PENSIONS AND LIFETIME SAVINGS ASSOCIATION

ADDRESSING THE CHALLENGE OF DEFERRED SMALL POTS: A CALL FOR EVIDENCE

CONTENTS

EXECUTIVE SUMMARY

- The PLSA and the wider industry have been working on this issue since before the introduction of Automatic Enrolment. A significant amount of industry resource and expertise has already been devoted to moving the issue of small pot consolidation forward, to find solutions that are in the best interest of members, and correct for the detriment that we see building up as time passes without a solution being found.

- We see the small pots issue as a significant opportunity to optimise the success of Automatic Enrolment, and reduce the detriment that will and is already suffered by savers whose small pots are not automatically consolidated. The small pots issue represents a limitation on the success of the automatic enrolment policy, and will continue to do so if it is not resolved even when necessary reforms to improve pensions adequacy are implemented.

- Industry has repeatedly found, most recently through the efforts of the Cross Industry Co-Ordination Group supported by the PLSA and Association of British Insurers (ABI), that Government action is needed in new legislation to implement a new policy solution to address this problem.

- We see the Department's Call for Evidence as a positive indicator that the Government intends to take action, and that relying on existing mechanisms or saver behaviour will not be sufficient. We would continue to support the Government's efforts to address this problem as soon as possible, and in concert with other legislative and regulatory changes that both positively and negatively interact with this initiative.

- The PLSA position, aligned with the Cross-Industry Co-Ordination Group position, is that multiple solutions are likely needed to resolve both the existing legacy pot problem and address future small pot creation. It is equally important to address both issues. The PLSA Small Pots policy position remains that a combination of different options are needed:
  - a solution designed to operate in the short-term (e.g. same scheme consolidation, member exchange)
  - a solution designed to resolve the whole issue in the longer-term (e.g. a default consolidator, Pensions Dashboards as an engagement tool – in conjunction with other options).

- At a high level we agree with the benefits and implications summarised for each model under consideration in the Call for Evidence, but wish for further evidence to be gathered in line with previous recommendations to fully assess the merits and drawbacks of the different models against the proposed Key Criteria, as well as the PLSA's Principles and the Co-Ordination Group's design principles.

- The Cross Industry Co-Ordination Group has made significant progress on administrative issues that were identified by the previous DWP Supported Industry Working Group and made a series of policy and evidential recommendations that have been acknowledged in the Call for Evidence. However, this Call for Evidence does represent a departure from some of the previous areas of focus of this work, notably in terms of assessment criteria used analyse the models that remain under consideration. This has implications in that it has:
  - Resulted in the single default consolidator model, that was previously discounted, being included for consideration.
  - Proposed definitions of between £1,000 and £10,000 as opposed to the assumption of between £0 and £500 in previous work, particularly of the value of a small pot, where current evidence suggests that a great proportion of small pots have lower values[1].

  Further evidence would therefore be needed. It will be critical that the next stage of the Government's work assesses the impact of the full dynamic effect of potential policy solutions for the small pots problem, alongside the effects of wider DC reform initiatives, on the automatic enrolment market.

- In our view the Call for Evidence also revisits some other components of the debate that have been well considered elsewhere, such as the degree to which same scheme consolidation and member-initiated consolidation will impact the small pots problem. We are pleased that the Government appreciates that without a new policy solution specifically designed to address the small pots issue we would be unlikely to see anything other than an increasing trend to the detriment of savers.

- Finally, we encourage the Government to look beyond the areas addressed in the Call for Evidence, particularly taking into account all previous work of the Co-Ordination Group on administration, transfer costs, consumer journeys and 'push' vs 'pull' mechanisms in the next stages of the policy design.

[1] For example, see Small pots working group report - GOV.UK (www.gov.uk)

CALL FOR EVIDENCE QUESTIONS

Introductory note

1. Generally, we would encourage the Department to consider any small pots/cdc/vfm solutions in the context of the wider DC reform agenda; we can infer that the Government is intending to support innovation and consolidation (both at a scheme and a pot level), but that the ultimate intended DC and Automatic Enrolment saver outcomes, and required market composition, have not yet been set out with clarity.

2. It will be important that all proposals work in concert
with one another to achieve this vision, and that any points of tension to achieve the wider Government strategy for the UK pensions industry are identified in each policy strand and resolved. Scheme and provider strategy is of course dependent on the shape and scale of the market of the future, and therefore contingent on all interventions, such as these on small pots.

1. Do you agree that these are the appropriate key criteria to inform development of a market-wide small pots consolidation solution? Are there additional/different criteria to apply?

3. This Call for Evidence includes some similarities and differences between criteria previously used by the most recent assessments of potential small pot solutions. Where there are consistencies we support the approach proposed in the Call for Evidence, though we suggest that additional key criteria should be considered to better reflect the work on these issues so far, and to take account of the most optimal refinement of the model(s) possible for the needs of savers.

4. The Small Pots Industry Working Group, convened by DWP (DWP Working Group) and the ABI/PLSA convened Small Pots Cross-Industry Co-ordination Group (Co-ordination Group) both used assessment criteria to consider potential models alongside their work. There are several criteria which are consistent in spirit across these, as well as consistent with the new proposed criteria by this Call for Evidence:

   - Supports a competition, sustainable and more efficient workplace pensions market (trust- and contract-based), and
   - Minimising complexity and administrative burdens for employers.

   While progressing their work and continually assessing the models the Co-ordination Group found that further evidence would be necessary to be sure to satisfy these (equivalent) criteria, including the following:

   - Simulation exercises to understand cross holdings and costs of matching and transferring pots en masse (Co-ordination Group, September 2021)
   - Understanding the reasons small pots are created (for example, are these employer, scheme or member issues) and labour market analysis to understand the creation of small pots in

more detail. The Co-ordination Group found that DWP are best placed to undertake this analysis. (Coordination Group, September 2021)

- Research needs to be carried out into the effect of moving an estimated 2.5 million pots and if there would be an issue with so many small pots being divested from funds, assuming in a short space of time. Following the initial glut of transfers this should decrease to a natural flow where people are simply moving jobs. The Coordination Group found that DWP are best placed to undertake this analysis. (Co-ordination Group, September 2021)

For these reasons we therefore support these two criteria as key to assessing the small pots models under consideration, but would expect further analysis to be undertaken to provide sufficient evidence to undertake the assessment.

5. Two further proposed key criteria are somewhat similar to those used by other work before. These are:

   - Delivery of overall net benefits for members through improved value for money outcomes, achieving a meaningful impact on the number of existing, and flow of new, deferred pots, and
   - Commands confidence in the system for savers and taxpayers.

   We are pleased to see that these proposed criteria intend to address both the stock and flow small pots problem. It is worth noting that the Co-ordination Group did not directly assess models against the confidence for taxpayers and so different conclusions may be drawn on models as a result of this criteria. However, the Co-ordination Group did take account of presumed cost to Government, could be relevant to the intent of this articulation of an assessment criteria.

6. Finally, the Call for Evidence proposes a new key criteria:

   - Complements member engagement on their savings journey/retirement planning.

   We consider this a new stated objective of the small pots problem, as previous work has understood the intent of any model(s) would be to work alongside the widely successful inertia based automatic enrolment philosophy. It is likely that different models would be considered more or less favourably if they are assessed as ‘complementing’ member engagement in a way that contradicts conclusions reached by previous work to find solutions. For example, DWP’s mandate to the industry focused on the administration considerations associated with any potential small pots solutions, and this leads to conclusions about the best manner and frequency of communications with members, balancing their need for information on an ongoing basis, with the need for schemes and providers to remain cost effective as part of their wider intent to deliver good value. The Co-Ordination Group found that communication around opt out processes will be particularly important to get right in order to protect members from potentially bad outcomes; some savers may not wish for their small pot to be automatically transferred and they need to understand the way they stop this from happening

(Co-Ordination Group Report, June 2022). Previously the Co-Ordination Group did find that there was additional evidence that could helpfully be gathered on the consumer journey, including both consideration for the transfer solution and preferences on destinations of small pots:

- Consumer testing to understand views, particularly the potential consumer journey, for each automatic transfer solution, which will be crucial to making the final decision from the automatic transfer solutions that remain on the table. (Co-Ordination Group, September 2021)
- Updating consumer research previously carried out (by the ABI, in 2012) to understand where savers would want their money automatically transferred to out of the automatic transfer destinations: to follow them to their new employer scheme, or to a central aggregator. The Coordination Group found that DWP are best placed to undertake this analysis. (Co-Ordination Group, September 2021)

For these reasons we therefore support this new criteria one those used to assess the small pots models under consideration, but would expect further analysis to be undertaken to provide sufficient evidence to undertake that assessment.

7. The proposed criteria are missing elements that have been the focus of both of the most recent Working Groups' efforts', namely:

- Minimising the administrative burden for pension providers,
- Noting the potential for the specific needs of SME employers, and payroll teams, respectively, and
- Cost effectiveness of the model(s).

For this reason we would encourage DWP to consider making adjustments to the key criteria to take account of these factors as these are important to the success of the ultimate model(s) and policy.

8. The PLSA Small Pots policy position remains that a combination of different options are needed:
    a. a solution designed to operate in the short-term (e.g. same scheme consolidation, member exchange)
    b. a solution designed to resolve the whole issue in the longer-term (e.g. a default consolidator, Pensions Dashboards as an engagement tool – in conjunction with other options).

We do not see one solution working well in isolation; multiple solutions working in tandem are likely needed to resolve the problem of small pots, both for legacy pots and for future pots. Any longer-term solution will need to be underpinned by the following **PLSA Principles for Small Pots:**

- There should be no material detriment to the saver from being (automatically) transferred between DC schemes (including consideration of costs and charges).
- Transfers should be efficient for schemes (e.g. automated or semi-automated) and simple and quick for scheme members.

- Transfers should not rely solely on active decisions by savers to take place.
- The proliferation of small pots should be stopped so that administration and other costs do not continue to rise.
- Competition issues and issues of reciprocity must be managed appropriately.

We would therefore encourage DWP to consider adding criteria on transfer efficiency as other principles are consistent with the key criteria.

9. There are outstanding areas which need to be resolved before a final model is selected, such as better understanding the impact and potential costs and benefits to both savers and schemes, (including the financial implications and experience of interacting with savings), and proportion of the overall issue that is addressed.

10. No longer-term solution to small pots should come at the expense of a vibrant AE market, which would hurt savers. Therefore, careful consideration and financial modelling should be undertaken to assess how a solution would impact the AE provider market.

11. Generally, we would encourage the Department to consider any small pots solutions in the context of the wider DC reform agenda; we can infer that the Government is intending to support innovation and consolidation (both at a scheme and a pot level), but that the ultimate intended DC and Automatic Enrolment saver outcomes, and required market composition, have not yet been set out with clarity. It will be important that all proposals work in concert with one another to achieve this vision, and that any points of tension to achieve the wider Government strategy for the UK pensions industry are identified in each policy strand and resolved. Scheme and provider strategy is of course dependent on the shape and scale of the market of the future, and therefore contingent on all interventions, such as these on small pots.

12. In its most recent report the Co-Ordination Group also proposed design principles, which are the following:

    1. The automated solution(s) should help individuals keep track of their small pension pots, thereby helping to promote good outcomes for savers over the course of the accumulation phase.

    2. The solution(s) should be sustainable and support existing competition within the Automatic Enrolment market.

    3. The solution(s) should capture as many of the smallest deferred pots held within Automatic Enrolment schemes as possible.

    4. The risk of matching errors should be minimised as far as possible, with a suitable redress framework being established to compensate individuals should a matching error occur.

    5. The solution(s) should not require any action by the saver.

    6. The solution(s) should be cost effective and thereby reduce the cost burden for providers associated with administering and transferring new and existing small pots.

7. The solution(s) should present a minimal burden to employers and payroll reams whilst providing affordability and value for money for the taxpayer.
8. Savers should be transferred to an appropriate receiving scheme/provider.
9. Individuals should have the ability to opt out.
10. The saver's journey should be as simple as possible.

We could encourage DWP to consider setting design principles, alongside a set of key model assessment criteria as proposed, as these could be drawn up to reflect previous work done by industry to refine potential models in advance of any decisions being made on the ultimate policy.

2. How do you think we can increase member-initiated consolidation and what are the opportunities, risks and limitations of member-initiated consolidation?

13. We are pleased that the Call for Evidence expresses some reservations that efforts to increase member-initiated consolidation would have a meaningful impact on the small pots problem. It is our position that the true impact from assuming that member-initiated consolidation will sufficiently address the small pots problem would represent a dereliction of duty to address this known problem in the interest of savers.

14. It is the belief of the PLSA, alongside all of the work of the Co-Ordination Group and others in recent years, that member initiated consolidation is highly unlikely to represent a materially impactful approach to reducing the number of small pots. Primarily, it does not stop the creation of small pots in any way, and therefore the 'flow' of small pots will not be addressed by relying on this alone. For this reason, we see it as unlikely to meet the criteria proposed by the DWP in the Call for Evidence. Secondly, the automatic enrolment is successful at least in part due to harnessing the power of inertia; attempting to engage savers to address the small pots problem in sufficient enough volumes to make a material difference to the overall scale of the problem on an ongoing basis.

15. It is our view that, by progression with the Pension Dashboards initiative, alongside an approach to a solution designed to address the small pots problem, any potential increase in member-initiated consolidation would be additive to the wider solution, without over reliance on its impact.

3. We would be keen to understand from respondents, how far do you believe market innovations can go in reducing the growth of deferred small pots?

16. As our response to question 2 demonstrates, we do not believe that member-initiated consolidation is a realistic approach to addressing the small pots problem.

17. Market innovation, as well as individual transfers, are often comparably expensive and complex for savers and therefore these innovations are unlikely to be relied upon as either the most efficient of supportive of net member benefit across the whole market.

18. For example, DWP's own research on employer's perspectives on Automatic Enrolment found that employers believe a lack of pension saving habits were influenced by a lack of employee knowledge, among other factors (such as the age of employees or years from retirement).

4. Do you consider one of the values below to be the most appropriate starting limit for eligibility for automatic consolidation, and why – or is there an alternative value? a) £1,000 b) £2,500 c) £5,000 d) £10,000

19. The Call for Evidence proposes a series of very much higher pot sizes than has been assessed or considered as suitable for an automatic small pots solution in recent years. The recommendation of the Co-Ordination Group was that the initial focus of scenario testing of administrative processes and potential consumer detriment on very small pots ranging from £0-100, £100-£250 and £250-£500 (Co-Ordination Group, September 2021). The Co-Ordination Group discussed figures of up to £1k, but found mixed views, with some consensus for an upper limit of £500. The DWP Working Group report noted that 'a substantial proportion [...of deferred pots...] from recent analyses indicate that many deferred pots are extremely small (less than £100)'[2]. We are therefore very surprised to see such high values proposed as part of this Call for Evidence process.

20. We therefore do not support the pot sizes put forward by DWP in this Call for Evidence. This is predominantly because:

- We believe it is premature to ascertain an appropriate pot size without better understanding the volume and spread of small pots across the market and between providers,
- We do not believe that the pot sizes proposed accord with or reflect our collective best understanding of pot sizes that could be automatically transferred,
- There is too great a risk of member detriment without sufficient testing and a phased rollout from a low base,
- The capacity for an assumed very high volume of fully automatic transfers (without significant unintended consequences) is untested, and
- The dynamic effect on either providers or savers of such a significant proportion of medium sized pots has not been assessed in sufficient detail given the above lack of evidence.

As we set out elsewhere in our response, we believe that further evidence gathering and analysis is required before an appropriate pot size could be determined, and without this we believe it could be risky to

21. The Call for Evidence discounts a micro pot definition on the grounds that it limits the net potential benefit gained. It is unclear whether this assumes that any pots below the £100 de minimus charge protection limit is also intended for inclusion in the solution; we wish to seek

[2] Small pots working group report - GOV.UK (www.gov.uk)

clarity from DWP on the justifications for including these pots given their recent intervention on this.

Breakeven point, uneconomic pot sizes and impact on the financial sustainability of the market

22. We find that the Call for Evidence implies that the breakeven point, on which evidence is only being updated as part of this exercise, is not yet sufficient to make an assessment on likely eligible pot sizes.

23. PPI found that 'if the AMC at the highest permissible rate was charged the costs associated with running a scheme, with no additional flat fee, would require an average pot size of around £2,300 for the provider to breakeven (to be spending less or the same amount on administering the pot as the member pays in fees). When [the AMC] is reduced to nearer the industry average AMC of 0.5% or equivalent, the required average pot size to breakeven grows to just under £4,000.' [3]

Savers' best interest

24. Alternative assumptions about total saving through automatic enrolment for now and in the future, and the growth of small pots should be improved upon in order to propose a suitable pot value alongside breakeven point considerations. For example, average current and projected pot sizes saved by automatically enrolled savers have values in the low to mid tens of thousands, and this should be taken into account any policy to automatically transfer smaller pots will, naturally, disproportionately impact the outcomes of savers with lower levels of total saving.

25. Additionally, considering the proposed pot size in light of our wider knowledge about automatic enrolment savers, where the evidence base is more complete, could also be instructive. Expectations are that the average automatically enrolled saver will save £60k by the time they retire, after having 11 jobs during their working lives, and therefore with pots of an average size of less than £6k. We would question whether the intent of the small pots solution is to consolidate all of savers pots into one single pot as this is not one of its stated aims. Considering this another way; one month of contributions (including the employer contribution) assuming National Minimum Wage and working the equivalent of full-time hours equates to a pot of a value of £75 and one month of contributions assuming a median UK salary equates to approximately £160. If a large proportion of small pots are below this size a definition of a small pot strictly by value may not take account of the likely source of these small pots; namely missing the opt out window, seasonal working or many other factors that might be relevant to designing an effective policy solution.

26. The Co-Ordination Group noted that as pot sizes increase above small values tolerances for member detriment may shift (Co-Ordination Group, Summer 2021). We noted, for example, that at higher pot values different investment performance will have a larger member effect on member outcomes. For this reason, among others noted by ourselves above, the Co-Ordination

[3] https://www.pensionspolicyinstitute.org.uk/media/3610/20200922-ppi-small-pots-working-group-guide-to-booklet-final.pdf

Group found risks of including higher pot values, and different parameters may therefore be needed were higher value pots to be part of an automated small pots solution.

27. The Co-Ordination Group also explored factors associated with efficient and low-cost transfers, which are a necessary precondition of any small pot consolidation model with a focus on member protection; transfer costs can erode any potential benefit from the transfer for the saver (Co-Ordination Group Report, September 2021). Transferring these very low pot values will change the proportionate cost of managing and administering the pot, as this currently borne by the scheme and not the saver due to protections introduced below the £100 threshold. It is also worth noting that PLSA members have also raised some concerns about the impact of some small pot models on parallel efforts to increase DC allocation to illiquid assets, in a more general sense that just being able to facilitate low-cost transfers.

Available evidence on the values of small pots

28. Available evidence suggests that a large proportion of total small pots are at values much lower than the values proposed in this Call for Evidence.

29. The Co-Ordination Group has been clear that there is a clear evidential need to assess the average size of deferred pots and how many are being generated (as well as how many are already transferred) (Co-Ordination Group, September 2021).

Gradually increasing the eligible small pot values

30. As part of their work to consider the legislative changes required to implement a potential small pots solution, the Co-Ordination Group reviewed the existing PA2014 legislation on Pot Follows Member. At this time, PA2014 referred to pots of a value ‘less than the prescribed amount’ which would be determined in regulations. The Co-Ordination Group noted that the 2015 Framework document envisaged a £10k upper threshold below which pension pots are eligible for Pot Follows Member, and that this is ‘far higher’ than what is now under consideration. The Co-Ordination Group recommended that it is important to start smaller and prove the concept before including larger pots as part of an automatic transfer solution, and there was some consensus of an initial upper threshold of £500.

31. A lower initial threshold, such as £500, would be reached relatively quickly by someone working full time on National Minimum Wage and, as such, the sensitivity of the overall success of the preferred model to gradually increasing average pot sizes over time should be assessed. For example, this could be reviewed once smaller ‘stock’ pots have been addressed through implementation of the new model(s), and lessons learned applied through this to improve saver outcomes.

32. More generally, the Co-Ordination Group recommended that a phased rollout of an automatic transfer solution should be adopted to minimise the potential member detriment, with a first phase covering small pots held within authorised master trusts and contract-based workplace pension schemes used for automatic enrolment. For staging to be successful, for example with a second stage extension to cover all small pots held within workplace pensions schemes that are

used for automatic enrolment (including employer operated money purchase occupational pension schemes), further engagement with the wider industry would be needed. Staging could occur faster or slower depending on the model, but in all cases the Co-Ordination Group recommended that starting with lower value small pots and increasing the value over time would help to necessarily limit the pots within scope of the automated solution initially.

PROVIDER QUESTIONS

5. How many deferred pots does your scheme have within each of the above breakdowns, how many of these are within AE charge capped default funds, and what is the total AUM of deferred pots for each of these breakdowns?

6. What is the average cost of a pot transfer (ceding and receiving) for your scheme, within AE charge capped default funds?

7. Would the increase in pot transfers associated with an automated small pots solution affect your investment strategy? If so, how, and why?

8. What is the average cost of administering a pot for your scheme, does this differ by active/deferred, or by size? If so, what is the difference in costs and why?

9. What is the breakeven point for administering pots for your scheme, does this differ for active/deferred pots?

10. Do you think there should be a minimum pot size limit for pots to be eligible for automatic consolidation? If so, what do you think this limit should be, and what should happen to pots below that limit?

We have encouraged PLSA members to address these questions in their own consultation responses.

In our view DWP must take account of these responses in their assessment of the potential models, as well as undertaking further, similar (albeit likely more detailed) financial modelling of future solutions before selecting and implementing the appropriate policy.

In relation to Question 7, our members have noted that the model chosen might impact on the short- and long- term attractiveness and practicality of investing in illiquid assets. We therefore note that it would be perverse for any small pots solution in have the inadvertent effect of disincentivising investing DC funds in illiquid assets, for example because liquidity would be required in order to facilitate small pot transfers under a new model. This may be particularly pertinent to consider for the Pot Follows Member model.

It is worth also noting that the effect of proposals on DC illiquid asset investment have arisen in discussions on the wider impacts of the DC reforms package beyond the specific small pots solutions on the table.

11. Do you agree that setting a prescribed period for a pot to be classified as deferred is the most appropriate solution – and what period of time would be appropriate, and why? If not, what would be a more suitable approach?

33. The Co-Ordination Group position on this question is fairly reflected in the Call for Evidence in our opinion; the Group did on balance agree that a prescribed period is the best likely definition and we continue to support this proposed approach. However the Co-Ordination Group did qualify the prescribed time period recommendation with a need to better understand the consumer journey and labour market analysis, as well as noting that the most suitable trigger may be model dependent (for example, whether it is a push or pull model) (Co-Ordination Group Report, September 2021). We therefore would expect any final definition to reflect additional evidence gathered to refine this to the specific model(s) selected.

34. The Co-Ordination Group also found that a deferral definition will need to be in legislation, whereas the Call for Evidence is not specific on the intended mechanism for defining pot deferral.

DEFAULT CONSOLIDATORS

12. Do you agree with the above summary of potential benefits and implications of the default consolidator/s approach, and if not why?

35. In general terms we would agree with the summary of potential benefits and implications of the default consolidator(s) approach provided in the Call for Evidence.

36. The DWP Working Group found the following positives and negatives of different consolidator models which were specific to the different variations of the consolidator models: first provider, carousel of providers and single Government consolidator models. The Co-Ordination Group also found additional elements that should be considered as implications of the default consolidator variations.

Positives in addition to those noted in the Call for Evidence

- We agree that this model could remove a considerable number of deferred pots from current workplace pension schemes into consolidator(s), though we'd note that the Co-Ordination Group has found that this is the case in a push model on stock pots and depends on the criteria set and the trigger (Co-Ordination Group Report, June 2022). Pull models could potentially remove all stock pots from the system (Co-Ordination Group Report, June 2022).

Negatives in addition to those noted in the Call for Evidence

First provider	**Carousel of providers**	**Single Government consolidator**
Delays in pot transfers leading to pot erosion (DWP Report, December	Commercial viability is uncertainty	Cross subsidy implications for schemes (DWP Report, December

2020) Issues may arise where schemes are consolidated in the future (Co-Ordination Group Report, June 2022) Issues with authorisation if the first provider is not a Master Trust or a Group Personal Pension (Co-Ordination Group Report, June 2022)	(DWP Report, December 2020) If a provider is not designated a consolidator it may be 'penalised' compared to those providers that are designated consolidators (Co-Ordination Group Report, June 2022)	2020) Discounted by the Co-Ordination Group on the grounds of distortive impact on the market (Co-Ordination Group Report , June 2022) Discounted by the Co-Ordination Group on the grounds of cost to the tax payer (Co-Ordination Group Report, June 2022)
This model does not eliminate new small pot creation in either push or pull model formulations (Co-Ordination Group Report, June 2022) Multiple returners are a problem for these models as, if a saver re-joins a scheme, the pot may have already been moved to another consolidator (Co-Ordination Group Report, June 2022) The risk of splitting out money management from the accumulation process. For example, if a Consolidator that does not act as an accumulation vehicle could be established to receive small pots and manage the contributions in the early years when revenue for the consolidator from this business is likely to be very low and potentially below cost (Co-Ordination Group Report, June 2022)		

37. We disagree with the implication inferred from the articulation of the potential 'limit'(ation) of potential 'burden' on employers as a positive for this model as there are other implications of the erosion of the employer link that are not in savers' best interests.

38. We strongly agree that a robust authorisation regime would be needed and that transfers should only go to a consolidator of appropriate quality (Co-Ordination Group Report, June 2022).

13. What are the key benefits / risks of a multiple default consolidator and single default consolidator approach, including impacts on the wider pension market, and employers?

39. Pots will only be subject to transfer costs once. For this reason, this model may work particularly well for the micro and smaller pots across the lifetime of that pot, given that it will only be transferred once.

40. Potentially consolidator models (depending on how the policy is designed and implemented) solve the issues for all pots (including stock pots) but cannot address flow pots as these models don't act on the creation of small pots.

41. There would need to be careful consideration of what status the pot would have and what activities a consolidator could undertake. If they were authorised to act in the same way as any other providers (e.g. accept ongoing contributions and other new money, provide decumulation

solutions etc.) this could be very disruptive to the market were the majority of small pots to end up outside the 'traditional' providers (Co-Ordination Group Report, June 2022).

42. These consolidator vehicles would need to be included within the Pensions Dashboards framework to facilitate reuniting people with their lost pots (Co-Ordination Group Report, June 2022).

43. The Co-Ordination Group also recommended that further economic/market analysis in relation to the default consolidator model (Co-Ordination Group Report, September 2021).

14. Who should be able to be a consolidator; should there be a limited number, and, if so, how many, and why?

44. One of the potential comparative benefits of consolidator models are that they should not immediately impact the active pots market, though of course they could impact on the financial viability of some schemes over time as the market evolves.

45. As above we strongly agree that a robust authorisation regime would be needed and that transfers should only go to a consolidator of appropriate quality (Co-Ordination Group Report, June 2022).

15. What would be the appropriate approach to giving members choice in terms of choosing their consolidator, and what approach should be taken if the member did not make an active choice?

46. Member choice could be a benefit of consolidator models. Consideration would need to be given as to the mechanism for the choice, the schemes a member could choose from and whether they retained the right indefinitely to 'opt out' to using a consolidator for their small pot and make changes of their consolidator into the future. As acknowledged in the Call for Evidence, consolidator models could be designed to align with the principles of automatic enrolment and not require active involvement from the saver, though careful design choices would also be needed in this case to achieve this.

47. In either case, many members would not choose their default consolidator, and therefore an approach would need to be found to allocate them one. Both 'first provider' and 'carousel' models have been proposed to deal with this issue. Specific solutions might need to be found for pots that have been deferred for some time, where members may be even less likely to be engaged.

48. A single government supported consolidator would not, of course, support member choice where this was the full, 'default' solution.

49. One benefit of the other models when compared with default consolidator models is that no mechanism is needed to identify, record and maintain member choices over time. Questions also remain about how authorisation and supervision would be designed and maintained to provide savers with sufficient protection (see also our responses to questions 13 and 14).

POT FOLLOWS MEMBER

16. Do you agree with the above summary of potential benefits and implications of the pot follows member approach, and if not why?

50. In general terms we would agree with the summary of potential benefits and implications of the pot follows member model provided in the Call for Evidence.

51. The DWP Working Group found the following positives and negatives of pot follows member. The Co-Ordination Group also found additional elements that should be considered as implications:

Positives in addition to those noted in the Call for Evidence

- Reduces administrative burden on employers (DWP Report, 2020) and has in the past had the support of employers, though recent evidence suggests that there are reservations amongst employers about both models[4]
- Opportunities to build out from Pensions Dashboards data standards (DWP Report, 2020)
- Simplicity might enable greater consumer understanding (DWP Report, 2020)
- Under a pull model it would provide for greater assurance to receiving schemes of the security of the source of the transfer (Co-Ordination Group Report, June 2022)

Negatives in addition to those noted in the Call for Evidence

- Increased pot erosion resulting from transfers to schemes with higher fees (DWP Report, 2020)
- Increased transfers and associated costs could be passed on to members or risk scheme viability (DWP Report, 2020)
- It is important to consider the consumer experience if in 10-20 years, they are looking for a small pot that has been consolidated (Co-Ordination Group Report, June 2022)
- Under a push model it could represent a higher risk of scams if no or inadequate restrictions are placed on potential receiving schemes (Co-Ordination Group Report, June 2022)
- Consumer experience would need to be considered carefully where time has elapsed and a saver is searching for a pot; it is unclear whether the ceding scheme would be able to disclose where the pot had been moved after 10-20 years has elapsed without contravening GDPR obligations on data destruction (Co-Ordination Group Report, June 2022)

52. We agree that this solution would also need to address the issue of multiple jobholders and those that move jobs frequently, with some awareness of how prevalent these issues would present to the model given a better understanding of the number, spread and reasons for creation of small pots. For pot follows member to be a success it is dependent on a high proportion of savers who start a new job being enrolled into (and remaining in) their new employer's pension scheme long enough to allow the small pot from their previous employment to catch up with them (Co-Ordination Group Report, June 2022). DWP has undertaken some

[4] Workplace Pensions and Automatic Enrolment: employers' perspectives 2022 (publishing.service.gov.uk)

work to try and understand employers' views on small pot creation and the opt out window, for example, with mixed results suggesting that some employers believing that savers understand the opt out window well, whereas others believed that there is a generally low level of understanding of the opt out process[5].

53. In addition, as with default consolidators, a robust authorisation regime would be needed and that transfers should only go to a consolidator of appropriate quality (Co-Ordination Group Report, June 2022). This is not drawn attention to in the Call for Evidence for pot follows member models as it is for default consolidator models. The Co-Ordination Group has considered using AE Qualifying schemes as meeting the quality definition, or further refined to authorised Master Trusts and FCA-regulated providers with Independent Governance Committees (IGCs) or Governance Advisory Arrangements (GAAs). This is because these schemes must have an appropriate default fund, be charge capped and have appropriate independent governance and oversight of value for money (Co-Ordination Group Report, June 2022).

17. What are the key benefits / risks of a pot follows member, including impacts on the wider pension market, and employers?

54. Many participants of the Co-Ordination Group, at least in part of simplicity grounds, thought that pot follows member has the greatest potential to address the flow of small pots. One advantage discussed was that pot follows member builds on the existing system, rather than requiring the creation of new entities to facilitate the implementation. Participants also felt that this may also make the solution simpler to explain to savers.

55. The total number of deferred pots were found to be lower (by 3 million by 2035) as compared with other models considered after implementation[6]. In this model member charges and provider costs were also found to be lower.

NEW SMALL POTS CONSOLIDATION SOLUTIONS

18. Of the two solutions set out above what is your preferred approach, and why?

56. As noted elsewhere, PLSA believes that multiple solutions are needed to address the problem in full. The PLSA Small Pots policy position remains that a combination of different options are needed:

    a. a solution designed to operate in the short-term (e.g. same scheme consolidation, member exchange)

    b. a solution designed to resolve the whole issue in the longer-term (e.g. a default consolidator, Pensions Dashboards as an engagement tool – in conjunction with other options).

[5] Workplace Pensions and Automatic Enrolment: employers' perspectives 2022 (publishing.service.gov.uk)
[6] 20200723-deferred-members-final-report-for-the-website.pdf (pensionspolicyinstitute.org.uk)

Any longer-term solution will need to be underpinned by the following **PLSA Principles for Small Pots:**

- There should be no material detriment to the saver from being (automatically) transferred between DC schemes (including consideration of costs and charges).
- Transfers should be efficient for schemes (e.g. automated or semi-automated) and simple and quick for scheme members.
- Transfers should not rely solely on active decisions by savers to take place.
- The proliferation of small pots should be stopped so that administration and other costs do not continue to rise.
- Competition issues and issues of reciprocity must be managed appropriately.

57. The Co-Ordination Group made the following recommendations to identify a preferred solution or combination of solutions:

    a. A consumer-focused cost/benefit analysis needs to be undertaken on Pot follows Member, multiple Default Consolidators and Member Exchange; all costs as well as benefits will ultimately be borne by members and so it is crucial that this stage is reviewed thoroughly.
    b. Analysis is needed of where small pots are in the existing system, the key reasons for their proliferation, and the wider systematic benefits of removing small pots for savers and schemes. The output from the Pensions Data Project (PDP) will help to provide this. This should also include analysis of the potential movement of small pots under the different models still under consideration.
    c. Analysis is needed of the impact of different models on the financial sustainability of the AE market and the resulting impact on the consumer. This has yet to be commissioned but is considered to be a key element in identifying a preferred solution.
    d. A clearer understanding of the views of Defined Contribution (DC) savers and employers on the priorities for any potential solution. This should be provided by the research which has been conducted by DWP.
    e. Decisions about the preferred model will need to be accompanied with a direction for delivery, governance and funding of the project. The pensions dashboards project, for comparison, has centralised standard setting and procurement of technical architecture at the Money and Pensions Service (MaPS), which has access to levy funding and is subject to public accountability. It has a bespoke governance arrangement with some industry input, although these arrangements are currently under review with a range of working groups and more planned as the programme develops.
    f. The industry representatives view is that legislation will be required to enable any new framework and to implement a solution addressing the proliferation of small pots. In particular this will be needed to:
        i. compel all in-scope schemes and providers to take part in implementing the preferred solution,

ii. enable contract-based providers to carry out transfers without member consent and to broaden the scope for transfers without consent from occupational pension schemes,
iii. define the deferred pots and schemes in scope,
iv. set standards to identify eligible receiving schemes, and
v. define the liability model for trustees, providers and others involved in the relevant processes.

We believe this work is critical to sufficiently assess the model(s), and would be needed to assess the models against the key criteria proposed.

58. We are pleased that DWP are now trying to assess and identify the policy approach to address this issue for savers. We will be happy to support efforts to identify and implement the preferred approach as soon as possible.

19. Are there any further / fresh or hybrid solutions that are worthy of consideration?

59. We are not aware of any alternative solutions that are worthy of consideration at this time.

20. Should there be an initial focus on managing the flow of new pots or removal of the existing stock, and where does the balance of impact lie for each of the solutions presented?

60. Both stock and flow small pots issues must be addressed.

61. The PLSA independently, as well as the DWP Working Group and the Co-Ordination Group, have found that a package of solutions may be necessary to address stock and flow problems. Evidence from other jurisdictions, notably Australia, also found that a package of solutions is often necessary.

62. Addressing 'flow' will be particularly important given that any initiative to address the small pots issue will need to take account of future planned changes to Automatic Enrolment. Interventions to improve pensions adequacy, such as implementing the 2017 AE Review Recommendations, currently proposed through the Gullis Bill, are supported by the PLSA through our Five Steps to Better Pensions proposals. Solutions to address future and yet uncreated pots may not be well addressed by models that can deal well with 'stock' pots which may have been created for all manner of reasons, some which have been well understood for some time, such as the staged introduction of Automatic Enrolment through to natural job churn. We think it important that DWP therefore acts on both 'stock' and 'flow' pots as soon as practicable.

63. In general, under both pot follows member and default consolidator models there will still be a build up of small pots, albeit on much reduced levels than currently. This is because unless the transfer occurred immediately and simultaneously to an individual ceasing to contribute or being enrolled in a new pension their small pot would not be eligible for any solution (Co-Ordination Group, June 2022).

64. Stock pots may be better addressed and consolidated by using a push mechanism, whereas flow pots may be best addressed and consolidated using a pull mechanism (Co-Ordination Group, June 2022). To this end, a pull-based pot follows member model would deal with the flow of new small pots, but may be less effective in dealing with the current stock of small pots that already exist within the system (Co-Ordination Groupe, June 2022).

65. Participations in the Co-Ordination Group agreed that a combination of push-based default consolidators model and a pull-based pot follows member model could potentially work together to address both stock and flow small pots issues, and maximise the possible reduction of small pots in the system (Co-Ordination Group, June 2022).

MEMBER EXCHANGE

21. What could be done to incentivise, build momentum, and help build market and member confidence in member exchanges, either now or in future? Would this be best taken forward by industry or government?

66. We have found that introducing an industry-wide automatic small pots transfer solution will require legislation, as the industry can only go so far within the current legislative context to resolve the small pots problem (Co-Ordination Group, September 2021). We have not identified any 'incentives' superior to legislative change to support member exchange that would lead to greater improvement to member outcomes.

67. In advance of any compulsory legislative transfer framework, it could be helpful to have assurance or a statement from the Regulator to facilitate small pot transfers. It is possible that the member exchange proof of concept, and pilot, will identify the degree to which helpful assurance could be provided by TPR to deliver additional comfort for trustees and relevant parties to facilitate small deferred pot transfers before relevant legislation (Co-Ordination Group, September 2021).

68. Any such assurance from the Regulator should therefore be intended to help give some comfort to trustees in the short- and medium-term and should help unlock solutions that could work for stock pots. The Regulator may, for example, be able to provide a statement highlighting the holistic approach trustees must take, but any statement will be unlikely to establish rights savers have in the case transfers have occurred that they are not happy with, or asset which schemes offer comparative value for money were discretion for assessing this a part of the model (Co-Ordination Group, September 2021).

69. We are pleased to see that the Government intends to clarify that new legislation, for example relating to scams, should not be a barrier to transfers to Master Trusts as this was something the Co-Ordination Group called for (Co-Ordination Group, September 2021).

22. Could a member exchange form part of a hybrid model alongside one of the largescale consolidation solutions discussed in Section 5, or with a large-scale consolidation solution acting as a backstop?

70. The PLSA position is that multiple solutions may be likely to address the issues in question:

    a. a solution designed to operate in the short-term (e.g. same scheme consolidation, member exchange)
    b. a solution designed to resolve the whole issue in the longer-term (e.g. a default consolidator, Pensions Dashboards as an engagement tool – in conjunction with other options).

71. Even if member exchange is successful in achieving a level of small pot consolidation, it might also lead to distortions in the Automatic Enrolment market as it would mean in some schemes and providers relieving themselves of small deferred pots (at least to some extent) whereas others cannot participate. For example, Nest and contract-based automatic enrolment schemes are unable to undertake member exchange within the current framework as they cannot undertake bulk transfers without consent. The degree of any market distortion will depend on the scale and nature of small, deferred pots held within the participating trust-based sector compared with those excluded (Co-Ordination Group, September 2021).

SAME SCHEME CONSOLIDATION

23. Do you agree that same scheme consolidation has a key role to play in the wider consolidation of deferred small pots, and can act as a foundational measure to larger market-wide solutions? If not, why?

72. Same scheme consolidation is a measure that will have a limited impact on solving the problem of small pots. Whilst some providers have always linked a returning active member to the inactive pension pot, this practice is not required or always possible. Single member views are sometimes adopted in cases where actual pot consolidation cannot be undertaken.

73. Wider same scheme small pot consolidation within the Automatic Enrolment market could act as a foundation measure to help narrow the issue of small pots and slow their overall growth. Addressing these multiple pots within each provider could also make it easier to implement a cross-provider solution, as well as improving member engagement with their pensions. According to the data gathering conducted by DWP in 2021, in the best-case scenario, one million small pots could be consolidated under a same scheme arrangement, and so therefore would address less than 5% of the total small pots projected to be created by 2035[7].

74. In addition, same scheme consolidation is unlikely to occur for contract-based schemes, given the need for member consent to consolidate their benefits even within the same scheme or

[7] Assuming estimates that more than 27 million small pots will be created by 2035, 20200723-deferred-members-final-report-for-the-website.pdf (pensionspolicyinstitute.org.uk).

between schemes run by the same provider. For many of the small pots, a scheme will have great difficulty in getting that consent from the member.

75. Another challenge is the need to hold separate pension pots/accounts within a scheme for compliance and verification purposes and to make reconciliation easier to resolve contribution errors.

76. A further issue with same scheme consolidation is bespoke employer pricing, meaning pots are kept deliberately separated as they are subject to different pricing levels. Though this is not an issue for single charge Master Trusts, it is for some other providers.

24. If your scheme currently does not undertake same scheme consolidation, what are the reasons behind this and what would be required to overcome this?

77. Schemes will have different reasons, as above, for this not being possible. We do not believe that, even if all of these issues were resolved for all schemes (which for the reasons also above we do not believe would be possible), that this would make a material difference the overall scale of the small pots across the market.

25. As part of this call for evidence we would therefore welcome views on how protected groups are currently impacted by the deferred small pots issue;

- **a. whether the impact differs between groups and in comparison, with nonprotected groups;**
- **b. what mitigations providers are putting in place and the impact of each of the options on protected groups;**
- **c. and how any negative effects arising from them may be mitigated.**

78. Disproportionately those with small pots are likely to be lower earners, parttime workers, transient workers, women and ethnic minorities. They are also more likely to be under pensioned groups and those that suffer from wider issues of financial hardship. For this reason DWP should consider the financial wellbeing of those with small pots in the round.

79. For this reason refunding very small pots (previously referred to as micro pots) should be considered as part of the suite of solutions, particularly as the value of these pot could be beneficial to the saver immediately and will not materially positively impact their outcomes when considered in terms of their total retirement income adequacy (for example, including any eligibility to the state pension and other in-retirement means tested benefits).

Additional areas not specifically addressed through Call for Evidence questions

80. We would also encourage DWP to read the Co-Ordination Group response alongside our response for further information.

Administration and infrastructure

81. Data matching and low-cost transfers (Co-Ordination Group Report, September 2021) haven't been covered in any detail by DWP in this Call for Evidence.

82. The Co-Ordination Group found the assessment of existing data requirements and the implications for matching protocols show that various options remain for small pot solutions. However, it appears clear that 'raising the bar' for matching standards may well improve protections for savers from errors in some cases, but will also reduce the number of positive matches available for potential automatic transfer. The Group found the results of this work as contingent/needing to be reassessed given their findings, particularly given the likely complexity and costs associated with matching (automatically) small pots in order to transfer them en masse (Co-Ordination Group Report, September 2021). Data availability and quality were identified as unexpected key issues in data matching for small pots and the importance of these factors in making progress on administrative issues should not be underestimated. There will be some matching errors, the risk of which should be minimised (as far as possible) with a suitable compensation regime introduced to protect savers (Co-Ordination Group Report, September 2021). The recommended next phase was identified, at the time, to consider the implications for potential industry wide data matching standards (Co-Ordination Group Report, September 2021).

83. During this phase a transfers working group mapped the current individual member-initiated transfer processes to identify where costs occur and discovered potential efficiencies. Low cost transfers are a necessary condition of progressing small pot consolidation models as without these the net gain for savers from consolidation is likely to be severely curtailed (Co-Ordination Group Report, September 2021). Key barriers for low-cost transfers were identified, including those that are legislative and regulatory, and recommendations were made to reduce these (Co-Ordination Gorup Report, September 2021). Conditions for future small pot transfer processes were also considered, which have implications for the definition and scope of small pot consolidation models (Co-Ordination Group Report, September 2021).

84. Consumer journeys and push vs pull ecosystems (Co-Ordination Group Report, June 2022) also haven't, in our opinion, had sufficient focus in consideration of the different models in this Call for Evidence.

85. The Co-Ordination Group identified a need to test different consumer profiles against different models to better understand what a typical consumer's experience of the models may be. To do this the Group designed some very basic archetypes of consumers which – holding other elements constant – illustrate at a high level what might happen to them were different models implemented (Co-Ordination Group Report, June 2022). The assumptions used in these

consumer journeys are not the same as those proposed in this Call for Evidence (for example the definition of a small pot differs significantly in value) and so this work would need to be duplicated.

86. The Co-Ordination Group separately, and building on the transfers and consumer journey work, also assessed whether a 'pull' mechanism would be preferable to a 'push' mechanism, and found that it may be as it builds on existing processes and is in line with member-initiated transfers. This re-emphasised the importance and significance of the 'trigger' or definition of small pots as this was found to likely have a significant impact on consumers (Co-Ordination Group Report, June 2022).

87. Our collaboration report – 'Small Pots, Big Solutions' – created with partners ITM and Altus, identified where progress can be made, in auto-consolidation, data matching and pensions dashboards, and highlighted outstanding questions that sill need to be addressed. The report concluded that industry can learn from elements already in place, however this may not be sufficient to solve the new and complex issues associated with transferring small pots on a massive scale.

Refunds

88. Automatic refunds by default of micro-pots were also raised in discussion with the Group as a solution for smaller pots (i.e. those under the de minimis, currently set at £100) and as happens in Australia for those over 65 years of age.

89. There are certain scenarios where refunds might be particularly helpful:

    a. where an individual fails to opt-out within the opt-out window, and ends up ceasing to contribute or leaving the scheme shortly afterwards,

    b. recurrent re-enrolments that do not immediately optout, and

    c. workers who are no longer resident in the UK and who are not UK nationals who have been automatically enrolled.

90. An argument in favour of paying a refund is that it may be more efficient and more cost-effective than automatically transferring the micro pot. This is more likely to be the case if it is not possible to implement a cheaper, more efficient system for transfers. Short service refunds in DC pensions offer a precedent for this, although they are severely limited, being only available where an individual leaves employment 30 days after being automatically enrolled into a pension scheme.

91. On the other hand, paying refunds to people may in fact be more time and cost intensive than a new automated and efficient transfer process (particularly as pension schemes and providers are unlikely to be able to refund the pot without contacting the individual, and confirming that they have the correct recipient bank account information). It may therefore be preferable to convert micro-pots such as these into more meaningful pension savings by combining them with other pension pots that an individual has. Refunding micro pots may also be well received

by savers who will benefit immediately from a refund, without materially affecting their prospective income in retirement.

92. There may be other ways to address the issue of future proliferation of micro pots depending on the cause of their creation, for instance, if the cause is due to savers missing the opt-out window. Although existing evidence from DWP's 2020 Small Pots Report does not suggest that savers missing the opt-out window is the main driver for small pot creation. A broader data set may be desirable to establish the scale and nature, as well as distribution, of micro pots and analyse the drivers of their creation.

DISCLAIMER