Securing the future of pensions

Meeting future workplace pension challenges: Improving transfers and dealing with small pension pots

A response by the National Association of Pension Funds

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Executive Summary

Summary of NAPF Recommendations

a. Short Service Refunds for DC schemes must not be abolished until after an efficient system for transferring small DC pension pots has been implemented. The Department for Work and Pensions (DWP) is right to set this precondition as otherwise large numbers of small stranded pots will be created, especially after the introduction of automatic enrolment, increasing the costs of pension provision.
b. The UK pension system needs big Super Trust schemes as well as big pension pots, to enable good administration and governance at low charges. We need to develop a solution to the small pots problem that also helps drive up the quality of pension scheme provision.
c. A new system of transferring small pots should not be introduced until the auto-enrolment reforms are fully implemented in 2017 or 2018. Trying to implement such a radical overhaul of the system for transferring pensions by 2014 would be risky and impractical, and is not necessary given the auto-enrolment timescales.
d. The DWP need to assure employers, schemes and providers that an efficient automatic transfer process is compatible with UK and European law. As well as providing protections for scheme members whose pots are transferred, it is essential that the transferring scheme and trustees have legal protections from any complaints about what happens to the pot afterwards.
e. The DWP should develop a system to allow the automatic transfer of small pots from both trust-based and contract-based schemes into approved aggregator Super Trust schemes. This is the most practical solution and offers the most protection for members. The 'pot follows member' model should not be implemented because it is not practical and the risks of detriment to people whose pots are moved from a well-run low-charge scheme are not acceptable.
f. There should be more than one aggregator scheme, to allow schemes choice on what aggregator to use, to encourage competition between big Super Trust schemes, and to stop one mega-scheme dominating the entire market.

1. The proliferation of small pension pots is a potentially serious long-term risk to the success of the Government's auto-enrolment reforms. Automatic enrolment has been designed to tackle the UK's pension saving crisis, which without action would leave a large proportion of today's workers facing poverty in retirement.

2. Underpinning the success of automatic enrolment is the Government's proposal to reform the state pension system. The NAPF has long argued for radical reform of the UK's state pension system and welcomed the Chancellor's announcement in the Budget 2012 that the plans to combine the Basic State Pension and State Second Pension into a Single Tier foundation pension set at £140 a week. We believe the new Single Tier foundation pension

will give people the confidence they need to save in pensions, knowing it will "pay to save" for their retirement.

3. Whilst automatic enrolment and state pension reform will go some way towards tackling under-saving, changes in the composition of pension provision in the UK over the past decade give rise to wider concerns about the adequacy of pension saving. The continued shift from defined benefit (DB) to defined contribution (DC) means employees and individuals saving in pensions will be exposed to greater risks. With the majority of employees likely to be automatically enrolled into DC pensions, it is important that workplace DC pensions are designed to achieve the best possible member outcomes in retirement. This includes minimising the build-up of small pots.

4. Under automatic enrolment, millions of people will begin saving in DC pensions, many for the first time. But the nature of automatic enrolment and savings inertia is such that millions of small pots will be created as people change jobs. This creates administrative problems for pension schemes, but it also means it is less likely that people will be able to accumulate the size of pension needed to achieve a secure and adequate income in retirement.

5. The NAPF welcomes this DWP paper on improving transfers and dealing with small pots, which sets out the scale of the problem and looks at possible solutions around improving transfers. However, we do not believe it makes sense to try to solve the small pots problem in isolation from the 'small schemes problem'. The NAPF has long argued that large scale Super Trust DC schemes are the best way of delivering low charges, strong governance, effective administration and quality member communications. A successful solution to small pots will enable this provision to emerge, to make sure all pension pots have a good chance of being well-managed, even where the employee or employer are not engaged in pensions. Larger multi-employer Super Trust schemes mean fewer transfers and fewer small pots.

6. As a package, reforms to the state pension system and automatic enrolment into large-scale, good quality Super Trusts would significantly improve the outcomes for DC pension savers.

7. To inform our response the NAPF has conducted an online survey of our members to get their views on the issues of refunds, transfers and small pots. A summary of these survey results is in Box 1 on the following page.

8. We agree with the DWP's analysis that given the number of workers who change jobs each year, auto-enrolment will cause a proliferation of small pots that, in the longer-term, will increase costs and damage the success of the auto-enrolment reforms. The creation of millions of stranded pots is not in the interests of employees, employers, industry or Government, and we all need to work towards a practical solution.

Box 1: Summary of NAPF member survey

- 76% of those who responded currently offer refunds to members who leave after less than 2 years. In 2011 the median refund was £800 and the median number of refunds made by a scheme was 30.
- 60% of respondents think that scheme members find it hard to transfer pots at present, with just 16% saying it was easy.
- Only 26% think that transfers are easy for the scheme to administer and not a single respondent said "very easy".
- 64% of respondents prefer automatic transfers into an aggregator scheme and 22% would prefer the pot to automatically follow the member.
- 76% believe that there is a de minimis level below which it is uneconomical for small pots to be transferred – and the pot should continue to be refunded.
- Respondents are split roughly 50/50 on whether the Government is right to abolish short service refunds, but 86% agree that it is essential that small pots can be automatically transferred if refunds are abolished.
- 61% believe that schemes should not have to make changes to refunds and transfers until after auto-enrolment is fully implemented in 2017 or 2018.
- 87% believe it is essential that small pots are transferred into quality schemes with low charges, but respondents are split 50/50 on whether NEST is the best destination for these pots.

9. Whilst we support the DWP's work to address the small pots challenge, we do not support the proposed target for implementing a solution by 2014. The complexity of the problem means this deadline is impractical, and with automatic enrolment not being fully implemented until 2018 this urgency is not necessary. It is more important to get the right solution than a quick solution.

10. The DWP needs to set clear objectives for its work to improve transfers and tackle small pots. The NAPF's suggested objectives are set out in Box 2 below:

Box 2: Six objectives for transfers and small pots reforms

1. Stop the proliferation of small pots so that administration and other costs do not rise exponentially after auto-enrolment reaches steady state.
2. Make transfers efficient so they are quicker and simpler for members and not burdensome on schemes or providers.
3. Ensure more pension pots are large enough to be annuitised efficiently, so that more pension savers can get access to a good annuity deal.
4. Ensure that scheme members do not lose out by having pots transferred out of good pension provision and into less well run schemes with higher charges.
5. Encourage the member to remain engaged with their entire pension saving and make it harder for small pots to get lost.

6. Encourage the creation of large Super Trust pensions that will raise the quality of DC pension provision in the UK.

11. The NAPF does not believe that the incremental improvements to the current system will be adequate. A new automated system of small pots transfers is required, which builds on the automatic enrolment process being implemented from later this year. Given the number of pots involved and the potential costs, it is essential that any automated system is as efficient as possible.

12. The DWP needs to assure employers, schemes and providers that an efficient automatic transfer process is compatible with UK and European law and would not be burdensome on schemes and employers. A key concern of NAPF members is that the transferring scheme and trustees have legal protections from any complaints about what happened to the pot after it was transferred.

13. Our survey found that three times as many respondents prefer the aggregator model (64%) than the pot-follows-member model (22%). This very strong preference is borne out of their understanding of how pensions work and what is practical, and from their concern for getting the best outcome for members. The 'pot follows member' model has a number of disadvantages. Not only is it impractical, but it risks causing detriment to people whose pots are moved from a well-run low-charge scheme to a poorly-run high-charge scheme.

14. Improving trust and confidence in pensions is also key to the success of automatic enrolment and therefore it is vital that any automated system of small pots transfers is well-governed to ensure that the interests of scheme members are protected. 87% of survey respondents believe it is essential that small pots are transferred into quality schemes with low charges. This is why the NAPF believes any aggregator model must exhibit the characteristics of Super Trusts – large-scale, well-governed trust-based schemes operating in the interest of members. Super Trusts could be licensed by the Pensions Regulator to ensure they meet minimum standards around administration, charges, governance and communications. It is also important that there are multiple Super Trusts in order to promote competition and to drive up quality.

Introduction

15. The NAPF is the voice of workplace pensions, both in the private and public sector. We represent 1,200 pension schemes, with some 15 million members and assets of £800 billion. The NAPF and our members share the Government's objective of making auto-enrolment a success and extending access to workplace pensions. NAPF members operate all kinds of pension schemes including both occupational trust-based and contract-based workplace schemes. Most NAPF members operate more than one pension scheme, with 89% operating

an occupational DB scheme, 41% operating an occupational DC scheme, 37% a contract-based stakeholder scheme and 28% a contract-based GPP[1].

16. This paper sets out our overarching views and concerns about the issues of refunds, transfers and small pots, and options for reform. Our specific answers to the consultation questions are set out in Appendix 1.

17. To understand our members' views on the issues of refunds, transfers and small pots we conducted an online survey in February and March 2012, which received 113 responses. More details of the survey are in Appendix 2. This built on a previous member survey we conducted on short service refunds last year[2].

18. The DWP consultation explicitly asked for evidence on the scale of the current problem of small pension pots so the NAPF asked the Institute of Fiscal Studies (IFS), as part of a wider co-funded project with the Economic and Social Research Council (ESRC), to conduct analysis of holdings of DC pensions and the incidence of small pots. The full research is published in a separate report[3].

19. Our Automatic Enrolment Working Group has also met with DWP officials on several occasions to discuss the problems of small pots and transfers and consider the practicalities of different options for reform. This NAPF response to the consultation is therefore based on our members' experience of running good quality workplace pension provision, and their concern for scheme members.

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[1] *NAPF Annual Survey 2011*, December 2011

[2] *Regulatory differences between occupational and workplace personal pensions: A NAPF response to a DWP consultation*, April 2011 .

[3] A link to the IFS report *Defined Contribution funds holding* can be found at http://www.napf.co.uk/PolicyandResearch.aspx

Section 1: The case for change

Section 1 - Summary of Recommendations

a. Short Service Refunds for DC schemes must not be abolished until after an efficient system for transferring small DC pension pots has been implemented. The DWP are right to set this precondition as otherwise large numbers of small stranded pots will be created, increasing the costs of pension provision.

b. The UK pension system needs big Super Trust schemes as well as big pension pots, to enable good administration and governance at low charges. We need to develop a solution to the small pots problem that also helps drive up the quality of pension scheme provision.

c. A new system of transferring small pots should not be introduced until the auto-enrolment reforms are fully implemented in 2017 or 2018. Trying to implement such a radical overhaul of the system for transferring pensions by 2014 would be risky and impractical, and is not necessary given the auto-enrolment timescales.

The small pots challenge

20. In our response to the 2011 DWP consultation on the regulatory differences between trust and contract-based pensions (which focused on short service refunds) the NAPF urged the DWP to address the problem of auto-enrolment generating large numbers of small pots. We are therefore very pleased that the DWP has published this new paper looking at the options for tackling this problem. We agree with the DWP's analysis that given the number of workers who change jobs each year, auto-enrolment will cause a proliferation of small pots which, in the longer-term, will increase costs and damage the success of the auto-enrolment reforms. The creation of millions of stranded pots is not in the interests of employees, employers, industry or Government, and we all need to work towards a practical solution.

21. A second factor is that the DWP's desire to stop trust-based DC schemes from refunding small pots to members will make the problem worse. As we strongly argued in last year's consultation, stopping short service refunds will cause costs to soar for occupational schemes. Our members understand how refunds work and what the impact will be of removing them. 76% of the schemes that responded to our survey offer refunds to employees who leave after less than two year's scheme membership. The median refund size is just £800 and the median number of refunds given by respondents in 2011 was 30.

22. Respondents were spilt 50/50 on whether DWP is right to want to abolish refunds, but 86% thought it is essential that small pots can be automatically transferred if refunds were abolished. We therefore welcome the Government's commitment not to abolish refunds until after an efficient system for transferring these small pots has been implemented. It is essential that this commitment is kept; otherwise employers will consider closing high quality trust-based DC schemes because of fears over small pot costs.

23. However, we do not believe it makes sense to try to solve the small pots problem in isolation from the 'small schemes problem'. The NAPF has long argued that there are too many smaller schemes in the UK that do not have the scale to deliver low charges, strong governance, effective administration and quality member communications. In addition, contract-based provision usually lacks strong member-orientated governance. Therefore large Super Trust DC schemes are the best way of delivering good outcomes for pension savers. The DWP needs to enable this provision to emerge, to make sure all pension pots have a good chance of being well-managed, even where the employee or employer are not engaged in pensions. Larger multi-employer Super Trust schemes mean fewer transfers and fewer small pots.

24. The paper understandably focuses on the flow of new small pots from auto-enrolment, but there is also a considerable existing 'stock' of small DC pots. The DWP consultation explicitly asked for evidence on the scale of the current problem of small pension pots so the NAPF asked the Institute of Fiscal Studies (IFS), as part of a wider co-funded project with the Economic and Social Research Council (ESRC), to conduct analysis of holdings of DC pensions and the incidence of small pots. The full research is published in a separate report[4]. A summary of the key findings on small pots is in Box 3 below.

Box 3: IFS research findings on the current stock of small DC pension pots

- There are an estimated 0.7 million employer-provided DC pension funds and 0.5 million individually-arranged pension funds containing less than £5,000 that are no longer being contributed to. Collectively the IFS estimate that the small retained employer-provided pots under £5,000 are worth £1.4 billion, while the retained individually-arranged pots are worth approximately £0.9 billion.
- There are an estimated 0.3 million employer-provided DC pension funds and 0.2 million individually-arranged pension funds containing less than £2,000 that are no longer being contributed to. Collectively the IFS estimate that the small retained employer-provided pots under £2,000 are worth £0.2 billion, while the retained individually-arranged pots are worth approximately £0.1 billion.
- Younger individuals, women, and those with low levels of other wealth are more likely to hold smaller retained pots than they are likely to hold DC funds in general.
- There is scope for these small pots to be consolidated: many of these small pots are held by individuals who also hold at least one other DC pension pot.
- If all DC pension pots held by each individual could be consolidated, it is estimated that the number of retained pots containing less than £5,000 could be reduced from 1.1 million to 0.7 million, and would reduce the number of individuals holding any retained pots worth less than £5,000 by 0.3 million. Similarly the number of retained pots worth less than £2,000 could be reduced from 0.5 million to 0.3 million; this would reduce by 0.2 million the number of people holding retained pots worth less than £2,000.

[4] A link to the IFS report *Defined Contribution funds holding* can be found at http://www.napf.co.uk/PolicyandResearch.aspx

- There are gains to be had simply from consolidating employer-provided pension pots, but these would, obviously, be less wide-spread than if all types of pots could be combined.
- If individuals were able to consolidate all their employer-provided pension pots, we estimate that the number of such retained pots containing less than £5,000 could be reduced from 0.7 million to 0.5 million. However, the 0.5 million individually-arranged pots containing less than £5,000 would also remain.
- If individuals were able to consolidate all their employer-provided pension pots, we estimate that the number of such retained pots containing less than £2,000 could be reduced from 0.3 million to 0.2 million. However, the 0.2 million individually-arranged pots containing less than £2,000 would also remain.

25. Given the significant numbers of small pots already in existence there is clearly a need for these pots to be consolidated in the future. Even limited action focused on the smallest DC pots could help hundreds of thousands of pots be consolidated. However, finding a solution for these old pots will be even more complex than changing arrangements for the future. Therefore we recommend that action on the existing *stock* of small pots should be part of a second phase of work, once the problem of the increased *flow* of new pots has been solved.

Responding to the small pots challenge

26. Whilst we support the DWP's work to address the small pots challenge, we do not support the proposed target for implementing a solution by 2014. This is neither practical nor desirable for a range of reasons:

    - Employers, schemes and the pensions industry are already busy implementing the complex and challenging auto-enrolment reforms (and dealing with a whole range of other pensions initiatives). It is essential that their attention remains focused on this very important task, rather than being distracted during this difficult period.
    - This is a complex problem, and the solution may require building a new registry of small pots or clearing house system for transfers. It is highly unlikely that a solution could be implemented by 2014.
    - Auto-enrolment will not now be fully implemented until 2018, with the last employers auto-enrolling in 2016. The DWP's own analysis shows that the small pots problem will take time to build from 2017 – and offers no evidence that it needs to be urgently solved by 2014. 61% of respondents to our small pots survey believe that schemes should not have to make changes to refunds and transfers until after auto-enrolment is fully implemented in 2017 or 2018.
    - Neither is there any evidence that short service refunds need to be urgently stopped. Given that the minimum DC contribution rate will be just 2% until at least 2016, levels of potential detriment to those who receive refunds will be very small, and there is still no evidence employers are moving to trust-based provision to use refunds. In fact, all the evidence is that employers are continuing to do the opposite and move away from trust-based DC.

- Fundamentally it is more important to get the right solution than a quick solution.

27. Although we do not support the proposed implementation timetable, it is important to provide certainty to employers, schemes and the industry so the DWP should work as quickly as possible to set out the basic policy prescription and scope for the solution.

28. The DWP paper also fails to set out clear objectives to improve transfers and deal with small pots. For instance, is the problem just about small pots or is the problem that all pension saving is fragmented? How do these issues link into the joint DWP and HM Treasury work to improve the way the annuity market function, or into the Pensions Regulator's work to raise standards in DC pensions? Having clear objectives will make it easier to judge which reform options are most likely to succeed. The NAPF believes that any improved system of transfers should have the following six objectives:

    I. Stop the proliferation of small pots so that administration and other costs do not rise exponentially after auto-enrolment reaches steady state.
    II. Make transfers efficient so they are quicker and simpler for members and not burdensome on schemes or providers.
    III. Ensure more pension pots are large enough to be annuitised efficiently, so that more pension savers can get access to a good annuity deal.
    IV. Ensure that scheme members do not lose out by having pots transferred out of good pension provision and into less well run schemes with higher charges.
    V. Encourage the member to remain engaged with all their pension saving and make it harder for small pots to get 'lost'.
    VI. Encourage the creation of large Super Trust pensions that will raise the quality of DC pension provision in the UK.

Section 2: Options for reform

Section 2 - Summary of Recommendations

d. The DWP needs to assure employers, schemes and providers that an efficient automatic transfer process is compatible with UK and European law. As well as providing protections for scheme members whose pots are transferred, it is essential that the transferring scheme and trustees have legal protections from any complaints about what happened to the pot afterwards.

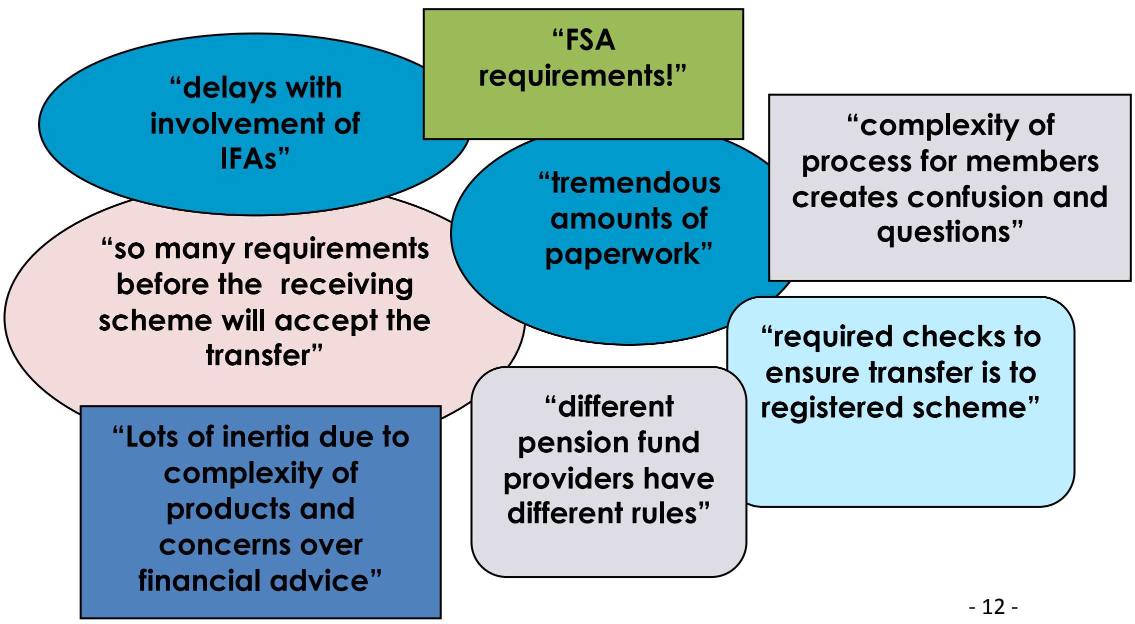
e. The DWP should develop a system to allow the automatic transfer of small pots into approved Super Trust aggregator schemes, as this is the most practical solution, and offers the most protection for members. The 'pot follows member' model should not be implemented because it is not practical, and it risks causing detriment to people whose pots are moved from a well-run low-charge scheme to a poorly-run low-charge scheme.

f. There should be more than one aggregator scheme, to allow schemes choice on what aggregator to use, to encourage competition between big Super Trust schemes, and to stop one mega-scheme dominating the entire market.

The transfers challenge

29. For consumers and pension schemes the current system of transfers does not work well. It is bureaucratic, costly and relies almost completely on scheme members taking the initiative. 60% of respondents to our survey think that scheme members find it hard to transfer pots at present, with just 16% saying it was easy. Only 26% of respondents think that transfers are easy for the scheme to administer and not a single respondent said "very easy". As part of our survey we asked those running schemes to give their reasons why transfers are difficult. Below in Box 4 are some example quotes.

Box 4: Quotes from NAPF members on why transfers are difficult



30. As these quotes from NAPF members show, the problems with transfers are complex, relating to administration, form filling, advice and regulatory and legal concerns. For small pot transfers to work they cannot involve advice (which would be too expensive in relation to the pot) and they cannot rely on the scheme member's initiative. The NAPF does not believe that the incremental improvements to the current system suggested in chapter 3 of the DWP paper will be adequate. An automated system of small pots transfers from both trust-based and contract-based schemes is required – which builds on the automatic enrolment process being implemented from later this year. Given the number of pots involved and the potential costs, it is essential that this automated system is as efficient as possible.

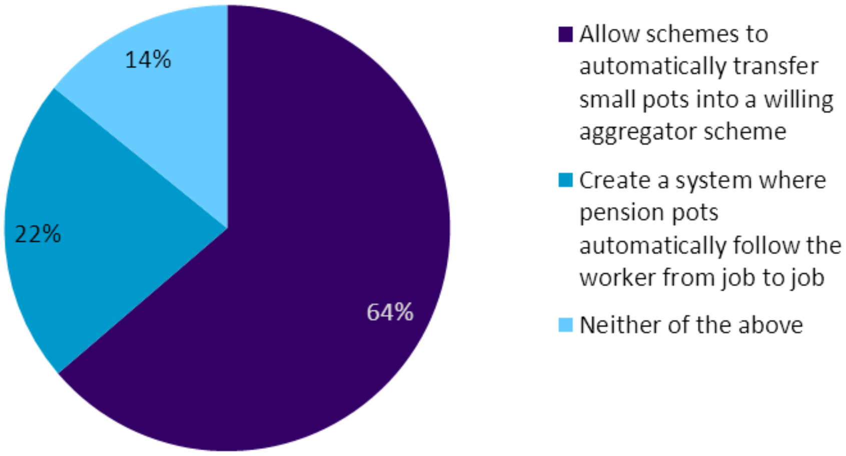
31. However, creating an automated system of transfers, where pots are moved from both trust-based to contract-based schemes without the explicit consent of its owner, could be very challenging given European Directives and UK common law around contracts and trusts. European Directives proved to be a major barrier to introducing automatic enrolment, and the UK Government had to negotiate a specific exemption. The consultation paper does not set out any explanation of how Government expects to solve what could be equally difficult problems with automatic transfers. The DWP need to assure employers, schemes and providers that an efficient automatic transfer process is compatible with UK and European law, and that it will not burdensome on schemes and employers. Without that assurance it is unsurprising that many schemes are worried about the prospects of being forced to take part.

32. A key legal concern of NAPF members is about the liability of schemes and trustees when it is later discovered that a transfer was not in the member's best interests. There will need to be strong protections for scheme members in any automatic transfer process, but it is also essential that the transferring scheme and trustees have legal protections from any complaints about what happened to the pot after it was transferred.

Comparing automatic transfer models

33. In our small pots survey we asked those involved in running DC schemes whether they would prefer automatic transfers into an aggregator scheme or for pension pots to automatically follow the member. Almost 3 times as many respondents prefer the aggregator model (64%) than prefer the pot-follows-member model (22%). This very strong preference is borne out of their understanding of how pensions work and what is practical, and from their concern for getting the best outcome for members. 87% believe it is essential that small pots are transferred into quality schemes with low charges. Discussions with our Automatic Enrolment Working Group and our Retirement Policy Council also identified a whole range of detailed concerns and drawbacks to the pot-follows-member model.

Improving transfers and dealing with small pension pots



34. Whilst the pot-follows-member model has some attractive features, the NAPF is concerned it has a number of disadvantages:

    - Pots could be transferred from a high quality schemes with low charges to schemes with higher charges and poorer governance, meaning some individuals could end up worse off. Whilst consolidating pots means you can argue overall most people will benefit, the risks of individuals losing out is unlikely to be acceptable politically or socially.
    - If an individual does not join another DC scheme then the small pot remains stranded at the old scheme. This will happen whenever a former scheme member becomes unemployed, chooses to opt out next time, moves abroad, leaves work to care for children, or moves to a public sector job.
    - The system will only work if all DC schemes accept transfers, which many are reluctant to do because of the costs and risks involved.
    - All DC schemes will have to be able to transfer pension pots to any one of the thousands of different schemes and provider products. For this to be feasible a new registry and clearing house system will need to be created. It is unclear how practical this is, who will pay for it, and how data and money will be protected.
    - If a person moves jobs frequently, the cost of transfers has the potential to erode the value of the pension pot.

35. NAPF members tend to prefer the aggregator model as it will be easier and less burdensome to deliver and will offer better protection for scheme members. Setting up automatic transfers into an aggregator would be a big change and it will be challenging, but it has a number of comparative advantages:

    - It will be easier to control the quality of the scheme in which small pots are transferred and to reduce the risk of detriment to the pension saver. Aggregator Super Trusts could have to meet minimum standards on charges, administration, communications and governance. The Pensions Regulator could license these Super Trust aggregators.

- Schemes would only have to deal with one or a small number of aggregators, making the transfer process easier. Ideally the trustees could choose an aggregator that they believe is most suitable for their members.
- Schemes that do not want to accept transfers do not have to.
- It does not matter whether or not the individual joins another DC scheme, the small pot can always be transferred into a well-run low-charge aggregator scheme, ensuring the pot is not stranded.
- The aggregator schemes could take responsibility for making sure there is an efficient transfer process, without there being an immediate need to create a big registry or clearing house system.
- There is the potential to develop the Super Trust aggregator model to allow members to continue contributing to their pot even if they choose. Employers could also choose to use the Super Trust not just as an aggregator but as its main scheme.

Table 1: Options compared

NAPF objectives	Pot follows member	Aggregator scheme
1. Stop proliferation of small pots so administration and other costs do not rise.	Individual schemes responsible for administration and transfer process.	Large scale would ensure low cost, high-quality administration.
2. Make transfers efficient so they are quicker and simpler members and schemes or providers.	Could only work if all DC schemes were forced to accept transfers.	Aggregator scheme accept transfers automatically. Schemes that do not want to transfer do not have to.
3. Ensure pension pots are large enough to be annuitized so more savers can get a good annuity deal.	Members would still need to make own decisions about annuity purchase and no guarantee of low charges.	Low charges under aggregator would provide better value for money. Aggregator could also provide annuities.
4. Ensure scheme members do not lose out by having pots transferred out of good pension provision into less well run schemes.	Risk of member detriment if member is transferred out of a well-run, low-charges scheme into a poorly-run, high-charge scheme.	Aggregator schemes would meet minimum standards on charges, governance, administration and communications.
5. Encourage the member to remain engaged with pension saving and make it harder for pots to get lost.	Pot could still become stranded if person does not join new scheme or leaves the job market.	Large scale would ensure good quality communication to keep members engaged.
6. Encourage creation of large SuperTrust pensions that will raise the quality of DC pensions.	Would still leave a large number of small DC schemes.	Aggregator scheme would be a kind of Super Trust with good quality governance and expertise.

36. The NAPF believes that there should be multiple Super Trusts serving as aggregators, to allow schemes choice on what Super Trust aggregator to use, encourage competition between big schemes, and to stop one mega-scheme dominating the entire market. The respondents to our survey are split 50/50 on the question of whether NEST is the best destination for small pots, suggesting that NEST should be one of the aggregators, but many of our members have different preferences. For instance multi-employer industry schemes may want to be aggregators for their sector.

37. Transfers of pots between the aggregator schemes should also be made easy, and the aggregator schemes may want to collaborate on transfers system or protocol. Creating an enhanced system between the aggregator schemes would be a lot more achievable than the huge all-encompassing system needed for the 'pot follows member' option.

How should automatic transfers work?

38. Automatic transfers into a Super Trust aggregator are necessary to keep the transfer process as efficient and low-cost as possible. Allowing people to opt out of the transfer would not be necessary under the Super Trust aggregator model as there would be protections in place to ensure that the pot was being transferred to a well-run scheme. Allowing opt outs makes the transfer process more complex and burdensome and wold make it more likely that small pots could end up being stranded.

39. However, automatic transfers from contract-base schemes to Super Trust aggregators may not be possible under current rules. But this would be in the interest of scheme members to be transferred to a good quality Super Trust so the DWP must explore how automatic transfers from contract-based to trust-based schemes could work.

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Appendix 1

Answers to specific consultation questions

1. **Do you have evidence on the scale of the current problem of small pension pots?**
The NAPF funded work with the Institute of Fiscal Studies (IFS), co-funded with the Economic and Social Research Council (ESRC), to conduct analysis of holdings of DC pensions and the incidence of small pots. The full research is published in a separate report[5], but a summary of the key findings on small pots is in Box 3 on page 8.

2. **Do you agree that the barriers listed on page 21 are the current barriers to transfers?**
The barriers listed largely match those listed by NAPF members. The problems with transfers are complex, relating to administration, form filling, advice and regulatory and legal concerns. For small pot transfers to work they cannot involve advice, which would to too expensive in relation to the pot, and cannot rely on the scheme member's initiative. NAPF member views are set out in Box 4.

3. **Would any or all of the proposals listed on pages 27 and 28 under this option be an effective way to facilitate more transfers and reduce the number of small pension pots?**
The proposals set out would help at the margins, but the NAPF does not believe that the incremental improvements to the current system suggested in chapter 3 will be adequate. An automated system of small pots transfers is required – which builds on the automatic enrolment process being implemented from later this year.

4. **Are there other ways to reduce costs further and make it easier for people to find any small, dormant pension pots – during the accumulation phase and at the point of retirement?**
See above.

5. **Taking account of our principles for reform, which of the two models in Chapters 5 and 6 do you think has the most merit?**
The DWP should develop a system to allow the automatic transfer of small pots into approved Super Trust aggregator schemes, as this is the most practical solution, and offers the most protection for members. The 'pot follows member' model should not be implemented because it is not practical, and risks causing detriment to people whose pots are moved from a well-run low-charge scheme to a poorly-run, high charge scheme. Our member survey found that almost 3 times as many respondents prefer the aggregator model (64%) than prefer the pot-follows-member model (22%). Paragraphs 26-29 of this response set out the case for an aggregator model in full.

[5] A link to the IFS report *Defined Contribution funds holding* can be found at http://www.napf.co.uk/PolicyandResearch.aspx

6. **Do you have any other suggestions for a process to overcome problems associated with small pots and improve transfers?**
The NAPF Super Trust aggregator model will be the best way of delivering on the DWP's objectives.

7. **Although the solutions in this paper deal with small pots in defined contribution (DC) schemes, we would be grateful for views on how defined benefit (DB) schemes should be treated and whether we should also consider applying any transfer solution to DB rights?**
The DWP are right to exclude DB from this process. DB transfers are much more complex and scheme members need much more protection. And DB schemes are already dealing with a huge amount of change on issues such as indexation, GMP equalisation and contracting out.

8. **Do you agree that under an automatic transfer system, members should have the right to opt out?**
This would depend on the design of the automatic transfer system that is implemented. In a pot-follows-member model it is essential that the worker can opt out, as the transfer could move their pot from a quality scheme to one with higher charges and less governance (though the opt out would be no guarantee that members interests would be protected). However, the opt out is not necessarily needed in the aggregator model, as there would be protections in place to make sure that the pot was being transferred to a well-run scheme. This is clearly one of the benefits of the NAPF's Super Trust proposal, where a large-scale, well-run aggregator scheme would have good quality governance, administration and communications. Allowing opt outs makes the transfer process more complex and burdensome and means some small pots could end up being stranded. If a scheme has an arrangement with a well-run aggregator, which the trustees are satisfied is a good deal for members, there is no strong reason why the transfer cannot be compulsory. The situation with contract-based pensions might be different and the Government needs ensure that it would be possible to transfer from a contract-based scheme to a Super Trust aggregator.

9. **Do you agree that individuals should not be required to take advice in an automatic transfer system, provided sufficient safeguards are put in place?**
For small pot transfers to work they cannot involve advice, which would to too expensive in relation to the pot, and cannot rely on the scheme member's initiative. This does leave risk of detriment to the scheme member, which is why it is important that an aggregator model is used so that there is some protection over the type of scheme used.

10. **Do you agree that solutions to address the expected rise in small pots after automatic enrolment should also be designed to take account of the existing stock of small and dormant pension pots?**
The NAPF asked the IFS to do research on existing small pots and this found there are 1.2m non-active DC pots worth less than £5,000. So clearly action needs to be taken. However, finding a solution for these old pots might be even more complex than changing arrangements for the future. Therefore we recommend that work on the existing stock of small pots should be part of a second phase of work, once the problem of the increased flow of new pots has been solved.

11. **What are the particular challenges and benefits created by introducing one or several aggregator schemes?**
    The NAPF believes that there should be more than one aggregator scheme, to allow schemes choice on what aggregator to use, to encourage competition between big schemes, and to stop one mega-scheme dominating the entire market.

12. **Do you agree with the aggregator scheme characteristics set out?**
    The characteristics set out need to be expanded on. The development of aggregator schemes offer the opportunity to move towards the pensions system the UK needs with large low-charge well-run DC Super Trust schemes. The licensing system for aggregators should set out standards on issues such charges, governance, administration, communications and help around annuitisation. The Regulators 6 principles for DC could form a basis of the assessment. Crucially aggregators need independent governance that means members interests are put first.

13. **Could the pensions industry offer an aggregator scheme with these characteristics?**
    A number of pension providers have entered the auto-enrolment market on a large scale with schemes that already exhibit some of these characteristics. Although NEST currently is banned from accepting transfers, it has a public service obligation to accept any employer want to use it, and it has competitive charging levels, an appropriate investment approach, and simple member communications.

    Super Trusts would also exhibit all of these characteristics and the Government should encourage the development of this kind of provision to operate alongside NEST.

14. **Have we correctly understood the implications of there being one or several aggregator scheme(s)?**
    It is unclear why having several aggregators would reduce competition if assuming members are disengaged. We believe several aggregators are needed to ensure competition amongst aggregators. From a member perspective, competition amongst aggregators might lead to innovation in member communication which would help with member engagement.

15. **Should there be several aggregator schemes or one?**
    Please refer to our answer to question 11.

16. **What are the advantages of NEST acting as the aggregator scheme?**
    The respondents to our survey are split 50/50 on the question of whether NEST is the best destination for small pots, suggesting that NEST should be one of the aggregators, but many of our members have different preferences. For instance multi-employer industry schemes may want to be aggregators for their sector. All aggregators would have to meet tough standards and be well-run and have low-charge like NEST, but it is important that there is competition in the

market. This is why the NAPF has advocated the creation of Super Trusts, to operate alongside NEST.

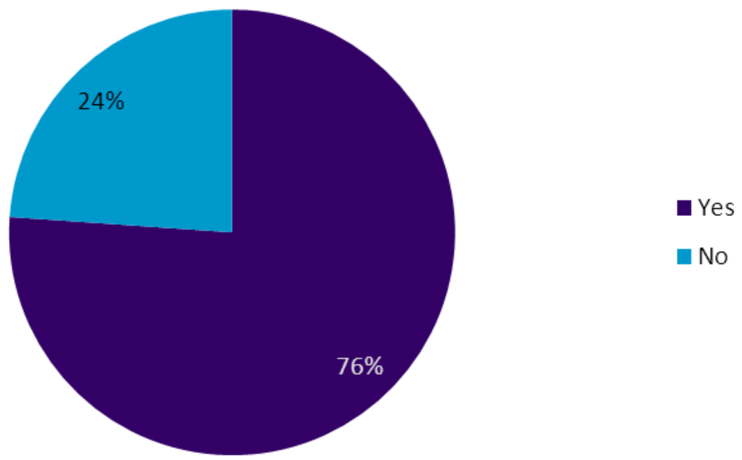
17. What is the best approach to defining a small pot for this option? Would it be preferable for:

- **Default transfers to be compulsory if the pot is under a certain size.**
- **Default transfers to be voluntary for schemes.**
- **Default transfers to be compulsory under a certain size, but voluntary within a band.**

NAPF members are split on whether small pot transfers should be compulsory or voluntary. 57% say it should be voluntary and 43% compulsory. If the small pot is in a high quality scheme that meets the standards that would be expected of an aggregator then there is no immediate reason why the scheme should be forced to transfer that small pot elsewhere. However, the DWP would probably want to compel trust or contact-based schemes which are not good for deferred members (such as those which levy high charges for deferred members) to transfer small pots. The increasing existence of 'Active Member Discounts' shows that non-contributing deferred members are not always treated well by a system where the employer chooses the scheme. Setting a standard for how deferred members should be treated and compelling schemes to transfer pots out if they do not meet those standards would be be bold way of raising standards and protecting consumers.

18. Should there be a transfer limit on pots below a certain size and if so, what should happen to the pot?

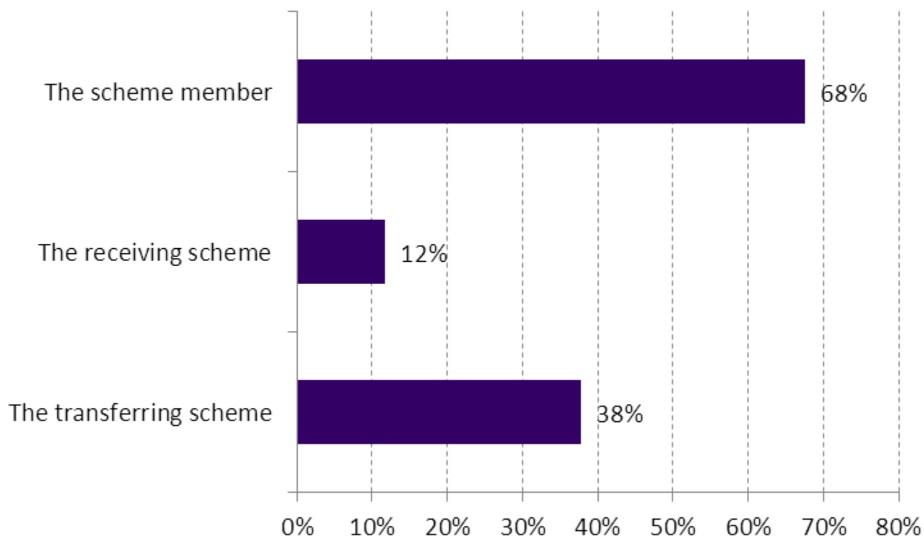
The NAPF believes that it is uneconomic to transfer very small pots, and that there should be a de minimis level below which 'micro pots' can be refunded to the scheme member. 76% of our survey respondents agreed that this made sense.



Some employers are worried that they will be left with large amounts of micro pots because many workers will not engage with the communications they are sent and will submit late opt out requests. These pots will be completely meaningless in terms of contributing to a retirement income and are burdensome for aggregator schemes to administer. In some cases the pot could be worth less than the cost of the transfer. It is also very likely that employee would prefer the money to be refunded. The DWP should make this decision on what size of micro pots can be excluded based on evidence of what happens after auto-enrolment. If large numbers of micro pots are being generated by employees who really want the money to be refunded, it would be perverse not to respond and allow micro pot refunds. Refunding micro pots might also make aggregators more economic, and mean that other pots (which will make a meaningful contribution to a retirement income) can receive lower charges.

19. Given the default nature of the transfer, which of the member, the transferring scheme or the aggregator scheme should pay the default transfer costs?

In our member survey we asked who should bear the costs of transfer. 68% said the scheme member, 38% the transferring scheme and 12% the receiving scheme (respondents could tick more than one option).



Given that all charges are in the end paid by scheme members (unless there is an employer subsidy) it makes sense that the person who has benefitted from the transfer pays. And it would be strange for a scheme like NEST, which levies a charge on members' contributions not to levy a charge on transfers coming in – this would mean than transferees would bypass charges faced by those making active contributions. The argument for charging members breaks down in the pot-follows-members model where they might be charged to have their pension moved into scheme that was of a lower quality than where it was.

20. Are the existing protections for individuals sufficient for this option where pensions follow people from job to job?

The NAPF does not believe that the pot-follows-member model is suitable, because members cannot be protected from the risk of moving from a good scheme to a lower quality one. The DWP's examples only focus on charges, but there are other ways in which members could lose out, for instance through a less suitable default investment strategy, poor administration and weak governance.

Improving transfers and dealing with small pension pots

21. Should a pot size maximum be applied to pension pots that are automatically transferred? If so, what should the maximum be?

One of the rationales for automatic transfer of small pots is that advice is uneconomic, so if the system was expanded to larger pots in the future it would need to consider pushing people to consider taking advice. However this is less of a worry in an aggregator model than pot-follows-member as there are more protections. The NAPF would recommend getting automatic transfer right for smaller pots as a first priority.

22. How could a central database successfully match members with their pension pots?

The pot-follows-member approach requires the development of an all-encompassing database and transfer system involving all DC schemes in the UK. All schemes will have to be able to transfer pension pots to any one of the thousands of different trust and contract-based schemes. For this to be feasible a new registry and clearing house system will need to be created. It is unclear how practical this is, who will pay for it, and how data and money will be protected. An aggregator model potentially makes this much simpler with schemes only having to deal with one or a small number of aggregators. The onus would be on the aggregator schemes to take responsibility for making sure there is an efficient transfer process, without there being an immediate need to create a big registry or clearing house system.

23. To what extent could the pensions industry deliver a suitable electronic platform/database?

See above.

24. What should happen to pots when an individual does not join an employer for a long time?

This is one of the major failings of a pot-follows-member model, and why aggregator schemes are needed, otherwise pots will remain stranded.

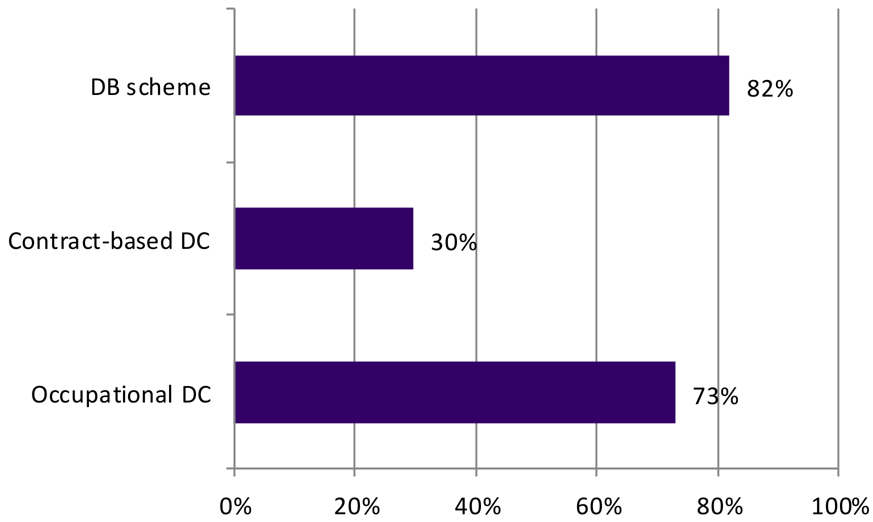
25. What should happen to an individual's older dormant pension pots in this proposed process (those pots in DC schemes), where pensions follow people from job to job?

Please refer to our answer to question 10.

Appendix 2

NAPF Members Survey Results

1. The online survey was conducted with NAPF members and members of our DC PensionConnections online forum in February and March 2012. We received 113 responses from schemes, trustees and pension professionals. Respondents were first asked what schemes they were involved in managing. The breakdown is below.



2. 76% of those who responded currently offer refunds to members who leave after less than 2 years. The median refund was £800 and the median number of refunds made by a scheme in 2011 was 30.

3. Respondents are split roughly 50/50 on whether the Government are right to abolish short service refunds, but 86% agree that it is essential that small pots can be automatically transferred if refunds are abolished.

4. 60% of respondents think that scheme members find it hard to transfer pots at present, with just 16% saying it was easy. Only 26% think that transfers are easy for the scheme to administer. Not a single respondent said "very easy".

5. 61% believe that schemes should not have to make changes to refunds and transfers until after auto-enrolment is fully implemented in 2017 or 2018.

6. 76% believe that there is a de minimis level below which it is uneconomical for small pots to be transferred – and the pot should continue to be refunded.

7. 87% believe it is essential that small pots are transferred into quality schemes with low charges, but respondents are split 50/50 on whether NEST is the best destination for these pots. 64% of

respondents prefer automatic transfers into an aggregator scheme and 22% would prefer the pot to automatically follow the member.