



Department
for Work &
Pensions

Addressing the challenge of deferred small pots: a call for evidence

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Introduction

This call for evidence has been launched to gather evidence to support the development of policy options for large-scale automated consolidation solutions to address the growth of deferred small pots in the automatic enrolment (AE) workplace pensions market.

About this call for evidence

Who is this call for evidence aimed at?

The Department for Work and Pensions (DWP) welcomes input from: pension scheme providers; trustees; scheme managers; members of workplace pension schemes; employee representatives; trades unions; consumer groups; employers; pension industry professionals; and members of the advisory community.

Purpose of the call for evidence

DWP is issuing this call for evidence to deepen the evidence base around the scale and characteristics of the growth in the number of deferred small pots. It is focussed on two large-scale automated consolidation solutions - a default consolidator model and pot follows member – whilst recognising the potential impact of other actions, including member exchange, and enabling more member engagement, that can help mitigate the growth in the number of small pots.

DWP wants to hear from the pensions industry, including those previously involved in the DWP-chaired and ABI/PLSA-led work on this issue, as well as from other stakeholders, including those who can offer a member-perspective on the effectiveness of consolidation approaches.

The responses to this call for evidence and other stakeholder engagement will inform DWP's development of our policy position on an approach, on which we will consult in due course.

Scope

Pensions policy is a reserved matter in Scotland and Wales. This call for evidence therefore applies to England, Wales, and Scotland.

Duration

The call for evidence will run for 8 weeks, starting on 30 January 2023, and ending on 27 March 2023. Please ensure your response reaches us by that date as any replies received later may not be taken into account.

How to respond to this call for evidence

Please send your responses to:

Small Pots Policy Team

Department for Work and Pensions,

Caxton House,

Tothill Street,

London,

SW1H 9NA

Email : smallpots.callforevidence@dwp.gov.uk

Note: When responding please indicate whether you are responding as an individual or representing the views of an organisation; whether you are content for your response to be quoted in a future response the government issues; and whether you would prefer this to be anonymous.

Government response

We will publish our response to this call for evidence on the GOV.UK website in line with normal government practice.

How we gather evidence

Feedback on the call for evidence process

We value your feedback on how well we seek evidence. If you have any comments on the process of this call for evidence (as opposed to comments about the issues which are the subject of the call for evidence), please address them to:

DWP Consultation Co-ordinator: caxtonhouse.legislation@dwp.gov.uk

Freedom of information

The information you send us may need to be passed to colleagues within the DWP, published in a summary of responses received and referred to in the published government response.

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided, or remove it completely. If you want the information in your response to the consultation to be kept

confidential, you should explain why as part of your response, although we cannot guarantee to do this.

To find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact the Central Freedom of Information team: freedom-of-information-request@dpw.gov.uk.

The Central Freedom of Information team cannot advise on a specific call for evidence exercise, only on Freedom of Information issues. Read more information about [Freedom of Information Act](#).

Ministerial foreword

We all recognise and rightly celebrate the success of automatic enrolment which has brought millions of workers into workplace pension saving, often for the first time. Automatic enrolment is re-establishing a culture of retirement saving for a new generation.

However, with this success has come a rapid growth in the number of deferred small pension pots; growth which is set to continue into the next decade. The growth of small pots means there is undue cost and inefficiency in the pension system. It creates a risk that deferred members lose track of their workplace pension savings - acting as a disincentive to member engagement. And it creates a cross subsidy risk for members with larger pots, which may impact their retirement outcomes. The additional administrative cost for providers managing deferred small pots reduces the value they can deliver for members, while also resulting in potential financial sustainability issues. It is vital that we find the right large-scale solution to tackle this problem so that automatic consolidation of small pots becomes integral to the operation of the automatic enrolment market.

We have already taken steps to protect members through a de minimis on flat fee charges. Pensions Dashboards and Simple Annual Benefit Statements will help members to keep track of their various pensions, including deferred small pots, and plan for their retirement.

Substantial groundwork has already been done to examine the growth and impact of deferred small pots. I welcome the work of the Small Pots Cross-Industry Co-ordination Group which has provided a better understanding of the issues and a substantial foundation for this call for evidence, but which recognises that more detailed analysis is required to create the comprehensive evidence base needed to inform a long-term and durable approach to the small pots challenge.

This call for evidence will build on that earlier work. It focuses on deepening the evidence base around two large-scale automated models for the consolidation of deferred small pots: default consolidator/s and pot follows member. We will assess the evidence to identify and develop an approach which puts the interests of members first by facilitating easy consolidation of deferred pensions, mindful that the approach needs to work for the whole of the automatic enrolment market. We will consider the shape and approach of legislation required, build a cost/benefit analysis, and consider the impact on the market of the potential solutions to inform our thinking.

I am determined to drive the agenda forward to help ensure that a better functioning and more efficient pension market meets the needs of more engaged members.

I welcome the interest that industry and other stakeholders have shown in tackling this important issue and hope that they will continue to fully engage with government as we now look at how to move forward.

Laura Trott MBE MP, Minister for Pensions

Section 1: The challenge presented by deferred small pension pots

1. The successful introduction of automatic enrolment (AE) in 2012 has transformed workplace pension saving with participation rates among eligible employees increasing from 55 per cent in 2012 to 88 per cent in 2021¹. AE has made workplace pension saving the norm for low / median earners and those who move jobs frequently. It has, however, resulted in individuals accumulating a number of deferred small pension pots over their working life.
2. The potential growth in the number of deferred small pots is well-documented. Research published by the Pensions Policy Institute (PPI)² suggested that in 2020 there was an estimated 8 million deferred pots and without intervention the number of deferred pots is likely to rise to 27 million by 2035 (with this number only including those held within authorised master trusts). Data from the Association of British Insurers (ABI), suggests that there are over 2.2 million deferred pots under £1,000 currently held within contract-based schemes.³
3. Alongside this, the PPI has recently published research on the total value of lost pension pots, which suggested that the value of lost pension pots has grown from £19.4 billion in 2018 to £26.6 billion in 2022. Their research suggested that there could be a link between the increasing number of small pots and the growth in lost pots between 2018 and 2022.⁴
4. This growth adds increased costs and inefficiency into the UK workplace pensions market with the Small Pots Cross-Industry Co-ordination Group estimating that the continued growth in the number of small pots by 2030 - 'will likely result in wasted administration costs of around a third of a billion pounds per annum. It impacts negatively on value for money outcomes for members and has implications for the financial sustainability of pension providers. It makes it harder for members to engage with their pension savings.'⁵
5. The threshold at which a pot is 'small' has been considered by industry, the Small Pots Cross-Industry Co-ordination Group broadly agreed values as a starting point through their working assumptions. The Small Pots Working Group's 2020 examination of the distribution of deferred small pots by size, found that from a

¹ Workplace pension participation and savings trends of eligible employees: 2009 to 2021 [June 2022]

² PPI: Policy options for tackling the growing number of deferred members with small pots

³ Small Pots Cross-Industry Co-Ordination Group: Update Report: September 2021

⁴ PPI Briefing Note Number 134: Lost Pensions 2022: What's the scale and Impact?

⁵ Small Pots Cross Industry Co-ordination Group: June 2022 Report

sample of 11.2 million deferred pots, 74 per cent were smaller than £1,000. Many pots were smaller - falling within a subset referred to as 'micro pots.' These are typically of £50 to £250 but may be smaller, with data suggesting that 25% of deferred pots are under £100⁶. These pot sizes compare starkly with the figure of £4,000 which PPI estimated as the breakeven point for pots to be profitable for providers, highlighting the financial impact of deferred small pots on provider business models.

6. The Government's over-arching ambition through reform of the pensions system is to help enable individuals to achieve the best pension saving outcomes they can, and for them to be able to plan more effectively for the retirement they want. This requires a pensions market that functions efficiently to provide the best possible value for money outcomes for all members. The stock of deferred pots already built up, and the continued increase in numbers, presents a clear challenge to market efficiency.
7. In September 2020, the Minister for Pensions and Financial Inclusion set up the Small Pots Working Group – chaired by DWP - to examine the scale, nature, and impact of deferred small pots and to build a consensus on the priority options to address their growth. The Group reported in December 2020. Their report found that whilst opportunities for member-initiated consolidation should continue to be maximised they would be unlikely alone to change the trend in the growth of deferred small pots. The Group concluded that the pension industry, working alongside government and regulators, should prioritise work on enabling automatic and automated large-scale low-cost transfers and consolidation for the AE mass-market. The Group considered that two large scale solutions should be prioritised - a default consolidator and pot follows member – but that final decisions should be informed and developed following examination by the pension industry of the underlying administrative challenges that may prevent the implementation of a large-scale automated solution.
8. In March 2021, at the invitation of the Minister for Pensions and Financial Inclusion, the ABI and the Pensions and Lifetime Savings Association (PLSA) jointly convened the Small Pots Cross-Industry Co-ordination Group to take forward analysis of the administrative challenges identified by the December 2020 report. In September 2021, the Co-ordination Group's first report ⁷ set out the progress they had made. This included agreeing a set of working assumptions that covered the nature and value of small pots assumed to be within scope of any future consolidation model, whilst also setting out further evidential needs to build the case for a large-scale consolidation solution. The Group made substantial progress on identifying the potential risks and benefits of consolidating deferred small pots for members. It developed understanding around the key barriers in relation to data matching for automated consolidation solutions. The Group also set out actual and perceived barriers within the current transfer system, identifying

⁶ Small Pots Working Group Report – December 2020

⁷ Small Pots Cross-Industry Co-Ordination Group: Update Report: September 2021

where costs occur and potential efficiencies. The Group's second report in June 2022 recommended that Government should explore three solutions: multiple default consolidators; pot follows member; and Member Exchange with development of a cost/benefit analysis and assessment of market impacts⁸.

9. The work of the Small Pots Working Group and Small Pots Cross-Industry Co-ordination Group has highlighted the range of risks that deferred small pots present in terms of member outcomes. Inefficiencies in the system are passed onto members, with those with larger pension pots effectively being charged more to subsidise the lack of revenue generated by small pots. Members may find that small pots are further eroded through charges. Whilst we have taken steps to protect members through a de minimis on flat fee charges, we would expect that the level of the de minimis may need to be reviewed to ensure that consolidation solutions work effectively for the consumer with appropriate protections.
10. Small pots negatively impact on the way that members engage with their pension savings. They may lose track of multiple pots over time or be dis incentivised or disengaged by multiple small pots that do not contribute in a meaningful way to their prospective retirement income and add a layer of complexity to their pension saving. These barriers and the time involved in navigating them may serve to erode trust and confidence in pension saving.
11. For some pension providers, the inherent inefficiency in the current system may threaten their longer-term financial sustainability with the administration costs involved for managing millions of deferred small pots outweighing the amount they receive through charges. Potentially this could bring unwelcome consequences for the consumer in terms of the cross-subsidy that operates within providers and through undermining confidence in a competitive and healthy market.
12. The deferred small pots challenge is a two-pronged one. There is a need to design a solution that can address the existing stock of small pots, and which also tackles the continued flow of new small pots. Recognising that it may not be easy to distinguish between the two. For example, in some cases, workers are retained but not remunerated in paid employment for different durations of time – so there may be periods when contributions are paused and then re-started, so distinguishing what is flow vs stock (or even if a deferred small pot at all) in this case could be more challenging.
13. Government is determined to resolve the deferred small pots problem through an approach focused on delivering overall net benefits for members through a better functioning and more efficient pension market. Given the nature of the data challenge involved, and that the work of the PPI Pensions Data project is still ongoing, there is a need to identify a preferred solution to be able to more efficiently focus the very detailed analysis that will be needed to underpin the development of a solution.

⁸ Small Pots Cross Industry Co-ordination Group: June 2022 Report

14. The approach, impact and timing of implementation will consider other policy developments and initiatives in the pensions market, including Pension Dashboards, our Value for Money agenda, and the Stronger Nudge to pension guidance.

Section 2: Our key assessment criteria

15. This call for evidence will deepen understanding of the issues identified by the Small Pots Cross-Industry Co-ordination Group and the evidence base required to address the outstanding questions it raised. To frame the analysis, we will consider solutions against five key criteria:

- i. Delivery of overall net benefits for members through improved value for money outcomes, achieving a meaningful impact on the number of existing, and flow of new, deferred pots;
- ii. Complements member engagement on their savings journey/retirement planning;
- iii. Supports a competitive, sustainable and more efficient workplace pensions market (trust and contract-based schemes);
- iv. Minimising complexity and administrative burdens for employers; and
- v. Commands confidence in the system for savers and tax-payers.

16. In order for automated consolidation of deferred small pots, to be successful, it will be vital that we are able to design a solution that has a meaningful impact on the number of deferred small pots – delivering an overall net benefit for members – as such this criteria will be prioritised as part of the assessment of solutions. Solutions will be further informed by the development of a cost/benefit analysis and consideration of their impact on the market.

17. It will be important that any solutions augment AE, protecting and locking in its success, and do not lose the tremendous gains in workplace saving that AE has delivered. Solutions will recognise the need for consistency with Government's broader pension policy reforms, including the Value for Money (VfM) agenda and other ongoing developments in the wider workplace pensions and savings landscape.

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?

Section 3: Member engagement

Role of member engagement

18. The 2020 DWP-chaired Small Pots Working Group report concluded that member-led consolidation alone is unlikely to change the trend in the growth of deferred small pots but was clear that the pensions industry, government, and regulators should continue to explore and enable opportunities for member-initiated consolidation.
19. Government and regulators are continuing to take big steps forward to ensure that savers have easier access to key information about their pensions that can support them in making decisions, including around consolidation. We have introduced Simpler Annual Benefit Statements for defined contribution schemes used for automatic enrolment. These aim to ensure that statements are simpler and easier for members to understand. This will help increase engagement with pensions, and prompt people to seek further information and guidance, including where they have multiple pension pots. The launch of a pensions engagement season – Pension Attention - by industry aims to also increase awareness of pensions and serve as a prompt for individuals to think about their retirement planning and their pension options. It will also support people to prepare for pensions dashboards.
20. Pensions Dashboards will further revolutionise how people interact with their pensions. They will provide people with online access to their pension savings information on request, helping them to engage with lost pension pots, and with their permission, provide delegated access to Money and Pensions Service (MaPS) guiders and Financial Conduct Authority (FCA) authorised financial advisers. We would welcome views of respondents to understand what engagement approaches can further support member-initiated consolidation.
21. International evidence from the PPI’s review of *“How have other countries dealt with small, deferred member pension pots”*⁹ demonstrated how Dashboards complement existing policies, increase the availability of information to members, and reduce the likelihood of lost pots. Australia, Denmark, Israel and Sweden all operate member dashboards in conjunction with other policies. The impact of their approaches varies between countries based on the wider policy context (for example, in Australia and Israel they operate an automated consolidation solution alongside the member dashboards). The report concluded that a national consolidation system will achieve more significant improvements than a dashboard on its own.
22. Alongside this Call for Evidence, the department has published research looking at member engagement with workplace pensions¹⁰, part of which explored member views on consolidation of deferred small pots. This research shows that whilst

⁹ PPI: How have other countries dealt with small, deferred member pension pots?

¹⁰ Understanding member engagement with workplace pensions: January 2023

some members understood the benefits of consolidation there were barriers preventing them from taking action, including concerns around scams, difficulty to process and lack of understanding about whether they could consolidate their pension pots. This research looked at both pot follows member and default consolidation solutions, to understand preferences. Both options appealed to the participants because of their simplicity for the member. It was perceived that the transfer and consolidation process would be managed on their behalf in either case.

Question

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

Member trust in solution

23. As set out in paragraph 18, member-initiated consolidation alone will not be able to significantly change the trend in the growth of deferred small pots. As such, it is widely agreed that there is a need for an automated consolidation system. For this approach to be successful, member confidence in the approach will be paramount. Our member research suggested some people had concerns about the perceived insecurity of pensions. Therefore, a consolidation system that was Government backed appealed to them

24. To ensure member trust in any consolidation solution, appropriate communications and regulatory safeguards will be vital, also building in individual redress if errors are made as a result of automated consolidation. We will consider learnings and insights from the implementation of AE and wider international evidence as part of this.

Market innovation

25. We have gradually started to see innovation within the market, with tech-based solutions, enabling providers to offer in-house consolidation solutions, which support their active members in transferring their deferred pensions from other providers into their active pot. Alongside this, we have seen an increase in the market of pension schemes set up solely for the purpose of consolidation.

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?

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

Pot value: what is 'small'?

26. A key consideration for any large-scale consolidation solution is what the maximum value is below which a deferred pension pot should be considered eligible for automatic consolidation. There is a fine balance to be determined when deciding on the right pot value for eligibility. Setting the maximum value at too low a level may result in insufficient consolidation which will then fail to adequately remove cost from the system to ensure that members receive the value for money dividend. On the other hand, if the size at which consolidation can kick in is set too high, there is an increased possibility that members may be put at risk of greater detriment as a result of their pots being moved into a single scheme which has differing and more costly charge structures or lower investment returns. There may also be a negative impact on schemes which begin to lose more profitable pots.
27. The Small Pots Working Group examined the distribution of deferred small pots by size. In their 2020 report, 74 per cent of a sample of 11.2 million deferred pension pots were smaller than £1,000.
28. To support members achieving greater value for money within their pension scheme, a starting point when considering the appropriate limit for eligibility for automatic consolidation could be to link it to breakeven points for providers given that this will enable schemes to transfer out pots which are not cost effective. Analysis published by the PPI¹¹ estimated that if a Master Trust charged an Annual Management Charge (AMC) at the maximum rate of 0.75%, they would require an average pot size of around £2,300 to breakeven. With an industry average AMC of 0.5%, the required average pot size to breakeven would be closer to £4,000, however, we anticipate that this breakeven point may fall as the market grows, enabling providers to reduce their costs.
29. At question 4, we have proposed some limits for eligibility for automated consolidation. These figures have been considered in line with the key principle of ensuring that any solution has a meaningful impact on the overall number of deferred small pots in the system, ensuring overall net benefits can be delivered to members. There is a risk that if the limit is set too low, that the cost of implementing an automated consolidation solution for providers will outweigh the

¹¹ PPI: Policy options for tackling the growing number of deferred members with small pots

potential savings a provider may receive from transferring out unprofitable pots – limiting the potential net benefit gains that could be passed onto a member. As part of implementation of a large-scale consolidation solution, we will also want to consider whether it would be appropriate to have a staged approach to gradually increase the eligibility to the chosen value.

30. As part of considering which pots should be in scope for automatic consolidation, we are keen to understand the costs to pension providers for administering deferred small pots, and the cost of ceding and receiving transfers.

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

Questions for providers

We understand that the following requested data is highly commercially sensitive. An individual provider's data will always remain the property of the provider; we will treat it as confidential and only use it within the Department where there is a clear business need to inform policy development. We will not use an individual provider's data publicly or with other government departments. As the data remains the property of the provider, it cannot be used to answer Parliamentary Questions or Freedom of Information requests.

We may wish to use the findings of analysis to underpin government public policy positions. Any such public use would be at an aggregate level, respecting the commercial sensitivities of the underlying data and would ensure that no individual provider is ever identifiable.

As part of the Call for Evidence, we would like to follow up with individual structured sessions on their responses to the below questions.

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

7. Would the increase in pot transfers associated with an automated small pots solution affect your investment strategy? If so, how, and why?
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?
9. What is the breakeven point for administering pots for your scheme, does this differ for active/deferred pots?

Micro Pots

31. In addition to looking at the maximum pot size that should be eligible for automatic consolidation, we are also keen to understand the views of respondents on whether there should be a minimum pot size that is eligible for consolidation.
32. During the work of the Small Pots Working and Small Pots Cross-Industry Co-ordination Groups, there was discussion about whether 'micro pots'¹² should be excluded from any automatic consolidation solution. Some parts of the pension industry consider that it may be more cost effective to permit refunds on micro pots rather than to automatically consolidate them.
33. Refunds could have a disproportionate negative impact on the overall pension wealth of lower earning individuals who move jobs frequently, which would run counter to the overall objectives of AE. It could undermine established messaging around the importance of long-term, sustained saving into a workplace pension and the norming effect that AE has created around pension saving, running counter to the criteria set out in paragraph 15 above. Alongside this, given the difficulties we have heard from providers regarding contacting their members, due to inaccurate / out of date contact details, there could be a significant burden on providers to make contact with members to seek the relevant information to undertake any refunds.
34. The negative impact that refunds can have on overall retirement wealth is demonstrated by the United States, where 22% of all funds contributed by those aged 50 and younger 'leak' out of the system¹³. This most commonly follows individuals leaving employment – resulting in either the individual requesting a refund or being forced out by the scheme rules for 'small' balances of \$5,000 or less.
35. Based on the data and the analysis carried out so far, there does not appear to be persuasive reasons to exclude micro-pots from an automatic consolidation solution.

¹² The Small Pots Cross-Industry Co-ordination Group considered 'Micro Pots' to be those valued under £100

¹³ Joint Committee on Taxation: Estimating Leakage From Retirement Savings Accounts – April 2021

However, this data should be kept under review in light of the developing evidence base – including the PPI Pensions Data Project.

Question

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?

Period of inactivity: what does ‘deferred’ mean?

36. The question of the point at which a pot should be considered ‘deferred’ and become eligible for consolidation is key to the design of any solution. The Small Pots Cross-Industry Co-ordination Group considered several triggering events that could make a pot eligible for automatic consolidation, of which the most significant were:

- (a) No employer or member contributions being made within a prescribed period of time;
- (b) The existence of a new active pot; and
- (c) A saver leaving employment.

37. The Group concluded that, on balance, (a) prescribing a period after which a pot is considered to be deferred if no further employer or member contributions are paid into it would be the most suitable trigger event for consolidation. Both (b) and (c) would rely on pension providers receiving information additional to that which they currently receive which could cause complications in situations where members have multiple active employments and impose a burden on providers, employers and individuals.

38. Setting a prescribed period for a pot to become deferred appears to be the most logical solution to identify whether a pot should be eligible for automatic consolidation. However, it will be important that this timeframe considers a number of factors: fluctuations in earnings; where members make an active decision to stop contributing for a period of time (whilst remaining in employment); and periods where a member may stop making pension contributions (for example during a career break).

Questions

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?

Normal Minimum Pension Age

39. The Normal Minimum Pension Age (NMPA) was introduced in 2006 and it increased from age 50 to age 55 in 2010. In 2014, following the consultation on 'Freedom and Choice in Pensions', the government announced it would increase the NMPA to age 57 in 2028 to coincide with the rise of state pension age to 67¹⁴.
40. In July 2021, HM Treasury responded to a consultation, setting out the approach to the implementation of the increase to the NMPA¹⁵. The response set out that members who have an unqualified right to take pension benefits before age 57 would not lose their protected pension age (PPA) as a result of either a block or an individual transfer. However, where there is an individual transfer the PPA does not apply to other sums or assets already held in the receiving scheme or any that are subsequently put into the scheme either by pension contribution or transfer.
41. The recent Small Pots Cross-Industry Co-ordination Group report, published in June 2022, noted that across the pensions industry there has been some concern that this may result in increased complexities for automatic small pot consolidation as it will require schemes to administer two different retirement ages within a single scheme.¹⁶ There is also a risk that a member may inadvertently lose their PPA because of subsequent scheme transfers.
42. The June 2022 report from the Small Pots Cross-Industry Co-ordination Group concluded that for automatic consolidation not to have a detrimental impact on members who have an unqualified right to access at their pension at age 55, the most appropriate approach would be to ensure that all transfers for the purpose of small pot consolidation should be considered a block transfer.¹⁷ This may also mean that any scheme that is eligible to receive automatic transfers may have to make changes to their scheme rules to accommodate members who transfer with this unqualified right.

¹⁴ Freedom and choice in pensions: government response to the consultation – June 2014

¹⁵ Increasing the normal minimum pension age: summary of responses to the consultation on implementation – July 2021

¹⁶ Small Pots Cross Industry Co-ordination Group: June 2022 Report

¹⁷ Small Pots Cross Industry Co-ordination Group: June 2022 Report

Section 5: Market wide automatic consolidation solutions

Models under consideration

43. The June 2022 report by the Small Pots Cross-Industry Co-ordination Group recommended that multiple default consolidators, pot follows member and member exchange proposals should be taken forward for further cost benefit analysis. The Group also thought that a combination of these models may be needed to have maximum impact. The Group's thinking is supportive of the recommendations by the DWP-chaired Small Pots Working Group in 2020. As part of this Call for Evidence, we are keen to gather information to build our evidence base to enable us to undertake a cost/benefit analysis and consider the impact on the market of both a default consolidator and pot follows member solution. Consideration will need to be given to how either consolidation solution operates within the context of the Value for Money Framework, proposed in the departments consultation: Value for Money: A framework on metrics, standards, and disclosures.
44. This section provides an initial summary of the benefits and implications of both default consolidator and pot follows member approaches, as identified by the Small Pots Working Group, Small Pots Cross-Industry Co-ordination Group and wider conversations with industry representatives.
45. Member exchange is discussed further in this section, as a complementary solution which some industry representatives have suggested could support either of the market-wide consolidation solutions set out above.
46. The department recently published research on employers' views and behaviours regarding AE, part of which explored consolidation of deferred small pots. One of the key conclusions drawn from this research, consistent with the key assessment criteria set out in section 2, was that employers across sizes and sectors were inclined to want an option that would provide them with the least amount of administrative burden.¹⁸

Barriers to implementation

47. One of the key conclusions from the 2020 Small Pots Working Group report, was the importance of overcoming the administrative challenges within the pension market, which may restrict the efficiency of a market-wide consolidation solution. The group concluded that current administrative processes would need to be

¹⁸ Workplace Pensions and Automatic Enrolment: employers' perspectives 2022

modernised across the AE workplace pensions market to ensure that consolidation solutions are implementable. It was recommended that industry investigate and address the administrative challenges which will be necessary to underpin market wide consolidation systems, with the following areas set out for further exploration:

- a) developing and testing data that would provide sufficient matching capability;
- b) developing and adoption of common standards is a key underlying element to support effective consolidation; and
- c) identifying requirements for a low-cost bulk transfer process.

48. The Small Pots Cross-Industry Co-ordination Group, across both their September 2021 and June 2022 reports, have explored these areas in detail making considerable progress. However, if there are barriers to implementing a market-wide consolidation solution which require further exploration, we would ask that you consider these in response to questions 13 and 17.

Default Consolidator

Under this model, deferred small pots which meet the chosen eligibility criteria for automatic consolidation would transfer automatically to a small pot consolidator, with members being given an opportunity to opt-out if they want to. There are a variety of ways through which a member could be allocated to a consolidator scheme. Some industry representatives have previously suggested this could be based on the consolidator being the scheme that a member is enrolled into when first automatically enrolled into a workplace pension. Alternatively, a member could choose from a list of approved consolidators and where the member does not take the opportunity to make an active decision, they could be allocated to a consolidator from a carousel system.

49. The DWP-chaired Small Pots Working Group considered the impact of the default consolidator option and found that it had significant attractions given that this approach aligns with the AE design principles whilst being unlikely to significantly change the central role of the employer in terms of how they meet their AE duties. Depending on the design choice, a level of personal choice for those who are engaged could be incorporated, again mirroring the design of AE itself.

50. The Small Pots Cross-Industry Co-ordination Group's June 2022 report considered the impacts of implementing a default consolidator approach. It noted concerns about a wider effect on the market and future innovation and the possible impact on providers which are not designated as consolidators, which may be perceived to be less competitive and potentially lose market share.

51. There is also the option of a single default consolidator. This option was discounted by the Small Pots Cross-Industry Co-ordination Group on the grounds that it could have a potentially significant distortive effect on the pensions market and could be costly for government to run as a solution. We believe that this

variant of the default consolidator approach requires further consideration, recognising the potential value of the simplicity it could offer. Furthermore, it is unclear whether a private sector solution would effectively address the deferred small pot challenge, as such, a State-backed solution may be required to deal with non-economic pots.

Potential benefits and implications of default consolidator

52. Based on the previous reports produced across industry groups over the last two years, the below benefits and implications of the default consolidator/s approach have been identified:

- This approach could remove a considerable number of deferred small pots from current workplace pension schemes into a consolidator/s. This reduction in the stock of existing small pots should result in an easing of financial strains on pension providers through reduced administration costs which will enable them to provide greater value for money to their members and support a better functioning and more efficient pensions system.
- It is anticipated that the default consolidator/s approach will, over time, enable consolidator schemes to generate scale to drive greater value for money and efficiencies for their members. For example, this may enable consolidator schemes greater opportunity to invest in more illiquids, whilst setting lower charges for their members.
- This approach would not require active involvement from the member, maintaining a simplicity that is aligned with a key principle of AE, although the member could choose their own consolidator if desired.
- A member's deferred pots would accumulate in a single consolidator, reducing the complexity inherent in multiple pots and making it easier for that member to engage with their overall pension wealth.
- Schemes would be able to transfer out deferred small pots which may improve the sustainability of smaller providers as they would no longer be managing unprofitable pots, with benefits being passed on to their remaining members.
- Some view that the default consolidator/s approach, especially a single consolidator, may have a distortive impact on competition in the workplace pensions market. With a multiple consolidator approach, there may be an increased burden for providers when identifying whether a member already has a consolidator pot, or if they wish to choose their consolidator. This burden would be removed under a single consolidator approach.
- A robust authorisation regime would be required to ensure that schemes acting as a default consolidator are able to manage consolidation effectively and without risk to member interests.

- With the default consolidator/s approach there would be no direct link to the employer which would limit any potential burden.
- If a multiple consolidator approach was taken, it is understood that there is enough interest across the workplace pension market to implement this solution with limited cost to the taxpayer.

Questions

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

Pot Follows Member

Under this model, when an employee moves jobs their deferred pension pot in their former employer's scheme would automatically move with them to their new employer's scheme, if it meets the chosen eligibility criteria for automatic consolidation. Individuals would have the opportunity to opt-out and leave any / all deferred pots where they are.

53. In their June 2022 report, the Small Pots Cross-Industry Co-ordination Group concluded that a correctly designed pot follows member model is likely to resolve much of the small pots issue, noting that an advantage of this solution is that it builds on the existing system, rather than require the creation of new entities – consolidators. However, there are situations where this model creates significant complications with a negative impact on employers, members and providers.
54. One example of this concerns the position of multiple job holders who have two or more active pots. In March 2017, there were approximately 1.1 million multiple jobholders, of which 72% aged between 22 and State Pension Age were eligible for AE in all or at least one of their jobs.¹⁹ Here it would not be a simple case of transferring the previously deferred pot to the member's currently active pot, resulting in an increased burden for the pension provider, the employer or the

¹⁹ Automatic enrolment review 2017: analytical report

member. Similarly, the Small Pots Cross-Industry Co-ordination Group noted concerns about members who move jobs frequently and whose deferred pots may never in practice catch up with them.

Potential benefits and implications of pot follows member

55. Based on the previous reports produced across industry groups over the last two years, the below benefits and implications of the pot follows member approach have been identified:

- As with a default consolidator/s this approach could remove a considerable number of deferred pots from current workplace pension schemes. This reduction in the stock of existing small pots should result in an easing of financial strains on pension providers through reduced administration costs which will enable them to provide greater value for money to their members and support a better functioning and more efficient pensions system.
- This approach would not require active involvement from the member, maintaining a simplicity that is aligned with a key principle of AE, although the member could choose to opt out of any automatic transfer if desired. For some, the simplicity of deferred pots transferring to their pot with their current employer may result in greater understanding / engagement with their pension.
- This approach should enable greater levels of consolidation to be achieved, however, there will be some situations where it may cause complications and a consequent increase in administrative burden, for example, the position of multiple job holders.
- Schemes would be able to transfer out small, deferred pots, reducing the administrative strain and financial burden on pension providers. However, as above there will be some cases of increased complexity and burden for providers, which may impact the affordability of this solution.
- As pot follows member makes a link to the active employer there may be situations where there is an increased burden on that employer, for example, in terms of handling more questions from employees about the way in which pension arrangements are working.
- There is a risk, dependent on the maximum pot value limit set, that members may end up reaching that limit relatively quickly and the pot becomes stuck in the system, resulting in the member still accumulating deferred pots – albeit at a greater value.
- There is likely to be minimal cost to taxpayers as a result of this approach.

Questions

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

56. Considering the key criteria for a solution, set out in section 2, we would be keen to understand views from respondents about which solution they think would be the most effective approach to tackling the growth of deferred small pots.

Questions

18. Of the two solutions set out above what is your preferred approach, and why?
19. Are there any further / fresh or hybrid solutions that are worthy of consideration?

Stock or Flow?

57. As section 1 notes, there are already millions of deferred small pots, and this number is set to continue to grow unless action is taken. The issue presents a dual challenge: a need to manage the continuing flow of new deferred small pots and the need to reduce the stock of existing pots so that schemes are not carrying a legacy and burden of deferred small pots into the future. Any solution must be considered in terms of the potential impact on both aspects of the challenge.

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?

Liability models

58. The recent Small Pots Cross-Industry Co-ordination Group report began to explore the issue of liability as a result of automated consolidation of deferred small pots. It will be important to have an agreed liability model in place for trustees, providers and others involved in the relevant processes, to rectify any erroneous transfers that occur through automated consolidation solutions.

59. This is an issue that will need to be resolved ahead of implementation of either market wide solution. However, this is an area that we think can be better examined once a decision has been made regarding the optimal solution and its design, as such, we will explore this further as part of the consultation on policy proposals.

Member Exchange

60. The Small Pots Working Group identified member exchange as a potential solution to growth of deferred small pots. Under this model, pension providers would use a trusted third party pseudonymised data service to conduct a regular exercise and identify 'matches,' where they hold a deferred small pot for a member and another provider has the same individual as a member making active contributions into another pot.

61. The Small Pots Working Group recommended that member-exchange proof of concept trials, involving low value small pots within master trust schemes, should be developed to test the concept if trustees and finance directors were prepared to run them.

62. The June 2022 Small Pots Cross-Industry Co-ordination Group report²⁰, sets out the progress that the member exchange group have made in the last 18 months, including valuable learnings that have emerged from their scenario planning exercise areas such as: charges; Environmental, Social and Governance Investment (ESG); VfM; and other scheme qualities like communications and record keeping.

63. The group Master Trusts continue to examine the potential of a member exchange pilot. As part of this, the group will consider the staging of the pilot and appropriate evaluation to enable them to draw conclusions to inform the wider work on large-scale automated solutions. While we do not believe that member exchange represents a complete solution to the small pots issue, we welcome this industry initiative as one which can make an early and immediate impact. It will provide evidence and analysis to support development and delivery of large-scale automated solutions.

Questions

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?

²⁰ Small Pots Cross Industry Co-ordination Group: June 2022 Report

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?

Pot for Life approach for returning members

64. As part of the 2020 Small Pots Working Group, there was consideration about whether schemes should combine return members into a single pot, to prevent members from accumulating multiple pots within the same scheme. The Group found that whilst some providers link a returning active member to the inactive pension pot so that they never have more than one pot per provider, this practice is not commonplace within the AE pensions market. As a result, some members may have multiple inactive deferred small pots held within the same pension provider.
65. Over Autumn 2021, DWP conducted a data gather to inform our evidence base around members with multiple pots within the same scheme.²¹ We received responses from 11 providers in the AE pensions market, covering 28 million pots. Across the entire sample, 4% of members had multiple pots within the same scheme - meaning if all providers in our sample were to have a single pot per member, it would lead to consolidation of over one million pots.
66. Wider adoption of a pot for life approach for returning scheme members, within charge capped and in default funds, in the AE workplace pensions market could act as a foundation measure to help narrow the issue and slow its growth, although for a market-wide solution this would need legislative changes to ensure that contract providers have the power to undertake this approach. Addressing these multiple pots within the same scheme could make it easier to implement a cross-provider solution, as well as improving member engagement with their pensions. We understand that for contract-based schemes, due to the requirement for member consent, they are currently unable to undertake same scheme consolidation.

Questions

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?
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?

²¹ Small Pots Cross Industry Co-ordination Group: June 2022 Report

Section 6: Equality Act

67. Under the Equality Act 2010, public bodies have a duty to give due regard to the needs of people with 'protected characteristics'. The Public Sector Equality Duty covers the protected characteristics of age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; sexual orientation; and marriage and civil partnership – in respect of eliminating unlawful discrimination only. Paying 'due regard' means that, in our roles as policy makers, we are required to consciously think about the three aims of the Public Sector Equality Duty: to eliminate unlawful direct or indirect discrimination, harassment and victimisation and other conduct prohibited by the Act; to advance equality of opportunity between people who share a protected characteristic and those who do not share it; and to foster good relations between people who share a protected characteristic and those who do not share it.

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 non-protected 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.

Annex A: List of questions

In addition to your response to these questions, we would welcome any further evidence or analysis which you would like to share about the issues under discussion in this consultation and which can inform the development of options to address the issues identified in this call for evidence.

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?
2. How do you think we can increase member-initiated consolidation and what are the opportunities, risks, and limitations of member-initiated consolidation?
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?
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
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?
6. What is the average cost of a pot transfer (ceding and receiving) for your scheme, within AE charge capped default funds?
7. Would the increase in pot transfers associated with an automated small pots solution affect your investment strategy? If so, how, and why?
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?
9. What is the breakeven point for administering pots for your scheme, does this differ for active/deferred pots?
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?
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?
12. Do you agree with the above summary of potential benefits and implications of the default consolidator/s approach, and if not why?

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?
14. Who should be able to be a consolidator; should there be a limited number, and, if so, how many, and why?
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?
16. Do you agree with the above summary of potential benefits and implications of the pot follows member approach, and if not why?
17. What are the key benefits / risks of a pot follows member, including impacts on the wider pension market, and employers?
18. Of the two solutions set out above what is your preferred approach, and why?
19. Are there any further / fresh or hybrid solutions that are worthy of consideration?
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?
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?
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?
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?
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?
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 non-protected 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.