Written evidence submitted by Zurich Insurance Savings (SGCB 05)

Zurich Insurance Group is a leading global insurer, providing life and general insurance products and services to retail and corporate customers in more than 170 countries. Zurich's UK Life business is a leading provider of personal protection, pensions and investment policies available through financial intermediaries.

Summary

We are supportive of any initiative which promotes saving in later life and we recognise that the Lifetime ISA (LISA) could be a valuable extra option for people who can afford to put more aside for retirement or for those saving for a first home. However, we wish to outline a number of our concerns regarding the product:

- **Saving via pensions remains the most attractive method of saving for retirement, principally due to the valuable benefits on offer including matching employer contributions and inheritance tax breaks.**
- **There is a real danger that the LISA could lead to confusion amongst savers, significantly derail auto-enrolment and reverse the progress which has been made in encouraging people to save for later life.**
- **The default fund option available on workplace pensions provides a more secure investment strategy appropriate for long-term saving in comparison with a LISA and the fact that many will save into cash only.**
- **The long-term savings market is over-complicated and more needs to be done to educate and engage individuals to encourage them to save more for retirement through existing products rather than increasing the number of products available.**

1.) The overall impact on retirement savings

1.1 It is clear that pensions remain the most attractive method of saving for retirement, offering valuable benefits including matching employer contributions and inheritance tax breaks.

1.2 We are concerned that people who opt to reject workplace pensions in favour of the new LISA could see their retirement pots shrink considerably. *Research conducted by Zurich found that a basic-rate taxpayer saving £100 a month into a workplace pension over 20 years would be £14,000 better off than a person saving into a stocks and shares LISA. (See Annex 1 for full costings).*[1]

[1] https://www.ftadviser.com/2016/08/01/investments/savings-and-isas/young-people-will-use-lifetime-isa-for-retirement-zurich-gXcoVUgL03zEWUFxGzx3rL/article.html

1.3 There is a real danger therefore that the LISA could derail the progress which has been made in encouraging people to save for later life if individuals opt-out of their auto-enrolled pension scheme to save into the new LISA.

1.4 By positioning the LISA as a retirement product we are concerned that it will be seen as an alternative to a pension when in reality many individuals need to save for both a property and their pension. As such, there is a danger that when an individual who has been saving into a LISA purchases their first house, they are likely to use all the money within their LISA to pay for the deposit. If they have opted out of an auto-enrolled workplace pension, they will likely have no other retirement savings built up and will effectively have to begin saving for their retirement from a much later age which will have a significant impact on what they are able to retire with. This will become worse if they then pay into a LISA and only invest in cash-based investments.

1.5 There may be some self-employed people that save for their retirement through a LISA - however we expect this to have a relatively small impact on the level of savings in total as many self-employed people are over 40 and therefore not eligible. In addition, there may be other ways to improve the savings position of the self-employed, which we outline below.

1.6 There may be some people who save into a LISA who don't currently save into a pension, but we would expect most of these will be doing so to fund their retirement.

1.7 Finally, the LISA may become a savings vehicle for wealthier parents or grandparents saving on behalf of their children or grand-children, although this will be a redirection of their savings.

2.) <u>How and whether individuals with limited resources will choose between saving in a LISA or a workplace pension</u>

2.1 Auto-enrolment works because it clearly makes sense for the vast majority of people to enroll, particularly for individuals with limited resources, due to the valuable benefits on offer including matching employer contributions and inheritance tax breaks.

2.2 The biggest risk is that the confusion around whether to save into a pension or a LISA causes people to do neither. There is also the risk that people start to save into a LISA and then stop making contributions after a year or two. The advantage with auto-enrolment into a pension is that the contribution comes automatically out of an individual's salary and requires an individual to opt-out, which from what we have seen so far is unlikely to happen .

2.3 The LISA is likely to only be a useful additional option for people who can afford to save extra for retirement. Indeed, feedback we have received confirms that many will incorporate the LISA into wealth planning, principally those looking to top up their retirement funds after they have reached the limit on their pension's lifetime allowance. As such it is essential that the LISA is not viewed as an alternative to a pension, which remains the most tax efficient method of saving for retirement for all.

2.4 We acknowledge that the 25% up-front government bonus on the LISA will be attractive to self-employed people who do not receive employer contributions into their pensions and may have limited resources. However, we expect this to have a relatively small impact on the level of savings in total as many self-employed people are over 40 and therefore ineligible for the LISA.

2.5 To encourage more self-employed individuals to save we believe that self-employed individuals' pension contributions should be eligible to attract National Insurance Contribution (NIC) relief in the same way employers' contributions do for their employees. Thereby providing an element of equality between the self-employed and employees receiving contributions from their employer.

3.) Whether the interests of LISA savers will be protected with regulation on charges and governance comparable to pensions;

3.1 We are concerned that the interests of LISA savers will not be protected as we believe that, many individuals, young people and those with limited resources in particular, will treat the LISA as a "piggy back pension" which they feel they can "dip into" when they need extra cash as the money is seen as more accessible.

3.2 *Research commissioned by Zurich in conjunction with YouGov found that 14 per cent of people would not be deterred from dipping into their Lifetime ISA before age 60. This is despite the individual having to repay the government bonus plus a 5 per cent exit fee (unless they use cash to buy a first home). A further 22 per cent of those surveyed were unsure. This means that over a third – 36 per cent – of people surveyed could potentially withdraw their savings prematurely.*[2]

3.3 Moreover, workplace pensions benefit from having an Independent Governance Committee (IGC) or Trustee Board to review charges and govern default solutions. We believe that it will be difficult to have an equivalent structure for the LISA.

3.4 Many of the default arrangements offered within workplace pension schemes also benefit from very low charges due to economies of scale and the purchasing power of the employer. In some cases this means that the charges are significantly lower than those on ISAs, which will add up if the LISA is being used to fund an individual's retirement.

[2] https://www.ftadviser.com/2016/08/01/investments/savings-and-isas/young-people-will-use-lifetime-isa-for-retirement-zurich-gXcoVUgL03zEWUFxGzx3rL/article.html

4.) <u>Whether LISAs will have an investment strategy appropriate for long-term saving;</u>

4.1 We are concerned that individuals who opt out of a workplace pension not only lose valuable employer contributions, resulting in a substantially lower income in old age, but could also see a bigger fall in their retirement pot by opting for a cash, rather than a stocks and shares LISA.

4.2 Experience to date is that large proportion of people that pay into an ISA utilise the Cash ISA as opposed to the Stocks and Shares ISA, thereby sacrificing the potential for higher returns from investing in equities, for the security that they get from investing in cash. Whilst this is not a major issue in the short-term if customers are intending to use the LISA to fund a house purchase, it will have a significant impact if instead they are utilising the LISA as a retirement vehicle. Cash investments typically grow at a slower pace and with interest rates hovering just above zero, returns are likely to reduce further in comparison to a stocks and shares LISA, leaving individuals with a much smaller pot in retirement.

4.3 *Worryingly, more than a third of Britons (36 per cent) Zurich recently surveyed claimed they would invest using cash leaving their retirement pots vulnerable to low growth and inflation.*

4.4 With a workplace pension, employers/providers will select a default fund which members can invest into. The advantage of this default fund is that it takes into account the age of the individual and therefore how long they are likely to remain invested. Those customers aged between 20 and 40, for example, are not likely to access their funds for at least 20 to 30 years and as such the default fund will invest a significant proportion of funds in assets that are likely to yield higher returns.

4.5 However, in contrast, with the LISA, providers will not know when or how customers are likely to access their funds, due to the option to withdraw funds to purchase a first home which can occur at any time. Any default will therefore need to be significantly more cautious as a result. The long-term impact of this for individuals using the LISA as a retirement vehicle is likely to be substantial.

5.) <u>Whether the choice of Help to Save accounts and LISAs will confuse inexperienced savers</u>

5.1 We would reiterate that auto enrolment works because it clearly makes sense for the vast majority of people to enrol. However, we are concerned that the introduction of the LISA could create confusion, particularly amongst younger savers, as to which is the most appropriate savings vehicle, with the possibility that some may opt-out of their auto-enrolled pension scheme to save into the new LISA. There is a real danger therefore that the LISA could derail the progress which has been made in encouraging people to save for later life.

5.2 We firmly believe that the focus should be on how we educate and engage people and get them to save more rather than increasing the number of products available which inevitably over complicates the market. It is it is essential therefore that the industry focuses on delivering complete and simple propositions which are aligned to the needs of members and enable them to save and plan for their retirement through existing savings vehicles. Indeed, there are already two fit for purpose savings vehicles to cover the dual purpose of the LISA, these could be enhanced rather than introducing a new product which brings added complexity to the market. We highlight auto-enrolment as a prime example of where the Government has successfully utilised existing products available to boost retirement saving.

6.) Conclusion

6.1 Any initiative that promotes saving in later life is welcome and we recognise that the LISA is a valuable extra option for people who can afford to put more aside for retirement or for those saving for a first home. However, we emphasise that the best way to save for retirement remains via a workplace pension.

6.2 We also remain concerned that moves to a Pension ISA or Workplace ISA and Tax Exempt Exempt (TEE) model are still under consideration, with the Lifetime ISA ostensibly a first step towards this. There is a clear consensus across the sector that the transition to a Pension ISA or TEE model would in fact lead to further disengagement by savers whilst requiring a complex and costly transition period.

6.3 A flat rate of pension tax relief could instead increase saving among lower earners, while ensuring pensions remain an attractive investment for higher earners and would be inherently fairer. Coupled with auto-enrolment, this would give a powerful boost to the pensions of millions of workers and help the vast majority of people to save more for retirement. It would also end the complexity of the current regime and set tax relief at a sustainable level for the long term.

6.4 We welcome plans by the Government, outlined in its response to the Work and Pensions Select Committee Pensions Automatic Enrolment inquiry, to ensure that factual sources of information on the Lifetime ISA will be available on Gov.uk but more still needs to be done to help customers distinguish between a pension and a LISA to prevent thousands of younger people being drawn to the LISA as the main way of saving for retirement and jeopardising the success of auto enrolment and their potential savings.

Annex 1

Zurich costings demonstrating why an individual is better off saving into a pension over a Lifetime ISA. Costings based on a basic-rate taxpayer saving £100 a month into a workplace pension over 20 years versus a person saving into a stocks and shares Lifetime ISA.

LISA vs Pension - Different Types of Tax Payer

Age	25	Basic Rate Tax	20	Bonus	0.25
Assumed annual growth rate (%)	2.5	Higher Rate Tax	40		
Size of Monthly Contributions (from gross income)	100				

Tax Status (work, retirement)	Retirement Pot - Lisa	Cumulative Retirement Income - Pension*	Retirement Pot ISA
Basic, Basic	31,097	26,433	24,878
Higher, Higher	23,323	21,768	18,658
Higher, Basic	23,323	26,433	18,658
Basic, Zero	31,097	31,097	24,878

*Includes 25% tax free cash

Comparison for employee with employer contributions - £24k per year, auto-enrolement minimum

	Retirement Pot - LISA	Cumulative Retirement Income - Pension*
Now	31,097	30,437
From April 2019	31,097	45,231

Annual Growth Rate	0.025			
Number of Years	20	Number of Months	240	0.647864

Monthly contribution rate to LISA after basic rate tax + bonus:	100
Monthly contribution rate to LISA after HRT + bonus:	75
Monthly contribution to an ISA after Basic Rate Tax	80
Montly Contribution to an ISA after HRT	60

Monthly Contribution to a pension under current auto enrollment minimum, for someone earning £24k pa (employer and employee)	115.15
Monthly Contribution to a pension under 2019 auto enrollment minimum, for someone earning £24k pa (employer and employee)	145.45