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Dear Small Pots Policy Team

SPP response to Addressing the challenge of deferred small pots call for evidence.

We welcome the opportunity to respond to this consultation.

We would note in advance of the individual responses to questions that this was a topic that generated mixed views from our membership, albeit with broad agreement on the general themes. It is clear that there are advantages and disadvantages of several options (number of consolidators, consolidator vs. pot follows member) and whilst this should not be a barrier to implementing a solution care should be taken whichever options are chosen in light of these challenges.

Detailed Response

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?

Broadly we agree that the criteria are relevant but note that they may sometimes contradict each other. Consideration should be given to how to address any conflicts.

We would suggest that another criteria would be to ensure members are safeguarded from making poor decisions, which could be different to a process delivering overall net benefits (with the latter being more about default mechanisms than active decisions). It is not clear whether the first criteria

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covers things like protections and guaranteed annuity rates accurately and we note that there are many potential areas where detriment could arise that may not be clear at the time (for example benefits are moved to a scheme with lower charges but subsequently the investment strategy performs poorly, as we have seen recently with annuity targeting funds).

Issues with this will reduce confidence (potentially bringing media attention) but safeguards will potentially add cost and complexity with checks and record keeping.

The fifth key criteria stated ("commands confidence in the system for savers") may be difficult to reconcile with the reality of the initiative as some people will feel action has been taken without their instruction.

We note that employers are covered by "minimising complexity and administrative burdens", but consideration should be given to other parties such as pension providers (which may be intended under the criteria of a "more efficient workplace pensions market").

In addition, reduced complexity/admin for an employer may mean more for providers, for example, member tracing which become far more challenging within a provider's environment as time goes by (albeit having funds follow members as an option should mean records are more up to date).

Finally, we would point out that there are reasons one might want to maintain a small pot. For example, to be able to take the whole pot as a small lump sum. This is covered in later responses.

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

By far the best way of increasing member-initiated consolidation (and by this we should be looking at informed consolidation/consolidation that delivers benefits – not all consolidation is positive) would be the proposed pensions dashboards framework. It is disappointing that this has been delayed, but equally, it has to be fit for purpose at launch given the importance of confidence highlighted.

We also note that in some instances not consolidating will be an active decision (e.g. an occupational scheme pot with protected tax-free cash greater than 25%).

As is alluded to above, bad active decisions can be more of a risk than inactivity, and this should be carefully considered. Similarly, there are consolidator firms advertising products that have relatively high charges and this might not be understood. This could be mitigated to an extent if all providers have to provide Value for Money information as per the current consultation on this.

Member initiated consolidation also has a potential downside in that it can make residual pots even less attractive to any arrangements looking to consolidate what remains (the funds transferred actively are likely to be larger than those that remain for auto-consolidation).

There are also less economies of scale with individual transfers, with individual transactions and risk disclosures. The risks themselves are multiple and include scams, loss of guarantees, loss of small pot treatment, crystalizing losses if investment strategies do not align, implicit transaction costs of disinvesting to cash (albeit the investment issues are less of an issue with small pots).

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?

Ultimately legislation is required here and not just in the consolidation process, a lot could be done with legacy schemes to remove penal transfer conditions/have rules that require a fair transfer value to be calculated.

There is no doubt that dashboards will help, but they will have most impact with those already engaged. The biggest issue with small pots will be those who are not engaged and do not consider dashboards until retirement if at all.

Where no trustees exist (e.g. with orphaned schemes) intervention would be required (and this will be a consideration for the Value for Money assessment too).

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**

We believe the lowest option here is the best one, and some of our members believe even £1,000 is too high. £1000 is cited as the average size of a DC pot, and if it's average, how can it be small? An amount of £250-£500 could ensure the system works and that trustees and providers are comfortable. It can also always be increased.

We note that when you get to £5,000 two pots of this size or more would take people above the small pots limit that avoids triggering the money purchase annual allowance.

There is also potentially less of an impact in relation to loss of guarantees when you have pots at this smaller end of the spectrum (e.g. GARs for a fund of £500 are unlikely to be of that much benefit to an individual in practice, even if as a % there is no difference).

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

We have not answered 5-9 as we are not a provider/administrator of benefits.

No comments.

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

No comments.

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

No comments.

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

No comments.

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

No comments.

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?

This makes sense as long as any pots below that limit are able to be refunded/paid out in some form. For example, a limit could be set at £100, and anything below this be paid out.

There is a question as to whether refunds are made (in line with AE procedures and historic two-year short service terms) or funds paid out as lump sums (including employer contributions and investment returns) but with a standard basic rate tax deduction on 75% (as per winding-up lump sums). We would suggest this approach is preferable as it means individuals do not lose the benefit of employer contributions and issues relating to salary sacrifice (where there are no employee contributions technically) are removed. With a limit of £100 allowing funds to be paid out would not significantly disrupt the auto-enrolment messaging. Debatably if fund values are in scope the limit could be higher – potentially up to £250. We note that the SPP has representation from many different types of organisations in the sector and there was a consensus that payment out of small pots would be desirable and not contradict auto-enrolment messaging.

There is a question as to whether employers or providers should be responsible for tracking down members (and there are issues with paying tax without a PAYE system), but this should not be insurmountable and if the payment is made relatively soon after employment ceases records should be accurate.

It is more feasible for ex-employers to track down short-term savers to pay a refund than providers, as they invariably have a last known address, possibly bank details, and know immediately when an employee has ceased working for them.

We acknowledge that some parties think refunds should be based on time, not value, but we believe value is the most relevant qualifier for individuals and a very small pot is a small pot (and as such note likely to be engaged with or useful at retirement) irrespective of how long it has been in existence for/taken to build up.

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?

We believe the most relevant trigger for this would be based on individuals having left employment. We note this is only relevant for workplace schemes but this will cover the vast majority of small pots. We do not think it would be appropriate to move a pot whilst the person is still in active employment and this could generate legal challenges where people are on parental leave or absent due to sickness. It also means that when people return their contributions will be started again in a new pot (possibly creating another small pot).

We believe that employers will generally note in uploads where employment has ceased and so the reporting should already exist. A period of 10 – 15 months after the pension scheme has been notified of employment ceasing could be an appropriate point for the consolidation process to start (and people could opt in earlier of the back of a leaver letter). We note some of our members suggested it could start even earlier at the start of the leaver process.

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

There is no perfect model as new small pots will always appear.

Pot follows member means that the pot is always in the most recent scheme, not necessarily the best, but recent schemes are likely to be up to date proposition wise.

Going back to a fixed consolidation option minimises implicit costs of transfers from disinvesting to cash and other investment matters are minimised. A potential option would be for individuals to be able to actively choose their consolidation pot with a default as a back-up.

A single consolidator raises questions about market competitiveness. Any consolidator should have minimum standards and be a qualifying workplace pension scheme. Providers may have to update their systems to allow this to work.

Ideally, record keeping will be of a high quality under any option so people can see which employers/employment periods a given pot has come from.

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?

It will be easier to track down pots under a single consolidator model and there should be economies of scale. Equally though there are questions of market competitiveness. A benefit of multiple consolidators is the potential for innovation and price competition.

The single consolidator model has the advantage of consistency of product features and target retirement age and may increase confidence in the solution.

The cost of administering a sub £1,000 pot significantly outweighs the charges levied. A consolidator's Business Plan will need to be scrutinised by TPR given the risk of consolidator failure.

There is also a chance providers will not be interested in this unless they are the only option.

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

As is mentioned above for sufficient scale to exist there will have to be a relatively small number.

A regulatory framework is needed and as there is already a governance regime in place for master trusts it could be that the solution is taken from this group. This market will also consolidate naturally.

It makes sense any option also meets the workplace pension criteria.

We had mixed views as a group as to whether members would benefit from more than one provider. If choice is desirable for innovation it is clear the choice should be small as scale is both needed and beneficial.

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?

There could be a default with the option to choose before, but the design of a default is a challenge that would require considering different situations (e.g., multiple providers).

Clearly, communications are critical and need to be a compromise between cost efficiency and the need to cover information and inform/protect members.

The existing scheme could send two communications, a letter to opt out and then a 'we haven't heard from you' follow up. Any new provider should also need to send a 'welcome' style communication to confirm where the fund has come from/to help the member keep track of what is where.

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

This process needs dashboards to work really.

Schemes could potentially link pots through National Insurance numbers but it will be complex and a person's new scheme may not be where they want funds.

We agree with the challenge of having more medium size pots depending on where the pot value limit is set (someone could have a number of £2,000 pots) but this is still a lot better than present and again the dashboards would support this outcome (allowing pots to be seen side by fine and then actively consolidated above the limit.

When new members join a scheme, statutory disclosures could be extended to include dashboard awareness and consolidation encouragement. Will require (in particular) FCA pragmatism.

As with all options, the 'burden' on providers and employers and the potential friction between these two perspectives (who wants to take responsibility) needs to be considered and the responsibilities of the roles clearly set out.

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

Pot follows member reduces the risk of being stuck in a legacy arrangement in the long term (i.e. old and potentially less than optimum investment strategies).

There are also challenges where people hold more than one job concurrently (which is not uncommon with small pot accrual) – to which arrangement does the pot go. There needs to be a process for this too.

Other risks include:

- The individual could have moved on again by the time the provider has found the new active pot and provided notices;

- There are operational challenges in running this and a question over what due diligence would be required on the new scheme prior to transferring (this links back into authorisation frameworks); and

- Not all schemes allow transfers in.

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

There were again mixed views on this – different people had different preferences. What is clear is that both approaches have pros and cons and whatever is chosen should be considered carefully. If there is to be a consolidator the number of providers should be small and there should be a refund system for very small pots. This should be supplemented by a framework of communications (and the pensions dashboard project) to help people make good active decisions where engaged.

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

Consideration should be given to other countries and their solutions, such as Australia where a member picks a pot and employers contribute. We note this is being considered in the Pension Contribution Bill which has just been published. There are complications with this too, especially from an employer angle.

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 would suggest data analysis drives this consideration, as there are pros and cons to both approaches.

It may make sense to start with existing stock as these older arrangements have the most potential for members to benefit (higher charges, older propositions etc.). That said they have more complexities and as a result risk due to guarantees in place and potential exit penalties. Starting with workplace pensions would be easier and get things moving allowing lessons to be learnt for the more complex legacy cases. It would also stop new small pots being built up.

As an aside those closer to retirement are more likely to engage with consolidation actively, but many still won't and automatic consolidation may benefit them in terms of their planning process.

Ultimately both groups should be dealt with sooner rather than later.

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?

There are mixed views on this. Some master trusts have appetite for this but not all and it tends to be those (understandably) keen to be involved in the consolidation progress. We would expect some legacy proposition providers are less keen for some of this. As has been mentioned before there does need to be legislative direction and a marketing campaign will be needed (as there have been so many scam warnings and this could look like that sort of thing at first glance). That said some lack of confidence in the industry is unavoidable, as is lack of engagement, so all that can really be done is to establish a default process that is well designed and delivers net benefits/controls risk for members. This in turn should help build confidence for the future.

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

This could be a useful option that would work better with small numbers (or 1) consolidator. Technology is key here and the dashboard framework should help when it comes.

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?

This could be part of a wider consolidation solution but may not make much of a difference in isolation.

We understand systems can be barriers too, however for the consolidator approach to work some providers at least would have to build this functionality. Anecdotally it frustrates members that if they have two pots with a provider (and with some providers it happens a lot) it's hard to consolidate.

There are other elements of complexity too. Two pots with 1 provider could easily be 1 SIPP and a trust-based plan and be incompatible. Equally what happens if there are two charges – does the lower one prevail and is the active plan always used.

In short this is a useful option, but the framework would need some thought.

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?

Legislation change could provide a solution to some barriers. For some providers systems just do not allow it and so platform adjustments will be required (which is less desirable for providers of legacy arrangements).

In many commercial Master Trusts employers are separately underwritten. Some allow bespoke investments and may choose a bespoke target retirement age. Therefore same scheme consolidation can be inhibited by different charges, investments and retirement date. It is down to fortune whether consolidation improves or worsens an outcome.

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.**

Given that these solutions require (ideally) a degree of understanding, any groups that find it difficult to engage with communications and make decisions would be more impacted.

Small pots are probably more likely to affect those on lower incomes and those who take periods of leave from employment (similar to the pensions gap and the AE qualifying earnings threshold).

Response ends.

Yours faithfully,

Martin Willis,
Chair, Defined Contribution Committee, SPP

Fred Emden
Chief Executive, SPP

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