Pensions Policy Institute

PPI

Increasing the value of saving in Personal Accounts:

rewarding modest amounts of pension saving

A PPI paper commissioned by B&CE

Executive summary

Summary of conclusions

The Government is proposing to auto enrol most employees into saving in a pension from 2012. Although the principle of auto enrolment has been broadly supported, some stakeholders have expressed concerns about the suitability of pension saving for some employees who will be auto enrolled.

B&CE Benefit Schemes has commissioned the Pensions Policy Institute to provide an independent assessment of one option for increasing the suitability of pension saving: the introduction of a 'pension income disregard'. This would allow individuals to have a limited amount of private pension income, without it affecting their entitlement to means-tested benefits in retirement. There was a pension income disregard in National Assistance when it was introduced in 1948, and it remained until 1980, so it is not an entirely new idea.

A pension income disregard could remove a discrepancy between the treatment of private pension saving and other forms of saving. Currently, the first £6,000 of 'capital' (such as saving in a bank account or ISA) is disregarded in the calculation of entitlement to means-tested benefits. In contrast, currently, all private pension income is taken into account.

This paper analyses a pension income disregard set at £12 a week. This would mean that a single person could have at least £6,000 in pension saving before it begins to reduce their entitlement to means-tested benefits. A pension income disregard set at this level would therefore be at least as generous as the existing disregard for saving in a bank account or ISA. However, there are choices for how a pension income disregard would work in practice. As well as the level of the disregard, there are options for how it interacts with Savings Credit and the existing disregard for capital, how it is uprated and its treatment of any income that results from contracting-out of the State Second Pension.

Returns from saving in Personal Accounts
People will have different returns from saving in Personal Accounts, depending on how they are affected by the state pension, tax and means-tested benefit systems. Some people might have relatively high returns, such as people in their twenties in 2012 with full working and saving histories, or older people if they already have some retirement saving.

It is not possible to say whether a given level of return is 'good enough' to make saving in Personal Accounts a suitable choice for any particular individual. This is because other factors could be relevant, such as the affordability of pension contributions, the extent of personal debt and individuals' preferences for smoothing consumption over the lifetime. However, some people could receive lower returns from their saving than others, and so be at higher risk of Personal Accounts being unsuitable.

The pension income disregard could increase the returns for people who would otherwise be at risk of lower returns, including:

- People with low earnings and broken working histories.
- Today's older people with low earnings and no prior savings.
- The self-employed.
- People who rent accommodation in retirement.

People who plan to rent accommodation in retirement could be at high risk of Personal Accounts being unsuitable for them, meaning that they might not receive back at least the value of their own contributions. This is because they could see significant reductions in their entitlements to Housing Benefit as a consequence of saving. Currently, around 20% of pensioner households are eligible for Housing Benefit. This level could reduce in future, if the number of pensioners who own their own homes continues to increase, although long-term trends are uncertain.

None of the individuals analysed would be in the high-risk group if the pension income disregard were introduced, meaning they are all likely to receive back at least the value of their own contributions. This could mean that generic advice can be clearer about the value of pension saving.

Government expenditure

A pension income disregard set at £12 a week could increase Government expenditure on means-tested benefits for pensioners by around £600m in 2012, from a projected £14.6bn without reform to £15.2bn with the pension income disregard, an increase of 4%.

Preliminary analysis suggests that the costs could remain relatively stable over the long term, relative to average earnings. If the policy enabled a clear message to be given about the value of saving in a pension, and the amount of pension saving increased as a result, this might tend to reduce Government expenditure on means-tested benefits in the long term.

The reforms could be paid for by increasing taxation, diverting state spending from other areas, or by making other changes to means-tested benefits. The reforms would not remove the need for Savings Credit altogether but could reduce the amount that Savings Credit needs to do to incentivise pension saving. One option for paying for the reforms is to make Savings Credit less generous by increasing its withdrawal taper from the current 40%. This option, however, would need to be analysed carefully in terms of the winners and losers relative to the current system.

The disregard could also increase the proportion of pensioners eligible for Pension Credit in 2012 by less than 5% from its projected level without reform of around 45%. A series of trade-offs therefore have to be made, including a trade-off between improving the suitability of pension saving and cost. The design of the disregard would affect its cost and benefits, so more research would be needed if the reform were to be taken forward.