# Strengthening the incentive to save: a consultation on pensions tax relief

Citizens Advice response

# Executive Summary

We welcome the government's decision to review tax relief on pensions and we support the principle of sustainability at the heart of the consultation. National finances will be more secure if people save enough in private pensions because fewer people will need means-tested support in retirement.

We also support the government's openness to radical reform of the system, but believe that changes should only be made if underpinned by long-term consensus with clear principles and objectives around consumer outcomes. We do not believe that reform of tax relief alone will achieve the best consumer saving outcomes. The work of the last 10-15 years has shown that the key is to establish new behavioural norms and auto-enrolment has shown that nudge-style approaches can be very powerful. So it is important that changes to financial incentives are carefully designed to encourage people to save beyond auto-enrolment levels. The government should seek to define what constitutes an 'adequate' saving for retirement income and then look more widely at how it can help more people achieve this, ensuring any government spending is targeted to maximise its cost-effectiveness.

We believe that the current system of exempt-exempt-taxed (EET) offers the best long-term results for individuals and the state. During accumulation, it offers a tangible reward for putting money aside and during decumulation it offers a healthy deterrent from withdrawing all savings at once. The alternative tax-exempt-exempt (TEE) proposal lacks these benefits and would complicate the system for many. It would mean that state and private pensions had different tax treatment and could create intergenerational imbalances if people don't pay any tax on their income in retirement.

However, we believe that the design of the current TEE system needs reform. Currently it mainly offers incentives for higher rate taxpayers and gives a large public subsidy for a minority of people who make pension savings well beyond a simply 'adequate' level.[1] The focus of reform should be to encourage more people to save for an adequate income in retirement.

Moving to a flat rate tax relief of, say, 33% would be an improvement on the current system. It would increase rewards for basic rate taxpayers while ensuring that higher rate earners are not taxed more for paying into pensions than taking money up front as income. However, we question how much this reform would in itself drive changes in behaviour to deliver genuinely adequate incomes in retirement.

Long-term reform should consider more ambitious options and a focus on adequacy in saving leads to two major questions. First, is enough being done to encourage

[1] The PPI estimated in 2013 that basic rate taxpayers pay 50% of pension contributions but receive only 30% of tax relief, while additional rate taxpayers make 10% of contributions and receive 20% of relief. See PPI, 'Tax relief for pension saving in the UK', 2013.

people to move beyond auto-enrolment levels? And second, is enough being done to encourage those not eligible for auto-enrolment to save? Hard-working self-employed people, part-time workers and carers all lack access to the new system and are not adequately encouraged to save. We know for example that just 2.2% of tax relief on contributions go to the self-employed, even though they represent 15% of the workforce.[2]

These questions should be placed at the heart of further analysis and discussion. We recommend that the government considers a more generous incentive to encourage people to move towards minimal 'adequate' savings. It could use tax relief to extend the 'incentive zone' so people move beyond existing auto-enrolment contributions.

For example, it could offer a £1 match for every £1 put in (i.e. 50% tax relief) on contributions up to 1% above auto-enrolment levels. This would offer an incentive for employees with auto-enrolment to increase their contributions beyond the minimum, such as from a total of 8% to 10%. It would also give the self-employed and part-time workers a 'kick start' to a savings habit and reward carers for continuing pension saving when they return to work.

We make the following recommendations:

- **The fundamental approach of the current EET system should be preserved** but can be better focused to improve its incentive effects.
- **A flat rate (of 33% for example) would be a modest improvement.** It would increase returns for basic rate taxpayers saving into a pension and would create a simpler system with a common rate of relief.
- **However, a more ambitious approach should be taken** to ensure that tax relief offers people more incentive save for an adequate income. We suggest the government should **use tax relief to extend the 1:1 matching zone to encourage people to move beyond their existing auto-enrolment contributions.**
- **The language around tax relief should be made clearer** - any new system should be branded as a '**matching contribution' or 'government pension bonus**' rather than being known as tax relief. If it is not easily understood, changes to tax relief will have limited effect. The government and industry should also **help people understand how much they need to save**, either through a dashboard system or prominent rules of thumb.
- **The government should seek to build consensus on purpose of tax relief and incentives for retirement saving** to achieve lasting and sustainable reform. This could be used to set a reasonable level for annual and lifetime allowances to allow people to plan with more confidence.

[2] They get £600m out of a total £27bn on private pension contributions. ONS Personal Pensions Statistics, p.25, September 2015.

# Introduction

Citizens Advice is a national charity which delivers advice services from over 3,300 community locations in England and Wales, run by 338 registered local charities. We are helping more and more people to make informed decisions about their pensions. Last year over 310,000 people sought help from us with their pension, up from 220,000 in 2013/14. We have a good understanding of how consumers think about pensions, both through our Citizens Advice service and through delivery of face to face Pension Wise sessions, which began in April 2015.

As a charity we seek to empower people to help them make the best choices for their own lives. We begin this response by setting out our overall view on pension tax relief reform and then answer the specific questions in the consultation paper.

## Objectives for pensions, tax relief and incentives

We support the four principles set out in the 'Principles for reform' section of the consultation paper but consider them necessary but not sufficient. To produce a sustainable policy we think the government must set out and build a lasting consensus around the *objectives* for the system of pensions tax relief and incentives.

We believe the overarching objectives to guide the policy should be:

- To provide people with **strong incentives** and rewards for making **adequate** provision for their retirement.
- To ensure that above this 'adequacy' level, people do not face disincentives to put money aside for retirement.

These objectives go with the grain of the current system but by stating them formally and reaching agreement on how 'adequate' should be defined, the objectives could provide an enduring framework for tax relief and incentives. Defining the objectives also helps to illuminate areas where the current system is not working or is questionable such as:

- **Encouraging people in auto-enrolment to increase their contributions.** As noted in the consultation paper, most people need contributions totalling well over 8% to have a good chance of achieving a reasonable target replacement income in retirement. Yet the incentive to contribute above this level is not strong. For most people in this group the main effect of the current tax relief system is simply to avoid double taxation.The main incentive element is the 25% tax free lump sum, which we estimate as equivalent to a top-up of 6p for each £1 saved. We think a stronger (and better presented) incentive is needed.
- **Encouraging people not eligible for auto-enrolment to start saving.** Incentives are much weaker for groups such as the self-employed and those

(mainly women) at home caring for young children and disabled people who do not benefit from employer contributions. We think it is important that all those who are contributing to society and doing the right thing should have strong incentives and rewards for making adequate retirement provision.
- **Achieving value for money.** At the other end of the scale, even the reduced lifetime limit of £1 million from next April means that people are able to make tax privileged provision for retirement incomes that could be worth around £50,000 a year. Given the need to provide better incentives lower down the income scale we can see a case for setting a lower limit so money can be redirected to where incentives are most needed.

Any reform of the system will need to be phased in over a period of time. It will be important to protect existing accrued rights and legitimate expectations, and to avoid sudden shocks to the funding of defined benefit (DB) schemes. A lasting set of objectives and principles, around which a consensus can be built, will be important to stop the policy being re-invented before it is fully phased in.

### The current EET system

It is vital that people who save for a reasonable level of retirement provision do not face double taxation (both at the point of earning and at the point of drawing on their savings) that deters them from saving. The current system achieves this by allowing contributions from earnings before tax, and then making pension withdrawals subject to tax. An ISA- style "TEE" model could also achieve the goal of avoiding double taxation. Either system can then have incentives (beyond avoiding double taxation) built in.

The current EET system has a number of advantages:

- It applies taxation when money is withdrawn which creates a healthy incentive to spread a retirement pot over a reasonable period of time, reducing the risk that people run out of funds too early in (or even before) retirement.
- It allows tax relief at the point contributions are made which gives greater confidence by creating property rights for the individual. In contrast, a TEE system would rely more heavily on a belief that future governments (perhaps 50-60 years ahead) would not change or restrict the tax relief in retirement.
- The receipt of tax relief at the point of making contributions is likely to be perceived as a more immediate and tangible reward when compared to the promise of favourable tax treatment many years later.
- Many people are encouraged to save because they expect to pay a lower marginal rate of tax in retirement than they do in work. However, moving to a TEE system would create the opposite risk - people may have paid income tax on their earnings and then not benefit from the tax exemption in retirement as they are below the relevant tax threshold.
- Making the tax assessment at the point the person is receiving the income (in retirement), rather than when it is generated (when earning), means it is more

related to an individual's *current* financial circumstances. This creates an important incentive for people to smooth their lifetime income.
- The system is well understood and embedded into industry systems.

### Moving to a TEE system

Moving to an ISA-style model does have some potential attractions. In some respects (when fully implemented) it might simplify the landscape for savers. For example, it may be easier for people to compare ISA and pension vehicles. It would also allow post-55 withdrawals to be made without regard to the tax system. Overall, however, we are far from convinced about the benefits of moving to a TEE system and highlight the following concerns about such a move:

- It would involve the loss of six key advantages of EET listed above.
- It would involve a complex transition which would be difficult for customers and industry. Either there would be two or three generations of people who would have rights under different regimes, or some crystallisation of existing rights would have to be implemented which itself would be hard for many people to understand.
- At a broader level, the UK already has a substantial weight of unfunded pension promises, both through the State pension and some public sector pensions. Moving to a TEE system would add further to these liabilities (unless the government established a ring-fenced investment fund to provide for the costs of the promised future tax relief).
- By foregoing the right to tax private pensions in the future, the government could undermine confidence in future public finances.
- The intergenerational fairness of our future society would become increasingly questionable. It is hard to see that a model where pensioners paid little or no income tax while the working population picked up the bill would be sustainable.

We therefore think the overall EET system should be preserved to avoid double taxation but we believe it can be reformed to improve the effectiveness and fairness of the incentives it offers. We say more about this on page 6 under 'How EET could be improved'.

### Waste in the current system of tax relief

As well as avoiding double taxation, pension tax relief should incentivise and reward people to save for a reasonable retirement income. Its design should seek a balance between ensuring people save enough for an adequate income while also ensuring that money isn't wasted on incentives for those who don't need them.

We think that more could be done to encourage basic rate taxpayers (and non taxpayers) to contribute to their pensions. An improved system would reduce deadweight costs of tax relief for people who would be saving the same amount into

pensions even with lower levels of tax relief. The current system provides a number of financial incentives, but not all are widely understood or well targeted:

Box 1: Current pensions tax relief

- Allowing investment returns on pensions to grow free of tax is an important but little understood incentive and reward (compared to normal taxable savings and investments.) This is valued at £7.3 bn in the HMRC PEN 6 table and a comparable benefit is enjoyed by ISAs.
- Allowing up to 25% of pension rights to be taken as a tax free lump sum is a further reward. This is much better known and more often mentioned by individuals as an advantage of saving in a pension.
- Allowing relief on employer NI contributions in respect of pension contributions (valued at £14 bn in the HMRC table.) Although almost all pension contributors (and/or their employers) benefit from this, it is little understood by the general public. Since NI contributions are not payable on pensions in retirement, there is no 'double taxation' reason for giving relief on contributions. We think some of this money could be better targeted to improve incentives where they matter most.
- As noted above, there is arguably a further reward for those who pay tax at a higher rate when earning but not in retirement.

We think the government would facilitate informed public debate if it published full modelling and analyses of how the value of each of these elements is distributed across the income distribution, both at the point of contribution and during the period benefits are taken. A breakdown of these results between DB and DC pensions would also help illuminate the discussion.

### How EET could be improved: Incentivising and rewarding pension saving

In the absence of such data, we support moves which target incentives more effectively at people who need them. We see two main options here:

- A flat rate level of pensions tax relief.
- A stronger incentive to encourage people currently undersaving to put money aside.

### A flat rate level of pensions tax relief

Moving to a flat rate of tax relief - say 33% - would simplify the system by giving everyone the same rate of relief and would increase the incentives for basic rate taxpayers to save.

A 33% relief would give a message that for every £1 people put in, they get a 50p top up from the government (making their pound worth £1.27 if basic rate tax is payable on 75% of their pot in retirement). This level of support is attractive from a communications perspective, which is important because tax relief needs to be understood by individuals if it is to have an effect on their saving habits. It is also

attractive because it means that basic rate taxpayers would effectively receive tax and National Insurance (NI) relief, which they currently pay at a marginal rate of 32%.

This would be an improvement on the current position where basic rate taxpayers get a 25p top up from the taxpayer (making their pound worth £1.06 if basic rate tax is payable on 75% of their pot in retirement.) Higher rate taxpayers will lose some tax relief, but will still find it more tax efficient to save into pensions than into ISAs or other mainstream investment products.

We believe a flat-rate approach deserves serious consideration and would be preferable to the current situation. But it poses two big questions:

- Is the boost to the financial incentive for basic rate taxpayers enough to make a real difference to their savings behaviour?
- Could targeting of the incentive be further improved so that it focuses more directly on particular groups who need to save more, rather than on the whole tax-paying population?

We therefore put forward an alternative idea below which seeks to create a more powerful incentive and to focus it on those who most need to save more.

### Stronger incentives

An alternative approach could seek to make savings in areas where reliefs are least needed (see Box 2) and use these savings to create new incentives where they matter more. These could focus on specific aims such as:

- To encourage people in auto-enrolment to increase their contributions above the standard minimum, which we know is unlikely to be enough for a comfortable retirement for most people.
- To improve the pension position of some groups who do not qualify for auto-enrolment including: the self-employed, people working multiple part-time jobs and carers. This has important equality implications. We know, for example, that women in work are twice as likely as men to be ineligible for auto-enrolment.[3] Stronger incentive payments could help compensate for the lack of employer contributions these people have access to. Our analysis suggests that just 2.2% of tax relief spending on pension contributions goes to the self-employed, even though they comprise 15% of the workforce.[4]

As an illustration, these new incentives could be designed to extend the 'pound for pound matching' offered for employee pension contributions. Once auto-enrolment is fully implemented, employees contributing up to 4% will enjoy pound for pound matching from a combination of their employer and the government. But beyond 4%

[3] The Pensions Policy Institute, 'Who is eligible for automatic enrolment?', September 2015.
[4] In 2013/14, £600 million was spent of tax relief on pension contributions by self-employed people, out of a total of £27 billion. ONS Personal Pensions Statistics, p.25, September 2015.

contribution matching currently drops by three quarters from from £1 for £1 (from employer and government) in auto-enrolment to 25p for £1 (from government).

A first aim for the new incentives could be to extend this zone of pound for pound matching to contributions up to 5% (by the government contributing a further 1% of pay when the employee does so.) This might then make it possible to increase the standard auto-enrolment contribution rate from a total of 8% to 10%, helping to increase future private pension incomes by a quarter.

A number of detailed design issues would need to be worked through, such as whether the extra incentives are delivered through the tax relief system or as a separately identified 'Government pension contribution.' So these examples are simply presented as a basis for discussion: more detail is provided in Annex A at the end of this response.

Box 2: where savings could be found

Clearly any new incentive payments will need to be funded from savings elsewhere in the pension tax relief system. We believe a number of areas of the system should be looked at against two criteria:

- are the incentives offered by the reliefs actually leading to people saving more, or would they be saving anyway? (The deadweight test.)
- are the incentives focused on building an adequate retirement income, or do they reward provision well in excess of reasonable aspirations? ( The focus test.)

In applying the second test, there would be value in building a public consensus about the level up to which it is reasonable to actively subsidise pension provision.

With these tests in mind, we suggest that areas of the current system which may offer potential for savings include:

- Employer NIC relief on pension contributions. At a cost of over £14bn a year and with no limit (unlike tax relief) there must be a question about whether all of this spend is well focussed
- The 40% tax relief offered to higher earners. As noted above, even at 33% their pension saving would still be tax privileged
- The £1m lifetime limit which, though much reduced, can still entail the ordinary taxpayer subsidising those with much greater retirement wealth.

Changes to tax and NI relief will need to be managed carefully over a period of time since they are likely to affect costs for employers, the funding of DB pension schemes and the net pay of employees. It will be important to fully assess these and manage expectations over time. And in removing ill-targeted incentives it will be important not to create perverse effects (such as unwanted double taxation.) But by working with the current EET system, and having an enduring set of objectives it would be possible to gradually reshape the incentives within the system to achieve much better results.

## Behavioural incentives

Finally, it is important to stress that financial incentives are not, on their own, likely to dramatically affect savings habits for most people. Instead, the work of the last 10-15 years has shown that the key is to establish new behavioural norms and auto-enrolment has shown that nudge type approaches can be very powerful.

It is therefore vitally important that changes to financial incentives are viewed in the auto-enrolment context. They need to be carefully designed to address areas (exemplified above) where it is not currently possible to say that saving more through auto-enrolment is clearly the best course of action.

# Responses to Consultation Questions

### 1. To what extent does the complexity of the current system undermine the incentive for individuals to save into a pension?

Simplicity in the tax system has intrinsic benefits and can improve individuals' understanding of saving rewards, but is not necessarily the most important factor. The complexity of pension taxation is one of a number of features that can make pensions hard for individuals to understand. So although simplification is in itself a good thing, we do not believe – for the generality of people - that tax complexity significantly undermines the incentive to save. The work of the Pensions Commission and others has shown that deeper attitudinal and behavioural preferences are more important here. The introduction of auto-enrolment has so far proved very successful in addressing them.

Tax does play a part, especially to help people pay in, but other factors often override it. These include complexity of pension products, confusion around the distinction between state and private pensions, mistrust of the government and of pension providers. The government's priority here should be to improve confidence and understanding of the system. Rather than fundamentally changing the pension system again, other targets like increasing clarity of pension language and reaching long term consensus around principles behind tax relief, would be more beneficial.

We believe that allowing pension contributions to be made tax free is a simple incentive for people to save. It may also be perceived as a more immediate and tangible reward when compared to the promise of favourable tax treatment many years later. Moreover, our experience suggests that many people understand that they get a tax break on their contributions but aren't interested in whether they pay tax on gains during accumulation or income during decumulation.

There is also a risk that moving to a TEE system could leaving some people paying more and therefore reduce incentives. For example, people may have paid 20% income tax on their earnings and then not benefit from the tax exemption if their retirement income is below the personal allowance. A TEE system could include some government bonuses, but if these were linked to withdrawal dates they could increase complexity rather than reduce it.

We have not seen clear evidence that a move to a TEE system would improve incentives for people to save an adequate amount for retirement.

**2. Do respondents believe that a simpler system is likely to result in greater engagement with pension saving? If so, how could the system be simplified to strengthen the incentive for individuals to save into a pension?**

If more people can be brought within auto-enrolment, and build up more significant sums in pension savings, this is likely to increase their engagement and improve the probability of embedding the savings habit. This should be the priority for government.

We do not believe that re-engineering the whole system (by moving to an ISA model) shortly after auto-enrolling millions of people will make things simpler or promote greater engagement and saving. If anything it could deter engagement. It could create different systems of taxation both within people's private pension saving and between private and state pensions:

- If a shift to TEE was made without integrating existing rights, some consumers in 2100 would still be paying tax on some auto-enrolled income in retirement and not on others.
- From our experience, many consumers see their pension savings as a homogenous entity rather than distinguishing between state, private defined contribution and defined benefit pensions. Having different tax regimes for state and private pensions may add to confusion for people as some types of pension are taxable while others are not.

Our experience suggests that long-term consensus is the best way to make practical improvements to pension engagement, such as creating new cultural norms through auto-enrolment. Without being clear on the principles, changing to TEE would risk making the system less simple for people and discourage them from pension saving.

To the extent that tax does affect people's behaviour, we believe the key is to restructure incentives to make it more financially attractive for certain groups to save in a pension. These improved incentives should be focussed on those who are otherwise least likely to reach an adequate target income in retirement.

A more generous incentive will only be effective if people understand it. One option could offer a flat rate relief where anybody paying in £1 would receive 50p from the government. Or a bolder system could encourage people to contribute above the current levels of auto-enrolment entitlement. So for employees it could help extend total auto-enrolment contributions to 10% by matching every £1 put in by the employee for up to an additional 1% of income above 4%. For people not eligible for auto-enrolment it would offer a kick start of full matching on the first 1% of income contributed.

Both of these approaches offer clear rules of thumb to encourage people to save. And, importantly, they offer people immediate tax relief. The receipt of tax relief at

the point of making contributions is a more immediate and tangible reward when compared to the promise of favourable tax treatment many years later.

### 3. Would an alternative system allow individuals to take greater personal responsibility for saving an adequate amount for retirement, particularly in the context of the shift to defined contribution pensions?

Changes as those we outlined above could play an important role in creating a system which encourages greater personal responsibility and more adequate pension saving. Moving to the very different TEE system is likely to cause extra complexity for the transitional generations and is unlikely to help individuals take greater responsibility.

We believe that a better focussed system of pension tax relief would encourage more individuals to take personal responsibility for saving in retirement.

We also think that constant change to lifetime and annual allowances has not helped higher earning individuals plan their retirement saving. Continual changes to the tax regime for pensions over the last decade have made it difficult for these people to plan on a stable basis. Changing the system again will not of itself create a more stable basis, especially if coupled with concerns about future tax risks. Instead we see a need to build a lasting consensus about the objectives of tax relief which can underpin a lasting framework in which people can plan with confidence. Lifetime and annual allowances should be linked to a specific target (such as to help people save for a retirement income up to the median working-age income). If we can agree principles behind tax relief and allowances, people will feel more confident that they can plan for retirement rather than fearing allowances will be changed at the whim of governments.

We believe that principles should be established around the rate of annual and lifetime allowances to ensure that any changes are more predictable in future.

### 4. Would an alternative system allow individuals to plan better for how they use their savings in retirement?

An alternative (TEE) system may reduce the tax liabilities for people withdrawing their pensions, but this may have negative consequences. Applying taxation when savings are withdrawn creates a healthy incentive to spread a retirement pot over a reasonable period of time, reducing the risk that people run out of funds too early in (or even before) their retirement.

As discussed above, a TEE system may leave many consumers concerned that their money may be taxed again. Allowing tax relief when contributions are made gives greater confidence by creating property rights for the individual. In contrast, a TEE system would rely on a belief that future governments (perhaps 50-60 years ahead) would not change or restrict the tax relief in retirement that people are banking on. Many individuals, as well as advisers and pensions professionals may be wary of

putting reliance on this belief and that may undermine confidence and the long term savings habit. We know from speaking to individuals about pensions that there is low trust in government (caused for example by changes to the state pension age) and by previous problems associated with private pensions (such as Maxwell and Equitable Life).

### 5. Should the government consider differential treatment for defined benefit and defined contribution pensions? If so, how should each be treated?

The overarching objectives should be the same for DB and DC. But there is a danger that the particular funding requirements of DB schemes stand in the way of reaching an improved system for the ever growing number of people contributing to DC. It is therefore sensible to consider different treatment for the two types of scheme. For DC, we have illustrated above a possible approach to reform. We believe that similar principles could be applied to DB but appropriate adjustments and phasing arrangements would need to be considered.

### 6. What administrative barriers exist to reforming the system of pensions tax, particularly in the context of automatic enrolment? How could these best be overcome?

Nothing to add.

### 7. How should employer pension contributions be treated under any reform of pensions tax relief?

Nothing to add.

### 8. How can the government make sure that any reform of pensions tax relief is sustainable for the future?

The priority here should be to build a lasting consensus about the purpose of tax relief. Any reforms which are not based on long-term objectives with a broad level of agreement are likely to reduce rather than increase stability.

From a fiscal perspective, the best way to ensure that pensions are sustainable is to help more people save enough for their retirement. Strengthening incentives for people on low and middle incomes to save more would reduce the risk to the state of having to pay for rising means-tested pensioner support in the future.

At a broader level, the UK already has a substantial weight of unfunded pension promises, both through the State pension and some public sector pensions. Moving to a TEE system would add further to these liabilities (unless the government established a ring-fenced investment fund to provide for the costs of the promised future tax relief). By foregoing the right to tax private pensions in the future, the

government could undermine confidence in the long term sustainability of the UK's public finances.

As well as securing buy-in from different political parties, the industry, employers and employees, it is important that reforms achieve harmony across people of different ages. The inter-generational fairness of our future society would become increasingly questionable in a model where pensioners paid little or nothing in income taxes while the working population picked up the bill.

## Annex A : Incentivising and rewarding pension saving - An illustration of how new incentives could work.

**Current situation**

Once auto-enrolment is phased in an employee's pension contributions are matched £ for £ up to 8% of band earnings (by a combination of employer contributions which make up ¾ of the matching and tax relief which makes up the other ¼.)

But **above 8%** the employee receives only an extra 25p for each pound they pay in ( and since their pension is mostly taxable the true value of this is just 6p.)

The **self-employed** and those taking unpaid **caring breaks** from work do not benefit from matching up to 8%.

**An illustration of how incentives could be improved**

Employees who contribute 5% to a DC pension rather than the auto-enrolment standard figure of 4% could receive a matching 1% from the government.

*Questions and answers*

Q1. Would this be on unlimited earnings?
A1. To focus the incentive to best effect it could be paid just on auto-enrolment band earnings i.e. up to £42,385.

Q2. Would this also be paid to people already contributing 5% or more?
A2. There is a choice here. Including them would mean the incentive is less tightly focused but would be simpler and would reward those already doing the right thing. If it were necessary to contain costs then the payment could be restricted to those who have not contributed at (say) 7% or above in previous years. This would keep it focussed on those who need to contribute more.

Q3. How would it fit with auto-enrolment?

A3. It would allow a very simple message to employees: contribute up to 5% and your contribution will be matched pound for pound. It would also make it easier to raise the standard employee contribution from 4% to 5%.

Q4. What would it cost?
A4. If it were taken up by 5 million people, costs would be of the order of magnitude of £1 billion (around 3% of the current cost of reliefs.) This assumes the payment would be worth around £200 pa to the average individual (based on average pay of £26,000 pa and the lower threshold for AE of £5924.) These costs would be offset by savings elsewhere in the reliefs system, as described in our consultation response.

Q5. Would it discourage employers from making matching contributions?
A5. There is no reason why it should. Employers set their overall remuneration packages to attract and retain the people they want to employ.

Q6. What about the self-employed and those on caring breaks?
A6. For the self-employed, the payment could simply match the first 1% they pay into a pension. This would give an incentive to make a start with pension saving. For carers who have no earnings a cash payment (perhaps set at £200 pa) could be paid into their pension account: this could be time-limited and made conditional on them resuming pension contributions when they return to work.

Q7. Is 5% a big enough contribution from employees?
A7. Even with matching bringing it to 10%, most people will need to save more. Over time it would be desirable to extend matching up to 6% or 7% (bringing total contributions to 12-14%.) This might be possible as the savings from gradually reducing other reliefs should build up over a period of years.

Q8. What about people in DB schemes?
A8. This idea does not focus on them. In general, the incentives to save in a DB scheme are already strong and combined contribution levels tend to be significantly higher than in DC schemes.