ABI response to DWP's call for evidence on *Addressing the challenge of deferred small pots*

March 2023

The UK insurance and long-term savings market and the ABI

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The ABI represents over 200 member companies, including most household names and specialist providers, giving peace of mind to customers across the UK.

Executive summary

1. The ABI welcomes this call for evidence on reducing the number of small pots in the pensions ecosystem. We jointly convened the Small Pots Coordination Group with the PLSA, and have through this group furthered the evidence base from the work carried out by DWP's Small Pots Working Group in 2020. We endorse the work of the industry group, which can be found in its two reports[1].

2. Member-initiated consolidation is increasing and will help to reduce the number of small pots, but the level of reduction is currently unclear. Pensions dashboards will help to facilitate consolidation, because even if transactions are not directly possible on dashboards, people may be prompted by the information they see to go away and take action. This, as well as other engagement mechanisms like the industry's Pension Attention campaign, will help. Huge effort by industry and Government has gone into developing pension dashboards. They should be fully embedded first, with appropriate time for post-implementation review to understand consumers' behaviours. If it is found that pensions dashboards do not materially prompt users to take action to consolidate their pots, then we agree that an automatic transfer solution should be taken forward.

3. Reducing small pots is key to reducing the number of lost pots. We encourage DWP to consider these two key issues together. Provider-initiated efforts to trace gone away customers can only go so far in the current system, but could be significantly reduced if they were able to verify a customer's details with those held by Government. Reuniting people with their smaller deferred pension pots could encourage them to proactively consolidate.

[1] https://www.abi.org.uk/globalassets/files/publications/public/lts/2022/small-pots-co-ordination-group-spring-2022-report.pdf and https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2021/Small-pots-cross-industry-co-ordination-group-update-report.pdf

4. We support the call for evidence's conclusion that legislation is required for an automatic transfer solution to work for the whole of the market. Small pots are very common in contract-based schemes, so it is important that a solution works for both them and trust-based schemes. Legislation would be needed to compel all in-scope providers to implement the solution; to enable contract-based providers to carry out transfers without member consent; and to broaden the scope for transfers without consent from occupational pension schemes. For an automatic transfer solution to work, pots in scope need to be defined, and appropriate governance, standards and a liability model set.

5. There is significant detail missing from the call for evidence on the mechanism for a small pots automatic transfer. As outlined in the Small Pots Coordination Group's reports, a receiving and ceding scheme would have to have appropriate processes for matching pot details, wrapped around by appropriate governance,. The chosen solution would have to minimize time out of the market for the saver, as it is likely pots will have to be cashed out and reinvested in the receiving scheme. Fundamentally, the administrative transfer process in the UK is still far too expensive for an automatic transfer solution to be cost effective. Average transfer costs would have to reduce significantly for the solution to not bring more cost into the system than the inefficiencies it removes.

6. We agree with the five principles DWP has set out in the call for evidence, and pot follows Member (PfM) with a "pull" mechanism is the model which has the best possibility of meeting these. It is the model most likely to make sense to the saver, because their action (moving jobs) triggers the transfer of the pot. It is the solution which could have the least market distortion, and potentially be the easiest to administer. There would be no need for a new authorisation regime, and a legislative mechanism for PfM is already on the statute books. It would help solve the issue with the future flow of small pots, and reduce many existing pots. There are complexities such as multiple job holders, those who leave work for long periods of time or who move abroad, which would need to be worked through.

7. The single consolidator model does not meet the DWP's third principle of supporting a competitive market. The pot sizes the call for evidence references are large enough that automatically transferring them to one single consolidator would create significant market distortions, as is evident from the number and value of pots we have seen in our member survey results, and those of the PPI on the Master Trust market[2]. For these reasons it is our view this should not be developed further.

8. Multiple default consolidators could meet the principles, but risks increasing complexity in the system, and would be least efficient for the transfer process; it is also much harder to explain to pension savers. Enabling them to choose a consolidator for their pot to go to is akin to an engaged member-initiated transfer; it does not accord with the problem statement of disengaged savers with deferred small pots.

9. The small pot thresholds the call for evidence looks at are far too high, and for many savers would not be considered small. Someone on the median weekly wage in the UK working full time after a year would have a pot size of less than £2,000[3]; someone on a minimum wage earning would have c£770[4]. It would take these people a number of years to reach the upper threshold of £10,000. We suggest a phased

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[2] https://www.pensionspolicyinstitute.org.uk/media/3610/20200922-ppi-small-pots-working-group-guide-to-booklet-final.pdf
[3] Assuming mean wage of £640 a week, with 20 days annual leave, saving statutory minima in banded earnings. https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/annualsurveyofhoursandearnings/2022
[4] Assuming someone on minimum wage of £9.50 per hour, working 35 hour weeks with 20 days annual leave a year, saving statutory minima in banded earnings.

approach is applied, starting with much lower thresholds up to a lower maximum. Transfers could start at less than £500, before steadily increasing to £1,000 and then £2,500. We understand that the pots in scope of a small pots solution are likely to be automatic enrolment qualifying schemes, at least in the first instance. We would support the expansion of a small pots solution eventually beyond that, although pots with valuable benefits, such as guarantees, would need to be considered carefully.

10. The interaction of these small pot transfers with other regulatory measures also needs to be considered. This includes the proposed method for increasing the Normal Minimum Pension Age (NMPA). We welcome the call for evidence's assertion that small pot transfers would have to be block transfers to avoid overly complex ringfencing and potentially disadvantaging pot owners, but the current structures would mean potentially millions of pots would have a protected pension age (PPA), further undermining the objective of the NMPA change. This is a better approach for customers and for schemes, but illustrates why the Government needs to rethink the approach to increasing NMPA and take wider policy developments into account.

11. We have responded to relevant questions.

ABI response to the call for evidence questions:

Question 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?

12. Yes, we agree with the criteria.

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

13. Member-initiated transfers are now very common, especially in order to consolidate pension pots. Origo last month reported that transfers of pot sizes under £10,000 have increased by 40% over the last couple of years, which indicates there is increasing member-led consolidation[5]. But given the extent of the accumulation of pensions through AE, it is currently unclear how much member-initiated consolidation will reduce the number of small pots. Greater engagement in pension saving could help people to consider consolidating more of their pots, and some providers are using this key message in their communications to customers. Pensions dashboards could have a transformational impact on people's engagement with their pensions, including understanding the number of small pots they have, and where the pots are. Similarly, the ABI and PLSA's joint Pension Attention campaign aims to wake people up to their pension savings and get them to look at their pension pots. Continuing to encourage this behaviour, including through the use of pensions dashboards, will help to reduce the stock of small pots.

14. Pensions dashboards should be fully implemented before any small pots automatic transfer solution is developed. An understanding of how they impact consumers' behaviours should then be sought. As it stands, pensions dashboards will not directly allow someone to consolidate their pension pot. The aim is to provide the person with the information, all in one place, to help them make decisions such as whether they would like to consolidate their pensions. It does not allow for that transaction to occur on

[5] https://www.professionalpensions.com/news/4074661/origo-reports-increase-small-pot-transfers#:~:text=The%20number%20of%20defined%20contribution,%C2%A310%2C000%20rose%20by%2042%25.

dashboards. The person would be expected to go off onto the next stage of their journey and transfer their pension pot themselves. There are still ongoing discussions around post-view services and what these will allow for, and so there is the potential that dashboards could, for instance, display a button that directed you to the transfer page of the provider's website. However, this is still to be determined by the FCA following their CP22/25 consultation.

15. The Consumer Duty and the holistic review into the advice boundary may have an impact on the communications providers can give to their customers on thinking about consolidation. We would encourage DWP to engage with both these regulatory developments during the course of this work.

Question 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?

16. The ABI represents both contract and trust-based providers. There are much greater challenges in the contract-based environment to reduce the number of small pots without member consent, unless there is legislative and regulatory change. This is also the case for same-scheme consolidation. Greater market innovation and competition could help to increase member-initiated consolidation, as noted in the answer to Question 2 on pensions dashboards.

17. Reducing small pots is key to reducing the number of lost pots. The PPI work on lost pots, commissioned by the ABI, estimates there is £26.6bn in lost pots within DC pensions, and this is growing as a result of the low engagement levels brought about by automatic enrolment[6]. We encourage DWP to consider these two key issues together. Provider-initiated efforts to trace gone away customers can only go so far in the current system, although there are a number of tracing services which can help with the problem. These efforts could be greatly improved if providers were able to verify a customer's details with those held by Government. Reuniting people with their smaller deferred pension pots could encourage them to consolidate.

Question 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

18. The upper threshold of £10,000 is far too high as a starting limit for automatic consolidation; as is £2,500 and £5,000. The average DC pot size in 2020 for all ages was £18,300[7]. Someone on the median weekly wage in the UK working full time after a year would have a pot size of less than £2,000[8]; someone on a minimum wage would have c£770[9]. It would take these people a number of years to reach the upper threshold of £10,000.

19. We suggest a phased approach be adopted, given this was also successful during the implementation of automatic enrolment. This is because it is important to start small and prove the concept before including larger pots as part of any automatic transfer solution. The first phase could be less than £500, followed by

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[6] https://www.pensionspolicyinstitute.org.uk/sponsor-research/research-reports/2022/2022-10-27-briefing-note-134-lost-pensions-2022-what-s-the-scale-and-impact/

[7] https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/datasets/pensionwealthwealthingreatbritain

[8] Assuming mean wage of £640 a week, with 20 days annual leave a year. With statutory minimum contributions based on banded earnings (from £6,240). https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/annualsurveyofhoursandearnings/2022

[9] Assuming someone on minimum wage of £9.50 per hour, working 35 hour weeks with 20 days annual leave a year, saving statutory minimum contributions based on banded earnings (from £6,240).

£1,000 and then a maximum of £2,500. This phased approach could also include a select number of providers rather than just be based on pot size. Were anything to go wrong during the initial implementation phase of very small pots, the potential redress liability would also be much smaller.

20. We understand that the pots in scope of a small pots solution are likely to be automatic enrolment qualifying schemes, at least in the first instance. We would support the expansion of a small pots solution eventually beyond that, although pots with valuable benefits, such as guarantees, would need to be considered carefully.

21. When defining the scope of a small pot, DWP should also consider the interactions with other regulatory measures. One of these things is the proposed method for increasing the NMPA. We welcome the call for evidence's assertion that these would have to be block transfers. This would mean that for each transfer with a PPA, the scheme members' benefits in the receiving scheme would inherit the PPA, so that eventually, millions more policies would have a PPA. This is a better approach for customers and for schemes, as it avoids overly complex ringfencing and potentially disadvantaging customers with a PPA. To prevent customers losing PPAs in any small pot solution, DWP would need to require schemes to check for and keep track of transfers with a PPA, which they are not currently obliged to do.

22. Consolidating all pots into one will not be in the best interests of everyone. There are tax advantages to people having small pension pots below £10,000, as depending on the arrangement they are in, people will be able to commute these as a small lump sum. This enables people to access smaller amounts of their pension in a tax advantageous way – for example, it means the Money Purchase Annual Allowance is not triggered. An automatic small pots solution should consider the tax implications, and potential detriment, to those who have planned to ultilise their pots in this way. An opt-out mechanism which is not too burdensome on the transfer process may help resolve this issue, but would need to be carefully designed.

23. ***Question 5: 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?***

24. This depends on whether the cost of transfers falls significantly. If they do not, an automatic transfer solution may add costs to the ecosystem, rather than make it more efficient, thereby not meeting one of the five principles.

25. Reducing the costs of transfers has been explored through the Small Pots Coordination Group, and there is clearly still too little automation in the process. Changing regulations on transfer and in relation to pots (such as the pension transfer regulations, stronger nudge and NMPA), has impacted the speed and cost of transfers. Further such initiatives will continue to do so, and were an automatic transfer solution to be implemented, specific carve outs for these types of transfers would need to be considered.

Question 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?

26. Our model preference is PfM, with a "pull" mechanism. A trigger for a pot being classified as deferred under this model would most simply be that a saver has moved employment. We support this

classification being the primary one, over the 2015 PfM framework proposed triggers[10]. Under our preferred trigger, the provider who has been informed of a new employee would request the old scheme to transfer in. This model would work much better in practice; a deferred definition based on a time-limited contribution holiday risks people being in scope of a transfer who have not left their employment (i.e. on parental leave, or sabbatical). The old scheme would still be required to make some data available so that the deferred customer's pot can be identified.

Multiple Consolidator questions:
Question 12: Do you agree with the above summary of potential benefits and implications of the default consolidator/s approach, and if not why?
Question 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?
Question 14: Who should be able to be a consolidator; should there be a limited number, and, if so, how many, and why?
Question 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?

27. We do not necessarily agree that the consolidator model would be simpler than the PfM model. Multiple consolidators, where members would have the option to choose which consolidator they go to, would add lots of complexity. The highest threshold in question 4 for deferred pot transfers (£10,000) would distort the current market if transferred to a single consolidator; it is many multiples of the mean size of the average Nest pension pot[11]. It would also place the burden of handling small pots onto a single provider, whilst enabling only one provider to benefit from the potential upsides that managing small pots for all savers could bring.

28. The multiple consolidator model could take longer to implement, as new providers enter or existing pension providers start to offer these services. Limiting the number of market entrants, as question 14 suggests, would be uncompetitive. These consolidators would have to adhere to an appropriate authorisation regime. This would either have to be completely new, or if the consolidator is a master trust it would have to be authorised as such, or if it is a Group Personal Pension or Pensions Dashboard provider, be regulated by the FCA.

29. Providing consumer choice would impact the efficiencies of small pot transfers. It also goes against the basic principle of automatic enrolment's inertia, which has arguably made it the success it has been. For it to work, employers would have to have a relationship with a preferred consolidator, like the arrangement they have with their workplace pension provider. This could therefore add further burden on employers.

30. A single consolidator model, assuming it is government backed, will come with a cost to the taxpayer which may take decades to repay. New consolidators would also have to be subject to requirements around disclosure, pensions dashboards and Consumer Duty if contract-based.

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[10] These were: when an employer informs the scheme that the member has ceased active membership, or the scheme has not received contributions in the last 12 months.
[11] https://www.nestinsight.org.uk/wp-content/uploads/2021/09/Retirement-saving-in-the-UK-2021.pdf

Pot Follows Member questions:
Question 16: Do you agree with the above summary of potential benefits and implications of the pot follows member approach, and if not why?
Question 17: What are the key benefits / risks of a pot follows member, including impacts on the wider pension market, and employers?

31. The learnings and insight from pensions dashboards should be considered first ahead of any automatic transfer solution. PfM has more advantages on balance over the other models, assuming pensions dashboards do not materially reduce the number of small pots. PfM builds on the existing system, rather than new entities having to be created. A "pull" PfM model is much closer to the existing process of a member-initiated transfer. The consumer experience will also be simpler, and savers will have ownership over the trigger which moves their pot. It is their action which has initiated the transfer.

32. The automatic enrolment qualifying workplace market is highly competitive, with tens of providers. Introducing PfM is much less likely to distort it, as there is less concentration of transfers to one, or a small number of providers.

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

33. We believe a PfM model with a "pull" mechanism is the model which has the best possibility of meeting the five principles DWP has set out in the call for evidence. It is the model which is likely to be the most intuitive to the saver, because their action (moving jobs) triggers the transfer of the pot. It is the solution which would have the least market impact, and could be the easiest to administer. It is also already on the statute books, which creates a good base for any future legislative work.

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

34. We do not support a pot for life model, and agree with it not being considered as a potential solution as part of this call for evidence. While being able to choose a workplace pension provider has merits, a pot for life model is far removed from the current structures of the automatic enrolment market, which is working very well at keeping employers and employees participating in the pension system. DWP's own member engagement research highlighted the strength in employees' trust in their employer choosing the right pension arrangement for them[12]. A significant departure from that system risks undermining the success of the last decade, and should not be considered further.

Question 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?

35. Both should be considered. Member-initiated consolidation will increase over time with new digital engagement tools like pensions dashboards, and provider-initiated communication to reunite people with their lost assets will alert people to small pots they had forgotten, which will help with stock. A pull

[12] https://www.gov.uk/government/publications/understanding-member-engagement-with-workplace-pensions/understanding-member-engagement-with-workplace-pensions

mechanism under PfM will significantly reduce new pot creation, and will go some way to dealing with stock as people routinely move jobs.

Question 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?

36. The Small Pots Coordination Group report provides a clear update on the member exchange trials, in particular some of the barriers. The PPI's data project also has vital learnings for the scale of the challenge of matching people's pots. Moving actual pots in a voluntary system, like member exchange, will be significantly more difficult to do and would require decisionmakers like trustees to have comfort it is in the best decision for every member. This would be challenging without appropriate support from the regulators and Government. The Coordination Group recommended the Pensions Regulator give some assurance to help encourage and facilitate schemes to participate in member exchange; this could help. Member exchange does not allow contract-based providers to participate, given the barriers of moving pots without member consent. It will therefore only be an available option for part of the market.

Question 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?

37. A large scale consolidation solution will be the main mechanism for materially reducing the number of small pots, rather than a backstop. The barriers to reducing the number of small pots between providers absent of legislation have been articulated elsewhere in this response. It may be that a package of measures helps to materially reduce the number of small deferred pots in the system, and member exchange could be a part of it, subject to an appropriate framework being in place which works for trustees and provides them with the confidence to move members money to other providers. Without legislation, contract-based providers will not be able to take part in this.

Question 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?

38. DWP's own data collection from providers found that the number of pots belonging to the same person within the same scheme is not material (at 4%), and would not significantly reduce the number[13]. Some contract-based providers can display a person's multiple products with them on a dashboard, but they would be unable to merge them without member consent due to the nature of the contracts – for example, the charges and investments may differ, and the employers may prefer that the policy is associated with them. Same-scheme consolidation is therefore unlikely to be a large scale solution.

Question 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

[13] Small Pots Coordination Group Spring 2022 Report, https://www.abi.org.uk/globalassets/files/publications/public/lts/2022/small-pots-co-ordination-group-spring-2022-report.pdf

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

39. We would encourage DWP to consult the Small Pots Coordination Group's two reports which have explored member detriment by profile in detail[14].

[14] https://www.abi.org.uk/globalassets/files/publications/public/lts/2022/small-pots-co-ordination-group-spring-2022-report.pdf
https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2021/Small-pots-cross-industry-co-ordination-group-update-report.pdf