PENSIONS AND LIFETIME SAVINGS ASSOCIATION

ENDING THE PROLIFERATION OF DEFERRED SMALL POTS: PLSA RESPONSE TO DWP CONSULTATION

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ABOUT US

The Pensions and Lifetime Savings Association is the voice of workplace pensions and savings. We represent pension schemes that together provide a retirement income to more than 30 million savers in the UK and invest more than £1.3 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs, and others who play an influential role in people's financial futures. We aim to help everyone achieve a better income in retirement.

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, and to find solutions that are in the best interest of members. The fact that Government has come to a decision on how they believe part of the issue of small pots can be addressed through the multiple default consolidator model is certainly welcome, albeit there is further work to be done on the detailed policy, operational impacts and implementation. It will be critical for industry to be involved in the next stages, and for this reason we are very supportive of the launch of a Delivery Group, the mandate of which should include the design and implementation of the default consolidator framework.

We continue see the small pots issue as a significant opportunity to optimise the success of Automatic Enrolment, and reduce the sub-optimal outcomes 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 the necessary reforms to improve pensions adequacy, some of which are currently making their way through Parliament, 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. Our consultation response notes that the proposed detailed policy will need careful attention, including the pot sizes and definition of deferment used to include small pots in the new framework. The Government has proposed a pot size of £1,000. The PLSA and the industry working group preferred an initial size of £500. Administration and infrastructure questions also remain, and the decisions about these may depend on interconnected factors such as the definition of a small pot and the cost of transfers. Finally, the authorisation and requirements on future default consolidators have yet to be established in full, though we agree that a standard will be needed to protect savers. Many pension schemes and pension providers have found it hard to evaluate the proposals in this consultation due to uncertainty about the Government's ultimate vision for the automatic enrolment landscape, especially regarding the number of mass market pension schemes.

We see the Department's Call for Evidence, and this subsequent Consultation, as a very positive sign that action on small pots is forthcoming. We would continue to support the Government's efforts to address this problem as soon as possible. The support for this effort is in concert with the wider reforms that are being made at present. This consultation aims to promote pot consolidation and encourage increased investment in growth assets. We recognise the potential for greater returns that these reforms may offer, however, attempts to engineer an accelerated process towards investment in illiquid assets of consolidation comes with its own set of challenges (see our 2023 paper). We would welcome more attention from government on how the different strands that have been announced might come together in a cohesive strategy, and how the implementation of different strands will potentially impact other proposed interventions such as decumulation decision making.

We look forward to working with the Department on the next stages of policy design and implementation.

CONSULTATION QUESTIONS

1. Do you agree with this proposal, or do you believe a central registry would be a more effective approach to support the consolidation of deferred small pots, if so how would you design a central registry?

1. The choice of the model of Multiple Default Consolidator comes with benefits. It is also a more complicated model as consolidating to an existing pot is, naturally, easier to do. The DWP Working group previously found that a default consolidator model could remove a significant amount of the stock of small pots. As the Minister mentions in her foreword, the issue of deferred small pots could lead to hundreds of millions of pounds being wasted each year by 2030. Whilst, as our response will highlight, much more detail is required before the industry can fully assess the viability of this model, our members have expressed satisfaction with it.

2. A mechanism to decide the allocation of small pots is essential to the chosen Multiple Default Consolidator model. Without such a mechanism directing the travel of a pot, this policy would not work. Though the Clearing House option is the preferred one for government, the PLSA would rather that the government consider other options, such as a blended option of a Clearing House with Central Registry features, which would combine the most practical elements of both. Whilst, in an ideal scenario according to the PPI, a Clearing House has the potential to reduce the administrative burden on employers, while also reducing the potential impact of employer error on the member[1], the consultation simply does not provide the evidence to demonstrate how this would work in the UK. Some of the concerns with a Clearing House that will need to be answered include, the fees that may be charged for its services and setting up, the governance of it, data handling, storage and security considerations and the need to comply with as yet unknown additional regulation. As part of this consultation process, we would recommend that the DWP speak with service providers that have expertise in pension transfers which could be leveraged to the new application of small pots.

3. The government pointed to the Central Registry potentially being able to assimilate existing Dashboards infrastructure into its design. At present, this would not be possible as the Dashboards will not store any data. Instead, the ecosystem will function like a giant switchboard, connecting users with their pensions via the dashboard.

4. The combination of a Clearing House, that operates a Central Registry, could effectively manage the weaknesses of each option. If a Clearing House was receiving data, that it does not store, from schemes in real time and then subsequently allocating them in bulk, this could be a workable solution. It should be possible to explore whether some elements, even if not all, data infrastructure utilised for Dashboards could be repurposed as other alternatives are likely to be very expensive and/or prove ultimately duplicative.

5. As the consultation offers little detail as to what either option would look like, and the connected process for enabling the ultimate policy solution to come into being, the PLSA has put together a series of questions in the table below that need to be answered by the DWP before any final decision is made. We strongly believe that the Delivery Group, which the DWP intend to set up later this year, should assist with working out the answers to these questions raised, among others potentially yet unclear.

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[1] https://www.pensionspolicyinstitute.org.uk/media/3694/20210112-ppi-small-pots-international-report-final.pdf

Clearing House	Central Registry
• How is the data stored/ acquired/ transferred/ managed?	• How is the data stored/ acquired/ transferred/ managed?
• How would DWP define it? Does it match what the FCA would define as a Clearing House?	• A Central Registry can come in multiple forms, how DWP precisely define it beyond what the small explainer given in paragraph 107 of the consultation?
• Will this be government-run or independent of government?	• There is a suggestion this option could use existing Dashboards infrastructure, how would that work within the existing legislative and regulatory framework?
• If government-run, will it be a statutory body and who would it be regulated by? How will it be paid for?	• How automated would this process be?
• If it is privately-run, are the government expecting to use levies to pay for it?	• Will this option require further private sector capital to get up and running?
• How long will it take to set up?	• How easy would it be for schemes to engage with the registry?

2. Which, of the options we have set out, do you think is the best approach to allocate a member a default consolidator in cases where a member does not make an active decision? Are there alternatives?

6. The nature of the UK pension system means that it is fair to assume that most members will not make an active decision when it comes to deciding where their pot should be consolidated. This makes the steps that follow on from this so important. The consultation provides two options as to what could happen in extremely likely scenario that a member does not choose their consolidator. As currently formulated it is very difficult for schemes to model the likely outcome of either option for their membership or to assess the impact across the market. It is the PLSA's view that a third option could be considered as the weaknesses of both options A

and B could be insurmountable in their current form. The table below summarises the issues with each:

Proposed options	**Proposed Option A - Allocate all small pots between the providers who meet the criteria to be a consolidator at a level proportionate to their market share**	**Proposed Option B - Given the likelihood that a member will have a deferred pot already with a consolidator scheme, this scheme would be allocated as the member's consolidator scheme. (Should a member have pots with multiple schemes that are authorised consolidators, their deferred pots pot could be allocated to the consolidator scheme holding their largest deferred pot.)**
Summary of issues	This could have a distortive effect on the market. If the solution is to funnel small pots by market share, there is the possibility that it will unfairly benefit some schemes at the expense of others. There is a risk that this might fall foul of competition laws.	This option is based on an assumption that members will have a deferred pot with a consolidator scheme. If fewer schemes opt to become consolidators than Government expects, or more if there are more members that have no existing pot have small pots, this option quickly becomes problematic.

7. As mentioned, a third approach would be the PLSA's preference. We believe that any option for allocation should be based on the following principles and design considerations (aligned with the benefits of small pot consolidation noted by DWP as part of the consultation in paragraph 72):

A) Savers in mind – Any option should improve the outcome for the member achievable by the new default consolidator model. This would support the following key assumption made by the DWP "*small pot consolidation should deliver overall net benefits for members through improved value for money outcomes, and complement engagement on their savings journey. For providers, small pot consolidation should support a competitive, sustainable and more efficient workplace pensions market" (Page 35, Para 72)*

B) Supportive of a healthy market – Any option should be non-distorting, highly efficient and have a low error rate. This should help to ensure that the workplace pensions market is sustainable.

C) Promotes pension awareness – Any option should lead to increased member awareness of their total pension wealth. Once their pot has been consolidated, members should receive clear information about where their pensions are. For example, this could be clear signposting to Dashboards, or a digital information pack.

8. Any option will need to have administration and implementation costs at the forefront. This will ultimately decide whether it is in the members' best interest to consolidate. The consultation provides a very high-level view of a potential process (paragraph 111) but we do not believe this provides sufficient information to assess whether Option A or B, or indeed any alternative option, would meet the design considerations set out above as the ultimate process is intrinsically related. For example, one element of the future process that the consultation notes is that members will be afforded the opportunity to both choose their consolidator and opt out of consolidation altogether, and this choice alongside the procedure for allocating those that do not engage must be considered in concert. As is also noted, the industry has already considered many of these issues, and the next phase of this work should prioritise taking these considerations forward now that a default consolidator model has been selected; this work should be undertaken by the Delivery Group.

9. Any models must be accompanied with a detailed analysis of how they interact with cross holdings and transfer volumes, to make sure that the impact on both an individual and market level. For example, the consultation makes an assumption (paragraph 96) that were small pots distributed by default consolidators amongst those the providers that already have the largest number of active members this would have a lesser impact than alternative cases, but it is unclear whether this assertion has been tested.

3. Do you agree that there is a need for an authorisation regime for a scheme to act as a consolidator? If so, what essential conditions do you think should form part of the authorisation criteria?

10. We strongly agree that a robust authorisation regime would be needed to manage the risks associated with being a consolidator. As members will find their pension pots are being automatically transferred, public confidence in the quality of provision is paramount, so these organisations must operate to the highest governance standards.

11. However, we do already have a stringent regime in place for the authorisation of DC Master Trusts, and we consider the vast majority of this regime will be applicable to the business of consolidators. It is also highly likely that the organisations applying to become default consolidators are existing master trusts, so will by necessity, already be complying with expected standards (fit and proper requirements on those running the scheme, sufficient systems and processes, a continuity strategy to deal with set triggers or wind-up scenarios, scheme funder and financial stability requirements). Therefore, while we acknowledge that government will not require all master trusts to apply to become consolidators regardless of their intention to become one (which we would welcome clarification on in writing as the opposite was implied), there could, reasonably, be a requirement on consolidators to be fully compliant with the existing master trust authorisation regime. This would cover most of the key governance areas.

12. There may be select areas where additional criteria would be beneficial, given consolidators will be engaging with more 'default' transfer activity than other master trusts. More detail on the actual process for transfers, including on the central registry/clearing house debate, will be needed before specific requirements can be settled on, but it may be that consolidators should be required to comply with higher standards of administration and systems in order to safely deal with the necessary volumes of transfers. Additionally, in paragraph 107 government notes

the risk of consolidators marketing their scheme to members for consolidation, and we agree some controls around this will be necessary, however this may be better addressed by the regulator through a supervisory approach rather than at initial authorisation.

13. The main concern that the PLSA has with any potential authorisation regime is that it may be based on the assumptions that are made within the consultation. The frequent use of broad assertions, without being backed up by relevant evidence, when DWP is explaining the rationale for selecting the Multiple Default Consolidator Model in the consultation leads to concern that the authorisation regime may be based on who the government believes will apply to be a consolidator, rather than which organisations may actually apply. The Delivery Group could, for example, be tasked to consider whether there are operational risks that would merit from additional authorisation that should be reflected in the ultimate regime.

4. Do you agree with setting the initial maximum limit for consolidation at £1000, with a regular statutory review?

14. We have some concerns with the proposed limit for pot consolidation, without providing an impact assessment of the impact of selecting a maximum pot size of a £1000 pot size limit.

15. The Call for Evidence caused concern when it proposed classing a small pot up to £10,000. We are pleased this consultation has discounted that idea. Setting a pot at £1,000 is at the upper end of what the Co-Ordination Group previously deemed as acceptable, and the consensus was for the initial maximum pot size to be set at £500.

16. The PLSA believes a £500 would be more appropriate as a starting point, albeit with a clear path to reaching a £1000 maximum pot limit within a reasonable timeframe. A key reason for this is that if the maximum pot size is set too high, a much higher proportion of the total pot (and total assets saved through DC AE) will need to be invested in liquid assets to enable that they can be automatically transferred away in line with the default consolidator model. This potentially acts against the government's intention to channel more pension funds into illiquid and growth assets. This intention has formed a key underpinning for the selection of this model, as demonstrated by the following assumption made in the consultation "*These small number of consolidators, will be able to generate scale at a greater rate opening opportunities to invest in productive finance benefitting the wider economy" (Page 30, Para 58).*

17. However, the inclusion of regular statutory reviews does mean that the government can react to issues posed by the initial £1,000 maximum limit. The caveat to this is that it is important that the DWP set a clear plan of how often these statutory reviews would be. For example, whether these will be annual or every three years.

DWP proposal - No minimum value for a pot to be eligible for automatic consolidation

18. The consultation is right to recognise the levy payments schemes must make to cover a range of government pension bodies. It is also right to state that these levy costs come on top of administrative costs. These levy charges will result in charges on members' pots. It is for these reasons that, in order for industry to support there being no minimum pot size for small pot consolidation (for example, no pot size below which pots aren't included in the default consolidator framework but are instead refunded) the Government will need to detail how very efficient transfers would work and be achieved as part of the new model. For example, the new policy will need to be explicit in designing a process that facilitates period bulk transfers. It is feasible that this question would need to be revisited after the Delivery Group has input on this

issue; the Coordination Group previously found that transfer costs that are too high are likely to be a significant barrier to progressing towards a small pots solution. The Consultation found the cost of a transfer to be between £30 to £80 (paragraph 81), and policy and process design will likely have a material impact on either increasing or decreasing from this base, particularly depending on whether the number of bulk transfers can be minimised (paragraph 88).

DWP proposal – pot becomes eligible for automatic consolidation 12 months after the last contribution was made into the pot

19. The Co-Ordination group has previously agreed that a prescribed period for defining a small pot would be acceptable on the premise that it is rooted in evidence. It is disappointing to see that the DWP have chosen to set a prescribed period without providing sufficient evidence to explain the benefits of such an approach. The main rationale given in the consultation as to why government has decided upon classifying a deferred pot as one that has not had contributions made into it for a period of 12 months was because it was a "sensible middle ground". Whilst the government may feel that 12 months strikes the right balance between 6 and 18 months, we would disagree.

20. We would recommend that DWP explore the feasibility of classing a pot as deferred once the employer has notified the scheme that the employee has left the company. We accept that this information is not routinely reported to, and therefore captured by, all schemes. However, it is not uncommon for employers into cease pension contributions whilst a member of staff is on parental leave. Further, according to UK Government data, 6% of women take 53 weeks, or more, in maternity leave[2]. Under the proposed 12-month rule, an employee could return to work from such a period of leave to find that their pot has been consolidated.

21. If the Government finds that our proposal for the employer to provide full assurance of genuine deferral is unworkable, and publishes the evidence behind such a decision, it should set the deferred time period at 18-months, rather than 12, to avoid inadvertently consolidating pots that should not be consolidated.

5. Do you agree with this proposal not to mandate schemes to undertake same scheme consolidation at this current time?

22. In recent years, we have seen that Master Trusts have scale and are continuing to grow at pace. If a scheme has not yet undertaken same scheme consolidation, it should be understood there will most likely be a valid reason for this. For example, if same scheme consolidation leads to worsened value outcomes for a member, a scheme may not have proceeded with it. There is also the very small chance that some of the pots may have unique protections associated with them and consolidation would result in a member losing such protections. The consultation also acknowledges the constraints in contract-based schemes that are as yet unresolved (paragraph 115). Notwithstanding this, we would expect schemes to work towards consolidating pots or providing a single member view in cases where it is possible to do so and is in the members interests.

23. The PLSA agrees with the proposal that same scheme consolidation should be a requirement for schemes which intend to become a default consolidator. There would, however, need to be some consideration of the impact of this given that it could act as a barrier to entry for contract-based schemes. There could also be legal issues further down the line whereby a scheme consolidates pots within their own scheme, and it leads to poorer outcomes for members in an

[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/214367/rrep777.pdf

unpredictable way, and the regulatory regime will need to protect trustees from future 'what if' claims, where they have acted in line with regulatory requirements.
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6. As a whole, do you agree with the framework set out above for a default consolidator approach? Are there any areas that you think have not been considered, that need to form part of this framework?

Assumptions made in selection of the model

24. The PLSA has real concerns about some the assumptions made surrounding the selection of the default consolidator approach. One example of this being - *With a small number of authorised default consolidators, acting as a consolidator for deferred small pots providing greater value for their members through the economies their scale brings them (Page 30, Para 58)*. This solution is projected to increase AUM of consolidators by £4 billion, and further evidence should not rely solely on current but rather future projected potential benefits of scale. Benefits of scale should also not be overstated/disproportionately expected given other factors such as the general projected growth of the market.

Mention of stapling

25. The inclusion of a very short reference to member stapling in the consultation has caused some uncertainty. As clarity is essential for schemes, we would welcome a dedicated point of consultation on this so the industry can feed back appropriately to DWP. The approach of stapling, were it to be explored further in the future, would have widescale impacts beyond just the scope of this consultation on small pots consolidation. This model would lead to individuals being linked with their first private pension provider for the remainder of their career unless they decide to change providers. This has recently been introduced in Australia. However, as highlighted in 2022 Co-Ordination Group, the Association of Superannuation Funds of Australia predicted that this model would only reduce the number of unwanted pots by 500,000[3]. In addition, stapling comes with the real potential of increasing the administrative burden on employers as it could lead to them to having to shift from having to engage with one to multiple pension schemes. This reinforces the idea that careful consideration needs to be given to making a change as significant as stapling, even where it is considered in isolation solely on its impact on small pots; the direct impact is likely to be minimal, whereas the wider impact on the AE market could be severe.

Member exchange

26. Member exchange, which is a form of pot follows member, has the potential to provide an effective member choice. As noted by the PPI, member exchange may come with the benefit of it being unlikely to increase the administrative burden on employers[4]. However, it could also

[3] https://www.superannuation.asn.au/ArticleDocuments/359/2107_Multiple_balances_Paper.pdf.aspx?Embed=Y
[4] https://www.pensionspolicyinstitute.org.uk/media/3610/20200922-ppi-small-pots-working-group-guide-to-booklet-final.pdf

lead to members being transferred into schemes with higher charges and comes with greater administrative burden on providers [5]. Time has already been invested into a pilot programme. For progress on this, please refer to the 2022 Co-Ordination Group report on page 39. With the series of reforms announced by the Government, schemes are having to undertake lots of work. There is a risk that the resources to dedicate to member exchange are simply not available.

Delivery group

27. Throughout this response, we have made comments on where it would be appropriate for the Delivery Group to deliberate. The Group will need to have a clear and defined mandate. Owing to the level of detail that the Group will have to work through, the DWP should offer it proper support and ensure that it has an appropriate amount of time to provide recommendations. Our membership will be keen to support the work of the Group and engage with it going forward.

Timeline

28. There is little detail on timeline for change in this consultation. The government will need to put its timeline to the delivery group to allow it to properly scrutinise the proposals.

7. Do you have any comments on the positive or negative impacts of a default consolidator approach on any protected groups, and how nay negative effects could be mitigated?

29. Those with small pots are disproportionately likely to be lower earners, part-time 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, we feel that these groups stand to benefit the most from any future advantages of the consolidation of their small pots.

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