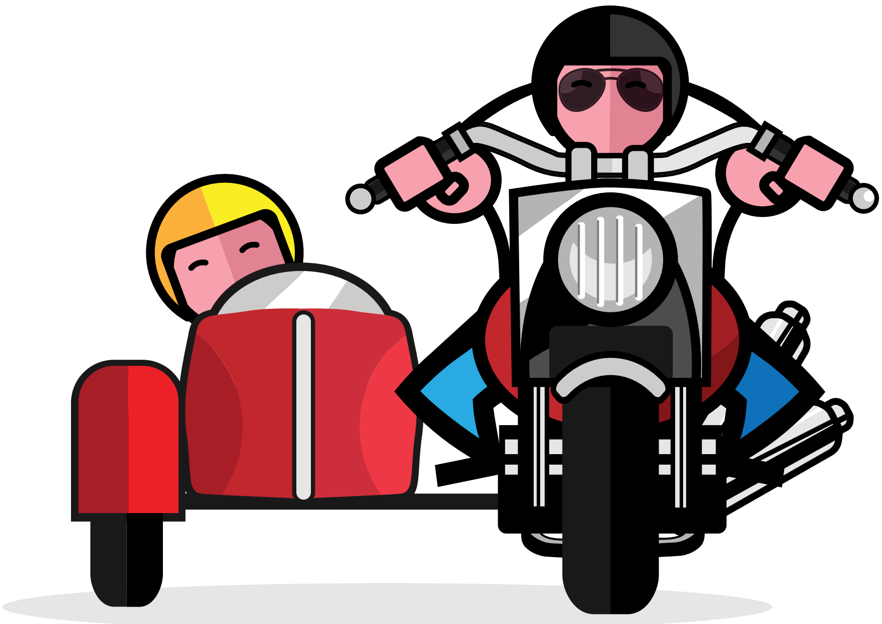


Summary
• A pensions sidecar is a separate savings vehicle alongside a retirement saving product, which can be accessed for short-term financial needs without affecting the pension pot.
• Sidecars could be used to tackle the population's lack of short-term savings, as well as helping self-employed people save for retirement.
• There are barriers for the creation of sidecars to overcome, such as its integration with auto-enrolment and its tax structure.

A smoother ride

Laura Blows considers whether pensions sidecars may just be the new vehicle needed to balance savers' long-term and short-term financial needs

Motorcycles can be tricky machines. While they may be a fun and enjoyable ride, capable of going far at fast speed, they are not always the best option for tackling treacherous conditions or coping with bumps in the road.

Pension products are much the same (although they rarely bring about the same exhilaration as riding a motorbike). They may be good for the heading off into the horizon of retirement, but they do not provide much support for the financial hazards faced along the way.

What can assist both is a sidecar, providing balance and making travelling over short-term obstacles a more bearable experience during the long journey ahead.

A pensions sidecar is a separate savings vehicle alongside a retirement saving product, which can be accessed for short-term financial needs without affecting the the pension pot.

There are various potential models for the creation of a sidecar, such as the 'waterfall' model, whereby all contributions go into the sidecar account until a threshold is reached; all subsequent contributions then 'fall' into the pensions account. If the savings account falls below the threshold due to a change in the threshold or a withdrawal from the savings account, future contributions go into the savings account until the threshold is reached once again.

Another option is where contributions are split between the sidecar and the pension fund. This could involve the minimum auto-enrolment contributions going into the pension, and any excess amounts being placed into the separate short-term savings account.

While not a sidecar model, the concept of early access to pension savings, under set criteria, was first mooted in the UK in 2010, but fell by the wayside. The concept has had success abroad though, such as with New Zealand's Kiwisaver pension scheme and in the USA, where there is already some conditional early access to retirement savings.

The USA's approach was the driver for Nest to explore the sidecar concept. Together with the Money Advice Service, it decided to explore whether the success of the auto-enrolment model in pensions could be applied to help address this lack of short-term, emergency savings. A trial, using the split contribution model, is taking place this year, involving selected employers offering the pensions sidecar account to their employees.

"The trial will gather data on take-up and use as the best approach to understand real demand for something like this," Nest Insight manager Michelle Cremin says.

Tackling problems

Whether there is demand is one thing, but there is clearly a need to help people build short-term savings.

The Money Advice Service's *Closing the Savings Gap* report from September 2016 finds that 26 per cent of working-age adults have no savings to fall back on and a further 29 per cent have less than £1,000 saved. Nearly 17 million people in the UK have savings of less than £100.

As worrying as these stats maybe, what do they have to do with the pensions industry – whose very existence is based upon saving for the long term, not dealing with short-term financial difficulties?

A lot, it seems.

"A lack of short-term savings is a problem for the pensions industry. When the boiler breaks down, and someone has no personal savings, they will turn to expensive credit lines and reduce pension contributions to meet the additional expense. Good financial health must involve a mix of short and long-term assets pools – you cannot consistently and securely achieve long-term financial aims without insulating against short-term shocks," Trafalgar House client director Daniel Taylor says.

It could also address problems facing the pensions industry.

Mercer UK DC and Individual Wealth innovation leader Shri Rengasamy points out that sidecars allow accessibility of contributions in a way that conventional pension schemes do not, which is "a common criticism amongst pension sceptics".

"Although the introduction of pensions automatic enrolment has been a brilliant first step into kickstarting people's pension savings, some in the industry are concerned that as contributions ramp up, the opt-out rate will increase too as people worry about locking up their savings and not being able to access it," Nucleus product technical manager Rachel Vahey says. "Sidecar savings may help with that concern in a neat way."

The implementation of sidecars also fits in well with the pensions structure, as contributions can be taken through payroll in a similar manner to auto-enrolment. This allows it to easily go alongside a traditional DC scheme or master trust. However, for a DB or CDC scheme, it might fit better with whatever 'AVC' structure may be in place for members of that scheme, Cremin warns. "But there's nothing fundamental stopping sidecars from working in workplaces with DB or CDC schemes."

Self-employed

But what about those people without a workplace pension to save into? Increasing focus has been placed on the significant proportion of the population left out of auto-enrolment: the self-employed. Could the sidecar model work for them?

In June, the Association of Independent Professionals and the Self-Employed urged the government to dismiss the idea of auto-enrolling self-employed workers and instead called for the creation of a sidecar pension scheme.

A potential sidecar model for the self-employed could have all their contributions initially directed to the sidecar, then prior to the end of the tax year, the amount remaining in the sidecar in excess of a pre-set 'buffer level' is rolled into their pension savings, Rengasamy suggests.

"The self-employed, particularly those with moderate to low incomes, often do not have security or certainty over their income. Such uncertainty breeds a desire to favour other types of investments for retirement such as ISAs. These products are easier to access in the event of an unexpected expense or during a period of lower earnings but don't offer many of the benefits of pension products. What this consequently means is that the self-employed have substantially less pension wealth than their employed peers. Essentially, a pension sidecar would be a way for the self-employed to have more access to their retirement savings while also getting them into the mechanism of saving into a pension to help cope in old age," Quilter head of retirement policy Jon Greer explains.

Bravura Solutions retirement specialist Jonathan Wileman highlights that, like the self-employed, lower-paid workers also cite a similar need for accessibility. "When minimum AE rates increase again next year, this could potentially minimise the number of employees opting out," he explains.

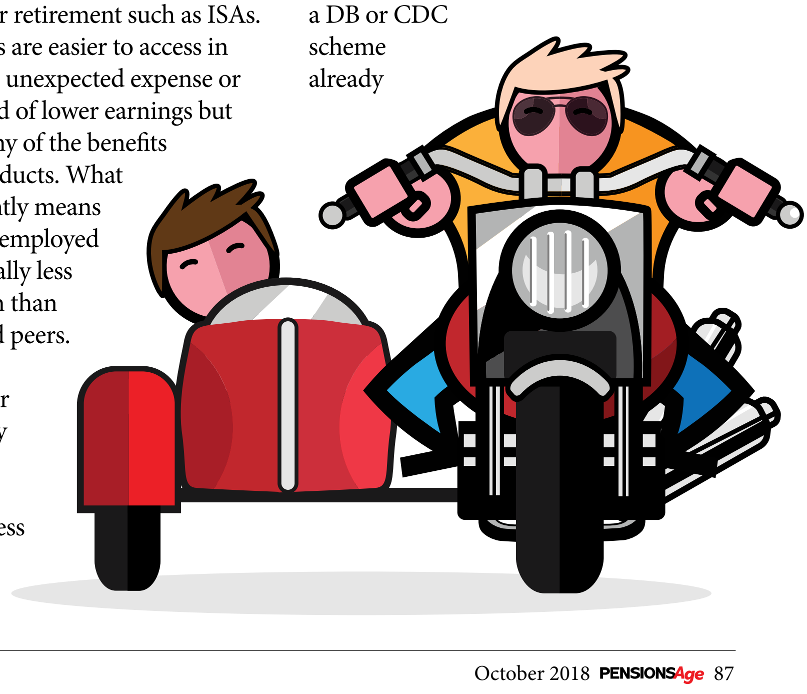
Barriers

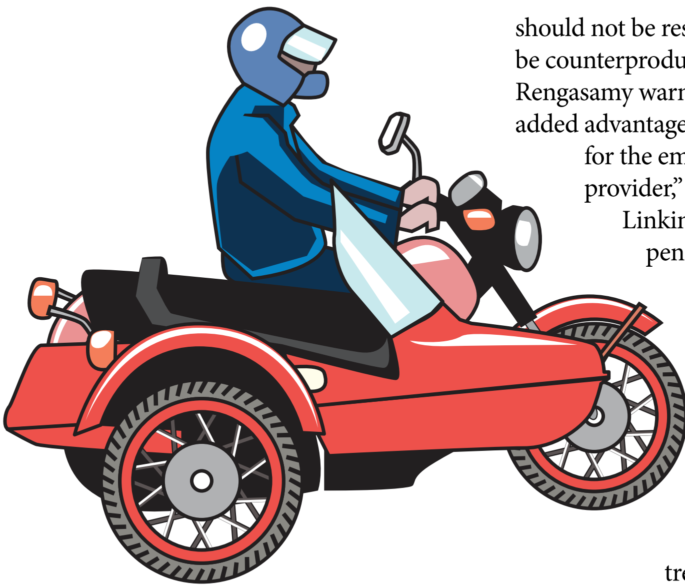
But for Barnett Waddingham partner Damian Stancombe, targeting sidecars at the lower paid is the wrong focus.

"Sidecar saving 'products' appear to be a concept vehicle, created by the ivory towers of academia, latched onto by the pensions industry as a way to boost contributions from those who can least afford them or indeed need to pay them," he states.

Instead, he recommends focusing on supporting employees, "rather than thinking up new products".

Wileman agrees that "while serving a slightly different purpose, workplace ISAs have already introduced the concept of members paying into a savings product alongside a pension". It could be argued that DC AVCs made alongside a DB or CDC scheme already





demonstrate that hybrid models can work well, he adds.

However, according to Cremin, workplace ISAs has generally been targeted at higher-income groups, while the sidecar model is aimed at increasing short-term financial resilience for lower to mid earners.

PLSA director of policy and research Nigel Peaple adds that the Local Government Pension Scheme already deals with the tension between short and long-term saving needs through an 'opt-down' mechanism, "which allows people to reduce their contributions for a short period of time, helping financially stretched savers stay in the scheme instead of opting out".

So the need for the sidecar is up for debate. Especially as its actual use may not necessarily match with its intentions.

"The biggest problem that could arise is that it is viewed as a source for discretionary expenditure (the 'wants' as opposed to the emergency 'needs')," Rengasamy says. "This could lead to persistent abuse of sidecar saving and in turn potentially negating any of the benefits from the arrangement."

The sidecar savings may be repeatedly withdrawn just before the level where it 'tips' into a pension, Vahey adds. However, access to the sidecar should not be restricted as that would be counterproductive to the concept, Rengasamy warns. "This also has the added advantage of administrative ease for the employer and/or sidecar provider," he adds.

Linking the structure of pensions with short-term saving products could also be tricky.

Pension savings are deducted from gross pay and are therefore not taxed. "If contributions to a sidecar account were to be similarly treated there would have to be strict limits to prevent tax avoidance," Aries Insight director Ian Neale states.

Solutions to this could be to freeze the personal allowance and create a tax-free sidecar savings allowance, similar to the 'saver credit' applied to interest on savings accounts at the moment. Alternatively a sidecar ISA (or SISA) could be created, to which contributions are paid automatically but after tax, while growth and withdrawals are tax-free, he adds.

The sidecar's structure may either cause affordability concerns, by getting people to pay over and above the AE minimums, or require a change to AE legislation to allow contributions to go outside of a pension, Redington director, DC and financial well-being consulting, Jonathan Parker, warns.

This inability to automatically enrol employees into savings vehicles is a barrier, Rengasamy states, as an opt-in arrangement is more challenging than an opt-out one. This also results in the additional barrier of encouraging member engagement.

"With the general understanding of financial products at current levels, a sidecar may end up joining the ever-growing list of underused, complicated financial products with noble intentions," he warns.

Support

With these barriers to overcome, there is going to have to be strong support for sidecars to be created.

However, the administration of a large number of small savings pots coupled with the ongoing cost of monitoring and rebalancing is unlikely to be attractive for many pension providers, Parker warns, adding that it would also need the support of employers who may be reluctant to take on the additional administration required to make it work.

Neale agrees that there is little evidence yet of appetite for the sidecar concept in the industry. "As usual, a lot will depend on the government and what incentives might be offered," he says.

These issues cannot be addressed without more research into the structure of sidecars. But some consider this a pointless endeavour. "Will there be any success in sidecar saving? I do hope not," Stancombe states.

However, others expect him to be disappointed. Rengasamy believes that "in the future, it is highly likely that sidecar savings will be the norm within pension products".

Wileman agrees that it is likely that sidecar saving products will arrive sooner rather than later.

"With the gig and self-employed economy continuing to grow, and both the government and industry recognising that the issue of these workers missing out on auto-enrolment must be addressed, a solution needs to be found to allow this cohort to feel that they can safely contribute to a pension without jeopardising their short-term needs," he explains.

Whether sidecars are the driverless cars of pensions, adding excitement and interest into the future of saving, or whether it ends up a niche product like its vehicular namesake, helping people tailor their financial saving to suit the route they want to take is surely a road worth travelling down.

Written by Laura Blows