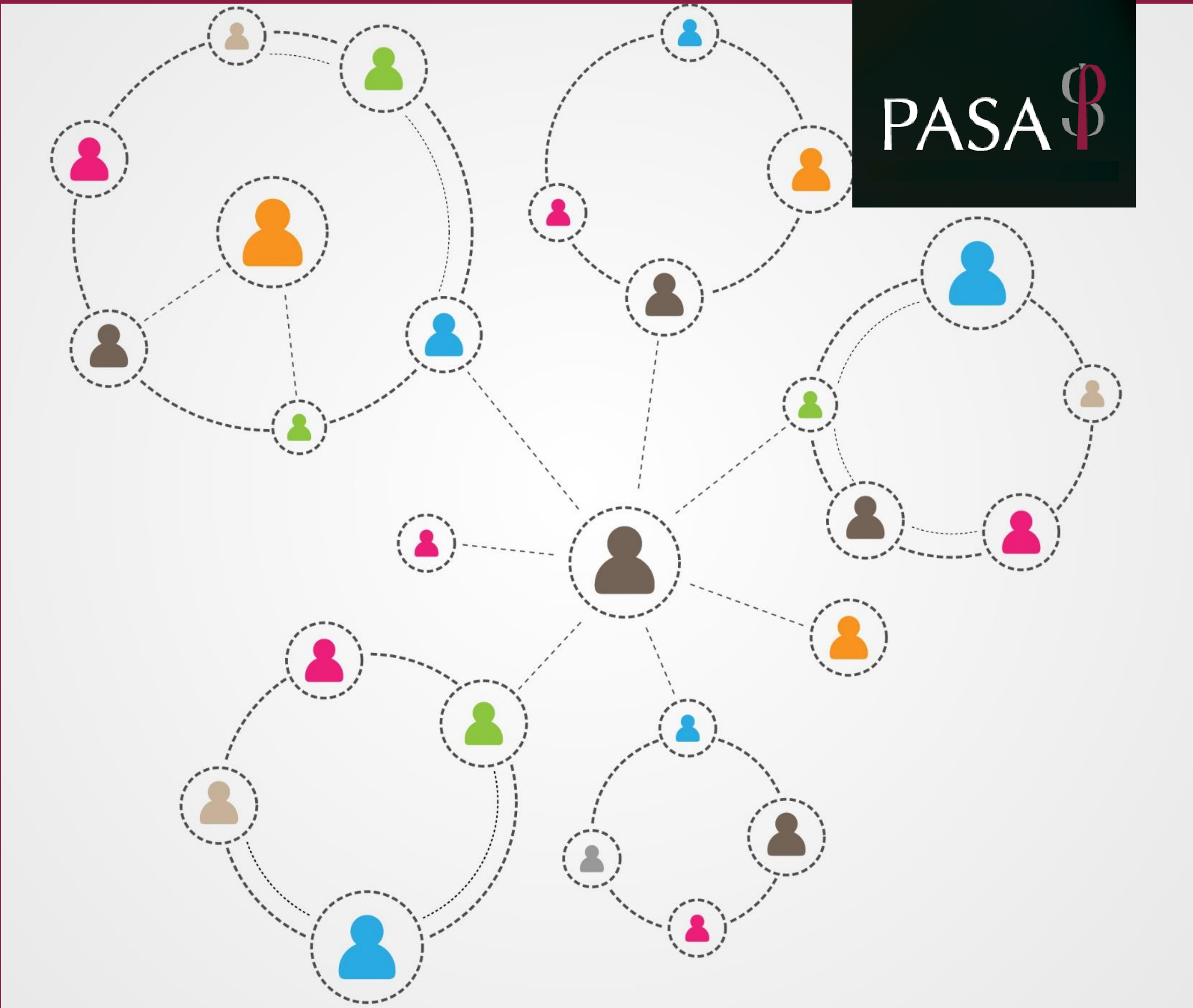

PASA DWP Consultation response

Ending the proliferation of deferred small pots

September 2023

DWP Consultation response – ending the proliferation of deferred small pots

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About PASA

The Pensions Administration Standards Association (PASA) was created to provide an independent infrastructure to set, develop, guide and assess administration standards.

PASA acts as a focal point and engages with industry and government to create protocols for understanding good administration - but also appreciates there’s no one size fits all. PASA develops evidential Accreditation practices allowing benchmarking across and between the industry regardless of how the administration is being delivered.

As well as raising the profile of pension administration generally, PASA focuses on three core activities:

1. **Defining good standards of pensions administration relevant to all providers, whether in-house, third party or insurers**
2. **Publishing Guidance to support those standards**
3. **Being an independent Accreditation body, assessing the achievement of good standards by schemes**

There’s no organisation providing such services across schemes, yet there’s a demand for evidence of service quality from scheme trustees, sponsors, administrators, insurers, savers and regulators.

1 Summary

As the consultation points out, the proliferation of small pots and the ongoing predicted rise in numbers, means action needs to be taken.

Not immediately pursuing pot follows member, or some form of stapling (as per Australia and briefly mentioned in p61 of the proposal), from the outset is a missed opportunity. A roadmap needs to be developed to address these issues, or risk them being pushed to one side with the proposed central registry approach.

If action isn't taken, there's a real risk the small pots problems will undermine the success of auto-enrolment. At best the issue introduces unwanted and unnecessary inefficiency in the system. At worst it could lead to people receiving less pension income. This could be because they have a proliferation of lost pension pots, pots being eroded through fees and pots of less than £10,000 being taken as lumps sums rather than the objective of providing retirement income.

There's not one single small pot problem, which means there isn't one solution able to solve all the issues. There are multiple problems, which have arisen due to:

- the design of the auto-enrolment criteria. Although this, in part, is mitigated by the interaction between the trigger and contribution thresholds, it'll never be completely solved as a large part of the auto-enrolment population is highly transient in nature
- the two separate regulatory regimes
- multiple forms of DC provision
- varied administration platforms and structures
- existing pots (stock) and future contributions (flow), as well as an infinite range of member engagements

Dashboard's delay is seen by the wider industry as another missed opportunity to bring all of the challenges together to improve outcomes and engagement for all.

The limit of eligibility suggested at £1,000 isn't large enough to provide meaningful, consolidated pots for savers. While it might suit the business models of providers, this should be a secondary consideration to the primary concern of saver outcomes. By only addressing pot sizes up to £1,000, there will still be millions of small pots over £1,000 which don't provide savers with value for money (VFM) or protect them from potentially inappropriate investment strategies. An active dashboard ecosystem would help savers see where all their pots are, and hopefully engage them into taking action. Without this in place, it makes sense to increase the small pot limit of eligibility over a staged period. But this should be achieved within a short timeline, once proof of concept is accepted and lower pot sizes are addressed first to halt fee erosion.

The recent DWP backing of a Private Member's Bill to extend the eligibility of automatic-enrolment to those aged 18, and from the first pound earned is a welcome development. However, once implemented, this is likely to increase the number of small pots in the system. In addition, or VFM assessment and the recent confirmation of additional regulatory requirement for evidence of VFM, may result in employers regularly moving between different providers, causing further increases in deferred small pots.

The responses below focus on the impact these proposals may have on administration delivery.

2 Consultation questions and answers

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

A pot follows member solution, together with a timetable for the introduction of either lifetime providers or stapling would be preferred, as this type of model scored most effectively against the DWP's stated assessment criteria. The desire for scale should not trump what would be in savers' best interests, and the best way of solving the small pots problem.

As pot follows member has been removed from consideration, a clearing house would be a more effective conduit for consolidation. There are numerous difficulties in setting up a registry, also this would largely replicate the dashboards.

The advantages to this option, include:

- There should be no need for a regulator (FCA or TPR) to directly regulate the clearing house as it can be an arm's length body of Government/DWP
- The speed and costs of introducing such a clearing house can be minimised as another Government body (MAPS, the Pension Tracing Service or similar) could be repurposed
- Industry providers can set up systems for dealing with a single Clearing House and would likely prefer dealing with an independent organisation rather than potential competitors

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

There are a number of potential problems to consider:

- the market for potential consolidators should be a level playing field, with consistent regulatory approaches applied across all consolidators.
- fixed amount charges shouldn't form part of any consolidators charging structure
- the authorisation regime will need to focus on the long-term financial stability and sustainability of any consolidator provider. This should preclude the use of cross subsidies or any other hidden accounting techniques. This includes any attempted arbitrage between trust and contract based portfolios from those providers operating in both markets

It would be overly prescriptive to define the charging structures consolidators must apply (which could risk overcharging and inflated profits in the longer term). However, charges need to be below the current charge cap limit of 0.75% pa. Given the scale of the market, charges would likely be substantially below this level. Within these parameters, charge levels aren't a suitable criterion for allocation as these only represent a small part of the VFM framework adopted by Government and regulators. If the construction of the current charge cap is considered suitable for offering an auto-enrolment scheme, it should be suitable for a default consolidator.

Administration needs to be remunerated, and needs investment. This is key to the successful delivery of good outcomes for savers. Costs need to be met to enable Administrators to continue to deliver accurate quality services, and evolve to meet ever changing regulatory requirements. Small pots cause inefficiency and commercial challenges, and cross subsidies already exist with income from larger pots helping cover the costs of small pots. A pragmatic approach would be to accept this and continue with an Annual Management Charge (AMC) only charging structure for the proposed consolidators.

The clearing house shouldn't second guess or supersede the regulators' functions in defining actual and perceived VFM. Which will of course vary between savers depending on their circumstances, objectives and beliefs.

One option could be to develop criteria for allocation based on what's best for the saver. For example, an approach could consist of:

1. saver gets the option to choose
2. if they don't make a choice then auto consolidation to a consolidator scheme they already have a pot with
3. if the saver has more than one pot with different consolidators, pot is consolidated to either the largest or most recently active pension
4. remaining pots then get allocated on a carousel basis between authorised consolidators

These new arrangements should be compulsory for those providers holding saver pots worth less than £1,000. There are advantages to permitting schemes to increase eligible pot sizes (i.e. £1,000 to £5,000) at their discretion where they believe it to be in the saver's interests. A timetable leading to the increase of eligible pot size from £1,000 to £5,000 should coincide with the launch of dashboards, but not tied to it. In case of delay. This increase in the limit of eligibility size will lead to fewer pots with less risk and cost to administrators, reducing costs to savers and providing a better engagement model.

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

An authorisation regime is essential and should be of equal robustness for both master trust and contract-based providers to limit the risk of inappropriate arbitrage. It makes sense for the regime to be built closely on existing authorisation requirements, ideally with stricter financial sustainability requirements to limit the risk of potential market failures.

There should be specific additional criteria for authorisation including:

- Specific authorisation to act as a consolidator requiring similar financial, systems & processes and 'fit and proper criteria as currently applied in the master trust regime
- AMC-only pricing
- Transfers out allowed in line with the statutory right to transfer
- Must be able to administer multiple benefit tiers so benefits can be transferred on a like-for-like basis (e.g. protected Normal Minimum Pension Age (NMPA) 55)

4. Do you agree with setting the initial maximum limit for consolidation at £1,000, with a regular statutory review?

Yes, as a starting point, with an increase to £5,000 over a short staged period once proof of concept is accepted and lower pot sizes are consolidated. This approach would ensure there's sufficient capacity within the industry to communicate with and transfer saver funds efficiently, while transferring the smallest pots. The limit of eligibility will impact schemes differently according to their saver demographic. Therefore the amount of work involved for the administrator, and the impact on any particular scheme, will be dependent on this.

There are other factors to be considered regardless of the limit of eligibility and we note further details will be provided on operational issues in due course. Guidance on the following would be helpful:

- How the limit would be calculated where a saver has multiple pots within the same scheme (e.g. through different employers)? Schemes should consolidate all of the saver's pots within the scheme first to avoid transferring out unnecessarily. This should be made as straightforward as transferring to a consolidator with no requirement for saver consent. If the pots are subject to different charging and/or benefit structures, consolidation should be informed by reference to the best outcome for the saver, not to the most beneficial result for the provider

- What would happen in a scenario where the value is below the limit at the time of the valuation but is above at the time of transfer (and vice-versa) due to investment gains/losses and the delay from valuation date to actual transfer? The agreed policy will require clear explanations to savers to avoid any confusion
- How the transfer process will avoid causing market distortion due to a potentially large amount of funds being sold and bought at the same time. i.e., will the transfers be phased at different times of the year for different providers?
- How often will the limit of eligibility be tested at the saver level? This should be done no more frequently than on an annual basis, which is consistent for all providers aligned with the benefit statement date. This will spread the activity over a year rather than all focused on a particular date
- Consideration of practicalities and timings such as managing bulk processing, administration provider risk, saver choices, the execution of sales and purchases. and avoiding regular 'blackout' periods
- What will happen on the deadline day in terms of the impact on market capacity, normal day to day processing, administrator capacity and fraud risk

5. Do you agree with this proposal not to mandate schemes to undertake same scheme consolidation at this current time?
Same scheme consolidation would be beneficial from an administrative perspective as this reduces cost, risk and increases customer service – as wells as improving the saver journey. Same scheme consolidation should be mandated within a small number of years or align its requirement to the launch of dashboards.

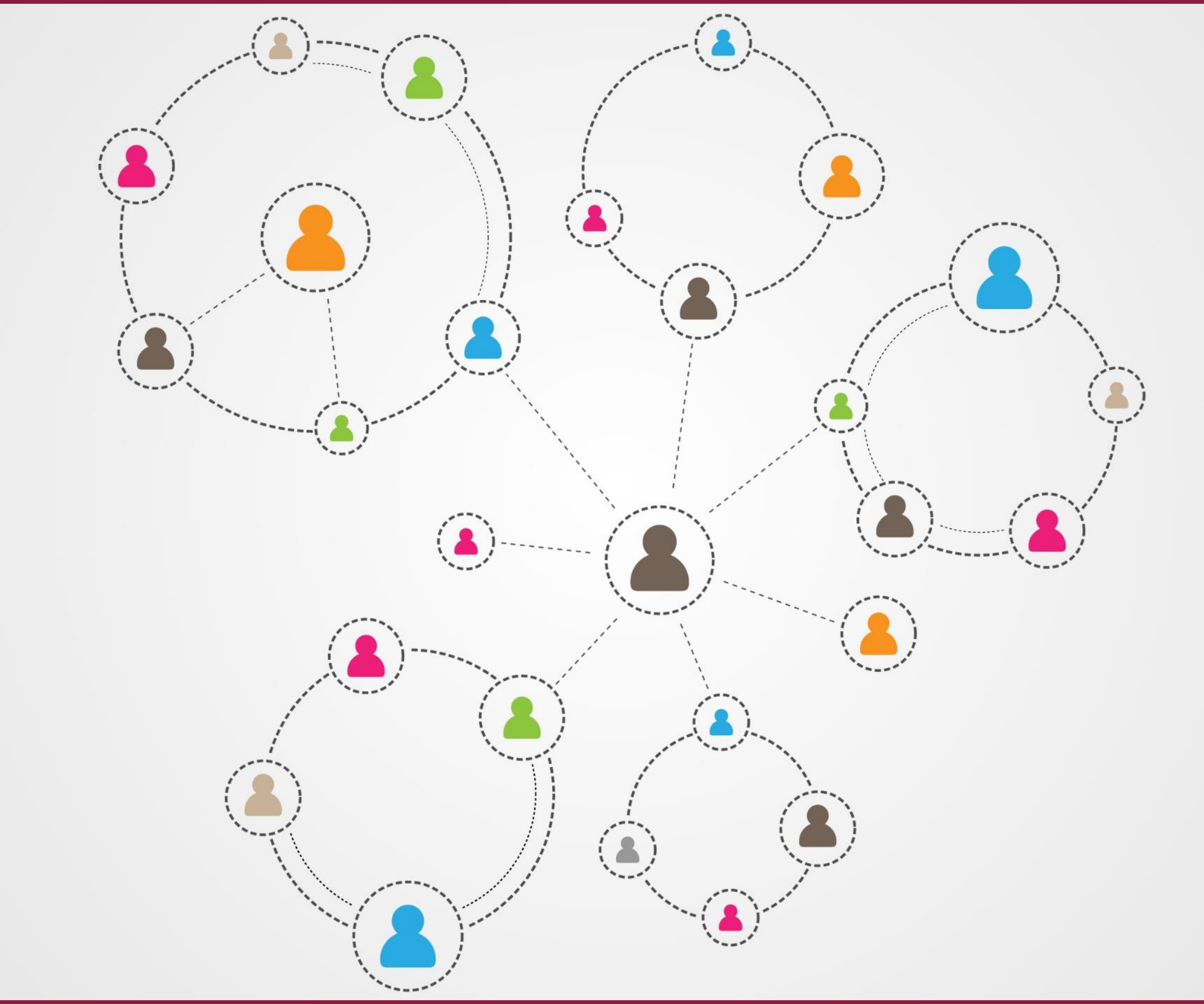
6. As a whole, do you agree with the framework set out above for a default consolidator approach? Are there any areas that you think have not been considered, that need to form part of this framework?
In the absence of pot follows member, a multiple consolidator approach is sensible.

There should be a firm and committed plan to evolve saver control and choice as outlined through this response. Stapling, aligned with a system based on defaults simplifies engagement, reduces cost and should improve saver outcomes due to higher engagement.

While seen as being some way off in the UK, this model should be a target future outcome for the industry. The proposed approach will only deal partially with the problem in isolation without a broader supportive strategic road map for these entwined issues.

The framework should ensure providers can deal with the various inherited scheme rules and the regulatory impact of changes. Historic benefits (especially from DC trust based schemes) and the rise in the NMPA from 55 to 57 all result in extra administration and the need to record multiple benefit tiers. These then need to be presented in a clear and meaningful way to savers .

7. Do you have any comments on the positive or negative impacts of a default consolidator approach on any protected groups, and how any negative effects could be mitigated?
Where a saver has selected a sharia fund or ethical fund, the receiving fund must offer an investment equivalent. This should be flagged by the administrator to highlight an exceptional event or process which may need more administrative support. Consideration needs to be given to auto consolidation of particular investment beliefs (including sharia, climate/ESG impact funds).



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