ASLEF Response to HM Treasury Consultation on Freedom and Choice in Pensions

1. The Associated Society of Locomotive Engineers and Firemen (ASLEF) is the UK's largest train driver's union representing approximately 18,000 members in train operating companies and freight companies as well as London Underground and light rail systems.

2. ASLEF has significant concerns over the government's changes to pensions in regard to ending the need to buy an annuity. The union feels the proposals promote less prudent saving, a significant cost to pensioners, potential short termism, inefficiency and a cost to the taxpayer. Additionally, if the correct restrictions are not made, it could have a negative effect on people in defined benefit schemes.

3. ASLEF understands that on the face of it, these changes which give people more flexibility over their pensions may seem popular. But what seems popular is not always the right thing, for either the taxpayer or the individual.

4. For a very long time, the annuity market has not delivered value. It has become to some extent a broken market. But a market that is not functioning does not mean that the market must be virtually scrapped. It also doesn't mean that the product cannot be a good one if reformed. Simply put, these measures are in danger of throwing out the baby with the bathwater. ASLEF believes that this is a bad deal for the taxpayer, the individual and the economy as a whole and will explain why.

5. The way the defined contribution pension system should work is as a partnership between the state, the individual and the private sector. Many of the arguments for the new changes have been along the lines that individuals should be trusted with their own money. Or, it's the individual's money that they have saved, why should they not be able to do with it as they please? This argument ignores the fact that the state offers very generous tax breaks for pension savings. The EET model means that there is tax and National insurance exemption on contributions and also tax exemption on investment growth.

6. Why does the state offer these benefits? It is done to encourage people to save through their life to create a steady and guaranteed income in old age. This means that there is more self-sufficiency and less need for the state to provide for those who no longer work. If people have the freedom (whether they choose to or not) to immediately take this money out and spend it as they choose, what reason is there for tax relief? People would be able to spend their pension pot recklessly and then rely on the state for the rest of their old age. Whether people tend to do this is neither here nor there. Why should the taxpayer subsidise a pension pot that does not have to then buy an annuity? Defined contribution schemes could become a method of tax avoidance. Protection for the taxpayer from having to pay for impoverished pensioners will be severely weakened.

7. Future generations could also lose out from tax revenue. These changes will lead to many people cashing in their pension pots, or large proportions of them. This could well lead to a jump in the treasury's revenue in the short term as people pay their marginal tax rate on the withdrawn money. But the flip side of this is that the steady stream of income from the tax on people's annuities over the years they receive them will dry up. As longevity increases, this could have an increasing effect.

8. Therefore this move must be seen as a bad for the taxpayer who is exposed to more potential liabilities as pensioners no longer have to have guaranteed income, despite the fact that the taxpayer has paid into their pension. On top of this a potential increase in revenue for the treasury in the short term would be followed by a reduction in income tax receipts over the following decades.

9. Pensions and investment decisions are hugely complicated. This is why decisions are made by qualified actuaries and financial advisors. In the most part (and as the experience in Australia shows) people in retirement are rather cautious with their money. However, this can be a danger in itself. Some people will simply underspend their pot, fearing that they will not have enough to survive off. This could lead to elderly people having an unnecessarily uncomfortable old age. Additionally this would have a negative effect on the economy with less goods and services purchased. Also, this fear could lead to people being unnecessarily cautious in investing their money. Due to the fear of investments going wrong, people could be tempted to leave huge amounts of cash in bank accounts that give very little interest. In real terms, their pots could therefore lose value. This is an extremely inefficient way to manage your money.

10. The flip side to this is that people may well underestimate how long they will live and overspend. Additionally, allowing individuals to take their cash and not take an annuity also removes the collective risk taking and pooling that annuities provide. About 3% of people do not survive to retirement. This means that collectively, we are able to save 3% in our pensions. Losing this means an automatic reduction of 3% in a pension’s value. If an individual is effectively giving themselves an annuity they lose out on this and must estimate their own life expectancy. When this is done across huge amounts of people (as is done with current annuities) the average life expectancy can be used to a far more accurate extent. This is a significant

amount of efficiency to lose. Individual investment is also far less likely to withstand the volatility of the market than pooled money.

11. People who have saved for their whole lives often have not had the opportunity to have a sizeable lump sum of cash before. It can often be a hard prospect to resist for many. A once in a lifetime opportunity. Again, this temptation may prevent sensible prudent decisions.

12. ASLEF strongly believes that there must legislation to stop the transfer of all Defined Benefit Schemes to Defined Contribution funds, whether private or public sector. It may be appealing for employers to allow this transfer out of their schemes as it de-risks their funds. However this puts the risk in the hands of the individual. You may well see people succumb to temptation and sell good guaranteed benefits for the opportunity to cash in.

13. The possibility of people transferring Defined Benefit Pensions as well as not taking annuities also poses risks for the wider economy. Defined Benefit Schemes are major investors in the UK economy. Tempting people to take money from these schemes could well reduce the amount that they have to invest in the UK economy.

14. Pensions and annuities account for about £2 trillion of assets in the UK. This is 130% of GDP. Two fifths of these are held by defined contribution schemes with the rest being held by defined benefit schemes. Reducing the amount of annuities being bought and allowing those in defined benefit schemes to take funds from them would reduce a huge pool of investment that is needed for economic growth.

15. Another danger is an even bigger housing price bubble. For decades we have witnessed the increase in buy-to-let and the private rental market. Buy-to-let in many cases has now become the obvious thing to do for those with capital available. For many it is a secure way of keeping your

money in an asset and guaranteeing a return through rental. Should people be able to access their pension pot at a marginal rate, ASLEF believes this could lead to many taking the buy-to-let option and thus creating a housing bubble. This would make worse an already unaffordable housing market for many people, especially potential first time buyers and would distort the market.

16. Sometimes, ideas that appear to be very attractive to individuals and employers can seem like a no brainer. This does not mean that they are the right ideas. The annuities market at the moment may not be offering real value for money. But that doesn’t mean that people should not have to use their tax subsidised pension pot to buy a guaranteed income. It is for this prudent acquisition that the taxpayer gives relief to pension contributions and investment returns. Annuities are essentially insurance products that protect people financially against the risk of life expectancy. If the car insurance market was not offering value for market the government would increase regulation. Not offer people the option not to buy car insurance. This is what should happen with the annuities market itself. It needs fixing. Not a death by a thousand cuts. We already know that 60% of people do not shop around for an annuity when they reach retirement age. This loses people between £115 million and £230 million of additional pension in total. There is work that could be undertaken to make the market fairer and easier for people entering retirement.

17. Whilst ASLEF opposes these changes in general terms we would strongly call upon the government to legislate to stop private sector defined benefit schemes allowing the transfer of funds to a defined contribution scheme.

18. Should the government press ahead with these changes, ASLEF would argue that people should have entitlement to full impartial and free advice as they would in essence be able to remove themselves from the guidance of professional investors and actuaries.

19. The union also opposes the increase to the minimum age at which a pension can be paid. If people are financial able to retire and in doing so a new job opportunity would arise for others, this must be permitted. We have a great deal of youth unemployment and forcing those who financial do not need to, or want to continue to work is illogical.

20. ASLEF calls upon the government not to allow stability, risk sharing and prudence to be sacrificed on the altar of choice. Doing so will be a bad deal for future pensioners, the taxpayer and the wider economy.

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