included several early access features:

- it allows permanent withdrawals for limited, defined reasons: buying a first home, serious illness, significant financial hardship, or permanent emigration;
- there is no repayment facility, and no limit on the amount that can be accessed;
- in 2008/09, 139 individuals applied for withdrawal on basis of hardship, of which only 10 were accepted.

In a 2008 survey, 10 per cent of joiners and 16 per cent of those considering joining cited the withdrawal options as a reason. However, due to the limited data, it is hard to tell what effect on overall saving or participation levels a permanent withdrawal option may have, and translating this to the UK is difficult as New Zealand has a very different state and private pensions system.[11]

[5] This type of feeder-fund design is set out by the PPI in 'Would allowing early access to pension savings increase retirement incomes?'

[6] For example, Michael Johnson, 'Simplification is the key' (Centre for Policy Studies, June 2010); Investment Life Assurance Group (ILAG), 'From Cradle to Cradle: A review of incentives to save for retirement' (April 2010); and the PPI (reference as above). PPI modelling suggests final funds sizes of existing savers could vary from a 16 per cent decrease to a 7 per cent increase with a feeder fund model.

[7] Withdrawals can be provided where an immediate, severe financial need arises and money cannot be provided from other sources, including any loan entitlement from their plan. Valid purposes for withdrawals are primary home purchase, higher education costs, to prevent eviction or home repossession, severe financial hardship, or medical expenses. There are also several non-financial reasons where withdrawals can be allowed.

[8] Employee Benefit Research Institute, 'Issue Brief 335: 401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2008' (October 2009).

[9] US GAO, 401(k) Pensions Plans Report, October 1997.

[10] Mitchell, Utkus and Yang (2005) found no difference in participation rates between plans with and without the loan, although they did find that a loan option increased plan contributions by 10 per cent (NBER, 'Turning Workers Into Savers?: Incentives, Liquidity, and Choice in 401(k) Plan Design').

[11] All figures from New Zealand Inland Revenue KiwiSaver reports: http://www.ird.govt.nz/aboutir/reports/research/report-ks

Views on the respective models

3.15 While the Government is aware of industry efforts to establish better evidence in this area, it appears that the visibility, appetite for and understanding of any of these early access options by individuals is still relatively untested. Although a recent ABI survey specifically asked respondents about the type of access they would opt to have if they did have an option to use their pension funds in a financial emergency, the single most popular answer was to still not be allowed to access pension funds (28 per cent). Early access to the 25 per cent tax-free lump sum was the next most popular response (21 per cent), while a loan option was least popular among respondents (5 per cent).[12]

3.16 The Government seeks evidence and analysis from interested parties on the relative merits, perceived issues and risks of each of these options, and in particular on the following questions:

- What are the relative merits of the early access models outlined above, or any alterative options the Government should consider?
- What evidence is there of the likely impact on individuals' participation and level of pension saving, and broader outcomes in retirement of any given option?
- What would the key costs and potential burdens be of providing any of these early access options on individuals, pension providers, or schemes (including if limited to cases of hardship)?

[12] ABI, 'Customer attitudes towards pensions' research brief, July 2010.

4 Wider pensions tax rules and early access

Related issues around flexible access to pension savings

4.1 For any consideration of early access there are a number of wider issues that would need to be addressed. One issue is whether early access should be limited to defined contribution (DC) schemes, including money purchase schemes, which would be easiest to implement but would limit the potential impact; or extended to defined benefit (DB) schemes, which would raise a number of complex issues. These would include the valuing of defined benefit rights of individuals, the problem of allowing withdrawals from pooled pension funds, and the risks to unfunded (or under-funded) schemes, both in the public and private sector.

4.2 Early access would also increase financial choices available to individuals. While the Government is keen to encourage choice and flexibility, it is also aware that some individuals may not fully understand the consequences of their decisions at the time they make them. Critically, they must realise the potential effect early access may have on their final retirement income. We therefore welcome views, supported by any relevant evidence, on the following:

- Could early access be offered by defined benefit schemes, and what would the main barriers or implications be for schemes, employers, and members?
- What are the potential implications for consumer advice and ensuring individuals understand the tradeoffs around early access?

Trivial commutation and small pension funds

4.3 While considering the potential for allowing early access to pensions, the Government is also keen to consider any further measures that may improve the simplicity and flexibility of pensions tax rules, while not creating fiscal risk to the Exchequer. In particular, there have been calls for changes to give more flexibility to individuals with small pension pots.

4.4 The main existing easement for those with small levels of total pension savings is trivial commutation, which allows an individual who is aged 60 or above with total pensions savings of less than £18,000 to withdraw their pension savings as a lump sum.[1] In addition to the general triviality limit, small occupational pension pots under £2,000 can also be taken as a lump sum, even where individuals have other pension savings in excess of the aggregate limit.

4.5 It has been argued that the £2,000 individual allowance for occupational schemes should be extended to personal pensions, in order to ensure equal treatment between different types of pension. Although this was considered when the previous easement was introduced in 2008, it was felt that a similar allowance for personal pensions posed a significant fiscal risk, since products could be designed to gain tax advantages by purposefully fragmenting funds.

[1] The first 25 per cent of this lump sum is tax-free, with the remainder taxable as income. An individual must commute all their pots within a 12-month period. Trivial commutation was previously defined as 1 per cent of the lifetime allowance (LTA). However, once the LTA is lowered to £1.5m in 2012 as part of the pensions tax relief restriction reforms, the triviality limit will be maintained at £18,000 to ensure that holders of small pension pots are not disadvantaged. This effectively decouples the trivial commutation threshold from the LTA. See paragraph B.13 in the summary of responses to the discussion document *Restricting Pensions Tax Relief*: http://www.hm-treasury.gov.uk/consult_pensionsrelief.htm. Legislation to remove the effective requirement to annuitise by age 75 from April 2011 will also abolish the upper age limit of 75 for trivial commutation.

4.6 Similarly, the Government is aware that there can be issues in achieving value for money annuities where individuals have several small pots. This can be an issue where individuals are above the triviality limit (for example, where an individual has a larger DB pot and smaller DC provision), or have already taken trivial commutation and later discover a further pension pot after the statutory time limit of twelve months for commutation is reached. Previous proposals to the Government have included the suggestion that couples could be allowed to pool small pension pots.

4.7 One of the reasons individuals end up with several small pension pots is that they lose track of funds when they move employer. Nearly 70 per cent of those using the Pensions Tracing Service stated they had lost touch with their pension(s) due to moving on from a previous employer. DWP have carried out some research into the issues of tracing 'lost' pension pots, and found that 19 per cent of pension trace requests result in confirmed eligibility to either a weekly pension or a lump sum payment. The median value of average weekly payment was £16 and the average median lump sum payment was £1,900 from these previously 'lost' pensions.[2]

4.8 There can also be barriers to the transfer and amalgamation of pension funds in some instances, especially with small occupational pots. The independent review into 'Making Automatic Enrolment Work,' highlighted that on average an individual has 11 different employers over their lifetime, and recommended that the Government should examine whether more can be done to make pension transfers easier for individuals moving employers.[3]

4.9 The Government is keen to consider proposals from interested parties on any of the above issues, in order to improve the accessibility of individual's pension savings and improve the choices available to them. However such proposals would need to meet the same broad principles relating to fiscal risks and burdens as outlined earlier (in Chapter 2):

- any change to pensions tax rules should be affordable, sustainable and maximise the value for money of Exchequer tax relief;
- any change should not create opportunities for tax avoidance;
- any changes to the tax rules should not add undue complexity or place disproportionate burdens on individuals, providers, schemes, or HMRC.

4.10 Subject to these principles, the Government welcomes evidence on the following two questions:

- **Is there a case for introducing further flexibility in the trivial commutation rules?**
- **What are the key barriers to transfer of small pots and are there any proposals from industry, consumer bodies or other interested parties as to how small pot transfers could be better facilitated**?

[2] Figures from DWP Report 697, 'The Pension Tracing Service: A quantitative research study to establish who is using the service, and their outcomes': http://research.dwp.gov.uk/asd/asd5/rports2009-2010/rrep697.pdf

[3] A Review for the Department for Work and Pensions, 'Making Automatic Enrolment Work': http://www.dwp.gov.uk/policy/pensions-reform/workplace-pension-reforms/automatic-enrolment/index.shtml

5 How to respond

How to respond

5.1 Responses to this call for evidence document should be received by **Friday 25 February 2011.** Please address written responses to: Early access to pension savings, Pensions & Pensioners Team, Room 2/S1, HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ.

5.2 Alternatively, responses can be e-mailed to: earlyaccess@hmtreasury.gsi.gov.uk.

5.3 Interested parties should respond with any evidence or research they have in relation to the key questions raise in this document. To help the Government evaluate responses, it would be helpful if respondents could explain their interest in the discussion and also make clear if their response is being made on behalf of a group or representative body. In the case of representative bodies, please provide information on the number and nature of the people you represent.

5.4 All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations. Responses will be primarily for internal use by HM Treasury, but may also be shared with HM Revenue and Customs and the Department for Work and Pensions.

Next Steps

5.5 The Government will carefully evaluate submissions received in response to this call for evidence. Based on this, the Government will consider whether any further work will be undertaken in this area as part of the Budget process.

Confidentiality

5.6 Information provided in response to this discussion document, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

5.7 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, among other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury or HM Revenue and Customs.

5.8 HM Treasury and HM Revenue and Customs will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

A Summary of questions for interested parties

A.1 A summary of the questions on which evidence is welcome from interested parties, as set out throughout this document, are as follows:

Q1. Is early access likely to have a net positive effect on retirement outcomes for individuals?

Q2. Would early access have particular benefits or risks for traditional groups who under-save, including those on low incomes?

Q3. Would allowing early access to pension savings in situations of acute hardship, for example where individuals face repossession of their home, help a significant proportion of people in such circumstances?

Q4. Is there an argument for early access as a way of promoting intergenerational redistribution of pensions wealth in cases where a pension saver's relatives face specific financial difficulties?

Q5. Would this create more risks for an individual's income in retirement?

Q6. What are the relative merits of the early access models outlined in Chapter 3, or any alterative options the Government should consider?

Q7. What evidence is there of the likely impact on individuals' participation and level of pension saving, and broader outcomes in retirement of any given option?

Q8. What would the key costs and potential burdens be of providing any of these early access options on individuals, pension providers or schemes (including if limited to cases of hardship)?

Q9. Could early access be offered by defined benefit schemes, and what would the main barriers or implications be for schemes, employers, and members?

Q10. What are the potential implications for consumer advice and ensuring individuals understand the tradeoffs around early access?

Q11. Is there a case for introducing further flexibility in the trivial commutation rules?

Q12. What are the key barriers to transfer of small pots and are there any proposals from industry, consumer bodies or other interested parties as to how small pot transfers could be better facilitated?

HM Treasury contacts

This document can be found in full on our website at:
hm-treasury.gov.uk

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