ASSOCIATION OF CONSULTING ACTUARIES

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Small Pots Policy Team
Department for Work and Pensions
Caxton House
Tothill Street
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Dear All

Call for Evidence: Addressing the challenge of deferred small pots

I am writing on behalf of the Association of Consulting Actuaries in response to the above consultation.

Our answers to your specific questions are set out on the following pages, and we summarise our key points below:

- We welcome the Government's call for evidence to seek to address the small pots challenge and support automated approaches to tackling this issue – relying on proactive action from individuals will not deliver the best outcomes.
- Our preferred approach is "multiple default consolidators" framework. We have concerns that pot follows member could fail to meet the stated criterion on delivering improved value for money outcomes.
- Dashboards have a key role to play in supporting "self-serve" consolidation but should not be relied upon to deliver effective consolidation.

We would be happy to discuss our response further if that is helpful. In that event, please contact me on 07557 031198 or at tessa.page@mercer.com.

Yours sincerely

Tess Page, Chair, DC Committee
On behalf of the Association of Consulting Actuaries Limited

Disclaimer

Annex A: List of questions

Section 2: Our key assessment criteria
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?

We support the five criteria in principle, but wish to raise the following:

- The aim to deliver “overall net benefits for members through improved value for money outcomes” is a sensible high-level goal, but value for money as a concept is not precisely defined notwithstanding the current consultation on a new VFM framework), and value may mean different things to different pension savers. A “pot follows member” approach would result in some small pots being transferred to scheme that may not be providing VFM (or poorer VFM than a current arrangement).
- The VFM criterion should also include consideration of minimising out of market risks – i.e. any process should not require a long settlement period during which member funds are exposed to out of market risk.
- Similarly, under “pot follows member”, some pots held in schemes that permit the full range of pension freedoms might be transferred to plans that permit none of them (but may have lower charges).
- Not all benefits can be accommodated in certain schemes. For example, some pre-A Day pots that can be taken 100% as tax-free cash could be moved automatically to arrangements that do not permit that facility.
- Minimising complexity and administrative burden is an important factor, but it should be acknowledged that this may conflict with the need to carry out the types of checks that typically accompany a non-consent transfer.

Regardless of the selected approach, we highlight the need for “safe harbour” regulations, as the transfer might not be the most suitable option for an individual (e.g. due to charges / flexibility options / guarantees / other features). There would need to be a safeguard for employers and providers to avoid any potential claims of mis-selling by individuals at a later date.

There could be unintended consequences from the interaction with other legislation - for example small pots legislation and MPAA triggers. These will need to be addressed as part of the introduction of any framework.

Section 3: Member engagement
2. How do you think we can increase member-initiated consolidation and what are the opportunities, risks, and limitations of member-initiated consolidation?

Nudges at timely points (such as tax year end, or on individuals’ birthdays) can prompt action, but to achieve the best results this generally needs to be “clickable” with a simple consumer journey – our experience is that the more forms a process entails (particularly in hard copy with wet ink completion) the less likely it is to happen. Digital routes should be encouraged or indeed mandated – a number of legacy providers that serve as homes for older small pots are not digitally enabled which can put barriers in place for members wanting to take action.

We note that leaver statements can be very variable in length, quality, and content. Simpler, standardised leaver statements that mirror the simpler annual benefit statements initiative would help.

That said, we believe that the experience of auto enrolment and auto escalation of contributions proves that automatic routes will deliver the highest chance of success.

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?

We consider that Pension Dashboards will, if delivered effectively, be a significant driver of pot consolidation. We acknowledge the emergence of new entrants to the market focused on DC consolidation, often with heavy marketing budgets including television adverts and targeted web advertising.

However, we believe that the cultural behaviour around retirement and pensions will take time to change and multiple interventions will be necessary. There will be a segment of the population that engages quickly with Pensions Dashboards, but many members will take longer to do so. Relying upon innovation alone is therefore unlikely to solve the need within a reasonable time frame.

Section 4: Which pots should be in scope for automatic consolidation?
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

While £10,000 would make consolidation more commercially viable for providers, we understand that this is almost double the sum estimated as being economically viable to administer, and still represents a large amount for some individuals. We could support £2,500 with a plan to review this over time to consider whether the minima has met the objectives.

Note that we have omitted the "questions for providers" (5-9).

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?

Yes, as for some small pots the costs of transfer (both for the member and for the ceding / new scheme) would be high relative to the pot size. We would support a system whereby pots below c£250 should be refunded back, after tax. This is unlikely to materially damage an individual's long term retirement savings, and achieves the simplicity criterion.

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?

Yes. Appropriate flags will be needed in order to avoid "unintended deferreds" – e.g. parental leave, sabbaticals and international assignments, etc, but this should be feasible within existing administration systems.

This time would also allow individuals to do their own consolidation if preferred and opt out of automated solutions.

Section 5: Market wide automatic consolidation solutions
12. Do you agree with the above summary of potential benefits and implications of the default consolidator/s approach, and if not why?

Yes we agree with the summary. However we would expect to see the right to transfer out extend to savers in a consolidator arrangement once their combined pot is over the de-minimis and for this to be communicated to them in standard regular communications (e.g. annual benefit statements).

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?

	Benefits	**Risks**
Single consolidator	• Less risk of errors in the transfer process. • Less of an administrative burden on employers. • Due to a large small pot population, the member journey and investment strategies can be	• Lack of competition so may not be best value in market and / or may not be incentivised to innovate. • Poorer member service due to perception that smaller pots require less provider attention. • Bottleneck as volume of transfers cannot be dealt with quickly enough.

	developed to better suit their needs. • Savers know where their pots are (albeit Dashboards should help with this too).	• Savers could argue they were not given suitable choices (higher risk where outcomes are lower than those delivered by alternative pension arrangements). • Other concentration risks – both around business failure (with associated reputational damage and loss of confidence) and operational (e.g. business continuity), that will impact only on a small pot population.
Multiple consolidators	• Provides a choice for savers, both in the original selection of a consolidator, and during the pre-retirement journey, if the member wants to switch consolidators. • Expected to creates a more competitive marketplace. • Small pots treated the same as other sized pots and so benefit from the same propositions. • Less administrative strain from the transfer process and so would not expect the same bottleneck issues as for single consolidator.	• Administrative complexity and more risk of errors in the transfer process. • Costs associated with tPR/FCA overseeing multiple consolidators. • Some providing better outcomes than others, so "luck of the draw" which consolidator a member is defaulted into. Becomes more of an issue where members have opted out of making a selection due to being overwhelmed by choice. • Member could end up with pots straddled across different consolidators, so can defeat the objective. • Providers defaulting to the same consolidator in order to reduce cost of the exercise/risk of errors in the process.

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

We expect that commercial master trusts could be badged as consolidators. Primarily because they require TPR authorisation and will be subject to ongoing TPR supervision.

Similarly, any FCA regulated pension provider could have the option to offer a consolidation scheme as authorised and regulated appropriately. It means that the existing regime can be expanded to adequately accommodate the small pots consolidation portfolio as opposed to a regime being specifically designed for this purpose.

Registered pension providers and master trusts should also have greater scale and be in a better position to drive through efficiencies. Enhanced governance is a feature through the appointment of professional trustees and Independent Governance Committees whose duty it is to ensure value for money for members is delivered. We do not propose that all commercial pension providers and master trusts act in this capacity – it should be those that have a de-minimis level of assets under management in order for efficiencies to be delivered in the way expected and for consumers to have confidence in the vehicles that are being proposed.

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?

We agree that savers should be given the option in the first instance. In the event of a nil response by the saver, the fairest approach for providers would be to operate a carousel approach; however, where the saver has existing holdings with a consolidator, a nil response should lead to augmentation of holdings with that same consolidator.

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

Yes, we agree with the summary. However, there are other factors to be considered (see Q17).

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

	Benefits	Risks
Pot follows members	• Easy to understand for individuals. • Simplicity of messaging. • Reduces risk of errors in the transfer process, as up to date member details are always available. • Better engagement with retirement savings, as individuals can see their total pension pot building up (dashboards will help with this).	• The member could end up in a scheme that provides poorer VFM (e.g. higher charges, poorer quality). • No employee choice (transfer would be to an employer determined provider). • Bad transfer experience could tarnish the employer brand, leading to a negative employee view of the employer. • Additional work for administrators / employers as part of the activity cycle - for example having to deal with additional questions and exchange of details between new and old schemes. • Will need an easily accessible way to determine which scheme to transfer to - for example where an individual has multiple jobs and therefore more than 1 active scheme. • Pot follows member will potentially stop when the combined fund is over the minimum small pot value. This may cause confusion with individuals when they have come to expect their fund to always follow them. • Individuals who do not go into a new employment will be left behind with a small pot - for example becoming inactive, career break or self-employed. • Employees who join a new employer and leave relatively quickly may find that they are in a 'transfer loop' and it might take a while for all the transfers to catch up with the latest employment. • If the new employer is in the process of changing schemes, this could lead to multiple transfers in a short space of time, confusion and extra work.

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

We prefer the default consolidator approach (provided this can be a competitive space rather than having a single provider), given the potential weaknesses to Pot Follows Member outlined in our response to question 16.

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

No, and we refer to the helpful work of the Small Pots Co-ordination Group in working to identify a sensible range of options, as addressed in this call for evidence.

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?

We see no reason to stagger the launch in this way. Both need to be addressed – the existing stock being managed will free providers from the challenges outlined in the consultation; managing new flows will ensure the problem does not reappear.

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?

Government needs to provide the industry with the framework (development and cost) to put this into place, otherwise the burden is too great and there are other priorities.

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

We note that the Member Exchange pilot found that creating a framework for transfers without savers' consent (which we believe will be essential to reduce the number of small pots) is not possible at this stage. Bringing forward legislation to compel relevant providers to take part in the solution and defines the pots in scope would facilitate this.

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?

Yes - will lead to a smaller number of providers, and we would also expect this to drive better outcomes through innovation, competition on VFM, more robust investment arrangements, and more engaging communications.

However, we note that even if schemes merged in which a member had separate pots, these would likely still be shown as multiple pots separately administered in one scheme. Barriers to simply combining these in a single view and single pot should be removed.

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?

N/a

Section 6: Equality Act

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; and
c. and how any negative effects arising from them may be mitigated.

Small pots are more frequent for individuals with low earnings, low contribution rates, shorter employment periods (including those in the "gig economy"), and those taking time out of employment (whether between jobs or on leave). Women are more likely to have these employment features. Overall, there will be a pattern of disadvantaged groups in society over-represented in small pots.