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Dear Natalie

Improving transfers and dealing with small pension pots

We are writing with our response to your consultation document on meeting future workplace pension challenges.

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes.

The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

Overview

Our view is that an aggregator scheme approach will meet your reform principles most successfully and that NEST is well placed to act as an aggregator scheme.

We do not think either of the alternatives are consistent with your principles. The proposed improvements to the current regulatory framework will not, in our opinion, have sufficient impact on current levels of member inertia. The proposal that small pots might follow workers from job to job would impose significant additional administrative costs, without the economies of scale which the aggregator scheme approach should achieve.

Our detailed comments are set out in the appendix to this letter.

Please do not hesitate to contact me (charles.young@hymans.co.uk) if you have any questions arising from matters raised in this letter.

Yours sincerely

Charles Young
Chairman, Pension Schemes Committee

Appendix

Chapter 2 – Small pension pots: the case for change

1. Do you have evidence on the scale of the current problem of small pension pots?

We have no reason to dispute the analysis set out in paragraphs 29 to 32 of the consultation document.

2. Do you agree that the barriers listed on page 17 are the current barriers to transfers?

Yes.

Chapter 3 – Improvements to the current regulatory framework

3. Would any or all of the proposals listed on pages 24 and 25 under this option be an effective way to facilitate more transfers and reduce the number of small pension pots?

These proposals are likely to increase the number of transfers and reduce the number of small pension pots. However, we would anticipate only a relatively small impact. Member inertia is still likely to restrict the number of transfers to a significant extent.

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?

It is not clear that all of the proposals would reduce costs. Enhanced disclosure requirements and a requirement for pension schemes to accept transfers in could increase costs.

Chapter 4 – Automatic transfers

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?

We much prefer the aggregator scheme approach to the proposal that pots follow people from job to job. The aggregator scheme approach also meets your principles for reform more fully. In particular, the principle of easing administrative burdens would appear to be very poorly addressed under the model outlined in Chapter 6.

6. Do you have any other suggestions for a process to overcome problems associated with small pots and improve transfers?

The aggregator scheme approach appears to be the obvious solution.

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 transfer of DB rights is likely to involve a fundamental change in the nature of the member's benefits (assuming the benefits would convert to DC). Members could be given the option of transferring their DB rights to the aggregator schemes but we do not think these benefits should be included in any automated transfer process.

8. Do you agree that under an automatic transfer system, members should have the right to opt out?

Yes, there should be a short period in which the member is entitled to opt-out of the default transfer.

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?

Yes. Given the size of the liabilities involved a requirement for bespoke advice would make the process disproportionately expensive. Generic information should provide an appropriate level of detail.

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?

Yes. We suggest that the trustees of DC arrangements should have the option of transferring small dormant pension pots to the aggregator scheme using a similar process.

Chapter 5 – An aggregator scheme for small pots

11. What are the particular challenges and benefits created by introducing one or several aggregator schemes?

An aggregator scheme should maximise efficiency and benefit from economies of scale. NEST would appear to be very well placed to act as an aggregator scheme as its focus on low charges and appropriate investment options is very well aligned with the characteristics which would be appropriate for an aggregator scheme for small pension pots (as set out in paragraph 95).

12. Do you agree with the aggregator scheme characteristics set out?

Yes.

13. Could the pensions industry offer an aggregator scheme with these characteristics?

As a number of private sector alternatives to NEST have emerged in the run up to auto-enrolment, it is possible that one of them may offer such a scheme. This is a question to address with the bodies concerned.

14. Have we correctly understood the implications of there being one or several aggregator scheme(s)?

Your summary seems reasonable. We note, however, that it assumes that a member must end up with all their benefits in the same aggregator scheme. An alternative approach, where more than one aggregator scheme is available, is for scheme trustees to decide which aggregator fund should be used as the default for their members. This would avoid the need for a "front end" process. Each aggregator scheme would liaise with schemes directly.

15. Should there be several aggregator schemes or one?

We do not have a strong view on this issue.

16. What are the advantages of NEST acting as the aggregator scheme?

As stated above, NEST would appear to be very well placed to act as an aggregator scheme as its charges and investment options are well aligned with the appropriate characteristics for an aggregator scheme for small pension pots. In addition, going forward, many individuals will accrue benefits in NEST or one of the new providers, so transferring small pension pots to the same place is more likely to result in a reasonable level of benefit in one scheme.

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.

We agree that £2,000 is a sensible threshold. We suggest that trustees should be able to decide whether to use a default transfer approach where the pension pot is below this threshold.

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

No, such a limit would appear to defeat the object of the exercise.

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?

This is a difficult issue. We suggest that the transferring scheme should meet costs relating to making the transfer and that the aggregator scheme should meet the costs relating to receipt of the transfer. The costs should be recouped through general charges, rather than through an explicit charge on transfer.

Chapter 6 – Pensions move with people from job to job

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

We do not think so. The receiving scheme could have significantly higher charges or limited investment options. Members could lose out as a result of the default transfer.

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

Yes, £2,000 is a sensible maximum.

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

We have not considered this in detail given our general concerns over this proposal.

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

It is not immediately clear how the costs of developing such a platform/database would be met. We suspect there would need to be a levy on schemes, or some other future income from operating the platform/database, and that Government would need to take the lead in procurement.

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

They should stay with the previous employer by default. The automatic enrolment process is complicated enough without requiring new employers to look back over an extended period.

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?

Again, we suggest that they should stay where they are as a default.

Response from:

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