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UK

Volume 2018 | Issue 44 | 7 August 2018

Treasury Committee Report on Household Finances

The House of Commons Treasury Committee has published a report on household finances which looks at income, savings and debt.

This influential cross party committee has recommended a number of changes and has not held back from making some controversial recommendations.

Many of the recommendations relate to the taxation of pension contributions, namely replacing the lifetime allowance with a lower annual allowance, introducing a flat rate of tax relief, and promoting the understanding of tax relief as a bonus or additional contribution.

The Committee is also recommending abolishing the recently introduced Lifetime ISA (LISA) due to the complexity of the product, but did recognise the benefits of incentivising short-term saving to improve the stability of household finances and expressed interest in whether this should be brought into the pension auto-enrolment system.

The Financial Conduct Authority (FCA), having imposed a cost cap on high cost short-term credit, including payday loans, is encouraged to move forward with its further proposals on consumer lending, including overdraft fees. The FCA is also encouraged to reconsider whether to impose a wider cap on high cost credit, and compulsory restrictions on unsolicited credit limit increases.

The Government is criticised for the current free-to-client provision of debt advice and urged to make more money available.

Whilst automatic enrolment is seen as a success, the Government is urged to extend it to the self-employed, and to start considering options for raising contribution rates still further beyond the 8% contribution rate which will be reached next April.

The State Pension triple lock is seen to be "clearly unsustainable" and the Government is urged to explore alternatives.

Background

The Treasury Committee is a cross party committee appointed by the House of Commons to examine the expenditure, administration, and policy of HM Treasury, HM Revenue and Customs and associated public bodies. Whilst the Government is not obliged to follow its recommendations it is an influential committee.

The Committee's inquiry into household finances had a broad frame of reference covering all aspects of household finances and was conducted against a number of headwinds which were putting the sustainability of household finances under pressure.

The Committee concluded that the overall responsibility for improving levels of household net savings sits more appropriately with the Government and HM Treasury than the financial regulators, because they have a broader remit and a wider range of policy objectives and tools.

Over-Indebtedness

The figures show that one million people have struggled with debt persistently over eight years and the problems of insecurity and indebtedness are getting worse rather than better. The UK is accused of lacking any robust system for monitoring problem debt and having no coherent cross government policy for tackling the issue.

The introduction of the short-term credit cap in 2014 was a reaction to payday lending in particular. However, the UK is now seeing more indebtedness involving utility bills and council tax. Accordingly, the Committee urges the Government to deal with this by improving practices around the collection of arrears to public authorities (non-credit debt). It criticises the collection of such debts, saying they are often pursued over zealously and with routine recourse to bailiffs.

The transferring of the regulation of consumer credit to the FCA in 2014, allowed the FCA to deal with the short-term loan issue and other such matters. Further studies by the FCA have shown there are issues with price controls on overdrafts and rent-to-own and the FCA has been urged to include a cap on all forms of high-cost credit, including doorstop lending and unsolicited credit limit increase on credit cards. The voluntary agreement brokered by the FCA with the industry is seen as insufficient. The Committee urges the FCA to move forward with its further proposals on consumer lending, including overdraft fees. The FCA is also encouraged to reconsider whether to impose a wider cap on high cost credit, and compulsory restrictions on unsolicited credit limit increases.

Debt advice

The Money Advice Service (MAS) provides financial support for free-to-client debt advice. It spent £49m on debt advice in 2016/17. However, demand outstrips supply and resources are overstretched. The Government is urged, in consultations over MAS's successor, the Single Financial Guidance Body (SFGB), to consider how resources available for advice can be increased. It should also extend the debt advice to non-credit arrears.

Saving for Retirement

Automatic enrolment

The Committee agreed that the UK has a low State Pension by the standards of other advanced economies. There is thus a need to rely on private savings to bolster incomes in retirement. A review in 2017 reported 12 million people in the UK are currently not saving enough for their retirement (38% of those aged between 22 and State Pension age). Whilst automatic enrolment had made a difference and the focus was currently on the smooth implementation of the 8% rate in April next year, further reforms will be necessary to ensure households have sufficient income in retirement. The Committee was concerned at the apparent lack of a future plan. The Government is urged to extend automatic enrolment to the self-employed, and to start considering options for raising contribution rates still further beyond the 8% contribution rate which will be reached next April.

Tax relief on pension contributions

The main financial incentive the Government provides for long term saving is tax relief on pension contributions which is recognised as being complex, poorly understood and poorly targeted. In 2016/17, the cost to the taxpayer of income tax and NIC relief on pensions was around £41bn.

The tax relief offered in recent years has also become significantly less generous with the annual allowance currently £40,000 (£225,000 in 2010/11). The lifetime allowance is now £1.03m (£1.8m in 2010/11). Additionally, the annual allowance has been tapered for high earners since 2016 and the money purchase annual allowance introduced alongside pensions freedoms.

The Government is urged by the Committee to revisit the idea of making fundamental changes to the tax system. In the short term, the Government is asked to seriously consider:

1. removing the lifetime allowance and further reducing the existing annual allowance;
2. introducing a flat rate of tax relief; and
3. promoting the understanding of tax relief as a bonus or additional contribution.

The Lifetime ISA

The Budget of 2016 saw the introduction of the Lifetime ISA. It is a combination of a long-term pensions saving vehicle and the Right to Buy ISA. It allows participants to save up to £4,000 each year until they are aged 50, in stocks and shares or cash. The Government awards a 25% bonus each year. The money can be withdrawn free of charge for the purposes of buying a first home (under £450,000) or after age 60. If it is withdrawn in other circumstances there is a tax charge of 25% on the whole investment.

It has been criticised for muddling house buying with pensions and for being too complex. It is yet to prove popular and the Committee recommends its abolition after only 16 months.

Planning for Retirement

Advice, guidance and consumer engagement

The Committee noted that the present level of many people’s engagement with, and understanding of, the retirement choices available to them is inadequate. Ways in which this might be improved include encouraging more people to take up the advice or guidance on offer, and introducing a strong form of default guidance or default pathways to ensure that people do not make poor choices in retirement.

The Committee recommends that Government should work with the new Single Financial Guidance Body (SFGB) to consider how a mid-life MOT could be introduced, and that the Government should make a cross-departmental effort to identify opportunities to “nudge” people towards pension guidance at life events where they interact with the public sector.

State Pension

The triple lock

The triple lock which raises the State Pension annually by the higher of either CPI price inflation, average earnings growth, or 2.5%, was implemented in 2012 and has remained in place ever since. With low earnings growth, State Pension has increased sharply against earnings. The Government is committed to maintaining the triple lock to the end of this parliament. The Committee has concluded that in the long term it is clearly unsustainable and that the next automatic enrolment review should explore options for replacing it.

Comment

The Committee Report confirms three big themes that we have seen developing over recent years.

Firstly, the Government continues to have doubts over the cost, distribution and effectiveness of pension tax relief. The Lifetime ISA may not prove to be part of the long term answer but future change seems inevitable, albeit with the strong caveat that Brexit issues are likely to dominate the political timetable for the foreseeable future and the Government's small majority makes bold legislation difficult. Nevertheless, we expect the restrictions on high earners to continue and trustees and employers should review how they manage the impact of this.

Another theme is the growing need to support people in making financial decisions about their retirement. Retirement flexibilities have given people more complex decisions to make about their DC pensions, and this is often further complicated by having DB pensions and other assets to take into consideration. Access to advice and guidance can be difficult and we are seeing trustees and employers looking to improve the support they provide in this area.

Finally, there is a growing awareness of financial wellbeing and recognition that managing problem debt and saving for the short term is just as important as saving for the long term. This is becoming a workplace focus as well as a political one and there are a range of actions that employers can take to tackle some of the concerns raised by the Committee.

In summary, the Committee report provides a succinct overview of the drivers of household finances and some indications on where the focus may be for future changes in pensions and savings policy. As such it is recommended background reading for all employers and trustees, particularly those who may be reviewing pension scheme design or strategy in the foreseeable future.

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