DWP Department for Work and Pensions

Government response to the consultation

Improving transfers and dealing with small pension pots

Presented to Parliament by the Secretary of State
for Work and Pensions by Command of Her Majesty
July 2012

Cm 8402 £10.75

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For more information about this publication contact:

Private Pensions Policy and Analysis
Department for Work and Pensions
1st Floor
Caxton House
Tothill Street
London
SW1H 9NA

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Foreword by the Minister of State for Pensions

Automatic enrolment is starting. From this month the first workers are being put into a workplace pension scheme by their employer. Many will be saving into a pension for the first time, benefiting from their employer's contribution and securing a better income in retirement.

This major reform will make pension saving the norm. But bringing more people into pension saving means that there will be more small pension pots in the system, and barriers in the current voluntary transfer system will prevent people from taking their pots with them when they leave an employer.

Our achievements would be undermined if people were to lose track of their pension saving and so miss out on valuable retirement income. So we want to help people engage and to support their pension saving decisions. We want to ensure that they can build up substantive pots so they can secure a decent income in retirement. And we want to tackle market inefficiencies of administering multiple dormant small pension pots.

That is why, on 15 December 2011, we issued our consultation document *Meeting future workplace pension challenges: improving transfers and dealing with small pension pots* (Cm 8184, December 2011). That consultation closed on 23 March 2012. I am very grateful to those who spoke to me or my officials during the consultation period, participated in consultation events and responded formally to the consultation.

The consultation set out options for reform ranging from small changes to the current system to encourage transfers, to automatic transfers of small pots. I was pleased that respondents overwhelmingly supported the case for change, recognising the issues associated with administering millions of small dormant pots and the potential poor outcomes for individuals. Respondents generally agreed that improving the existing framework for voluntary transfers would not go far enough. I agree. However, whilst I consider reform, I welcome the pensions industry's new working group which will also be looking at how to make immediate improvements to the current transfer system.

While many respondents favoured the automatic transfer of small pots into one or more aggregator schemes, they also acknowledged that this might not lead to real consolidation. We have investigated this further through the development of the Impact Assessment that I am also publishing today. This has shown that with an aggregator, a low pot size limit, perhaps around £2,000, would be required to avoid market distortion. This would result in significantly less consolidation for individuals and would limit the administrative efficiencies available because many individuals would have at least one active pot and one dormant aggregated pot. I have therefore concluded that an aggregator approach would not meet our objectives for reform.

I would therefore like to continue to work with all who have an interest in addressing the small pots issue to understand how our more ambitious option of automatic transfers into the new employer's scheme might work. I have heard respondents' views that we should not run before we can walk. We would therefore start with small pots that are created through automatic enrolment. I have also heard the concerns about consumer detriment, so I want to understand the issues better before setting a pot size limit for automatic transfers. We also need to work with the pensions industry to understand the role of IT in any solution.

In the consultation document, I also announced that I would abolish short-service refunds at the earliest legislative opportunity. But I have heard respondents' concerns that there is a case for allowing refunds of pots that are so tiny that they would not be worth transferring. Therefore, as an easement under an automatic transfer system, I propose to explore whether there is merit in allowing schemes to refund these micro pots.

While we work on all these issues, I plan to bring forward primary legislation at the earliest opportunity to allow automatic transfers to take place, to abolish short-service refunds and to enable an alternative mechanism for refunding micro pots.

Some consultation responses proposed the idea of a virtual amalgamation tool to help individuals see all their pension pots in one place, regardless of size of pot. This is an interesting idea and is one which I would like to explore further with the pensions industry as something that could be developed alongside an automatic transfer solution.

I look forward to working with all of you to ensure the success of automatic enrolment in a pensions landscape that is fit for the 21st century.

Steve Webb MP
Minister of State for Pensions

Introduction

On 15 December 2011, we published a consultation paper *Meeting future workplace pension challenges: improving transfers and dealing with small pension pots*. The consultation period lasted 12 weeks, closing on 23 March 2012.

The consultation focused on how to improve transfers to deal with small pension pots. It set out three key options to reduce the number of small pots:

- improvements to the current regulatory framework to help make member-initiated transfers easier and less expensive;
- a transfer system where small, dormant pension pots can be consolidated into one or more aggregator schemes; and
- a transfer system where small pension pots move to the new employer's scheme when the individual changes job.

The consultation document also set out our proposals to abolish short-service refunds.

We received 81 formal written responses and also undertook a series of stakeholder meetings and a workshop involving a wide variety of stakeholders, including pension providers, IT providers, and employer and consumer organisations. We are grateful to everyone who replied and participated in this process.

A list of organisations that responded to the consultation is at Annex A. A glossary of the terms used in this document is at Annex B.

In this document we have set out an analysis of the consultation responses, our considerations, the evidence that we have taken into account and our proposals going forward. Alongside this document we are publishing an Impact Assessment setting out the impacts of the different options for addressing an increase in the number of dormant pension pots.

This Government response is available on the Department for Work and Pensions website at www.dwp.gov.uk/consultations/2012/govt-response-small-pension-pots.shtml

Executive summary and Government response

Starting this month, automatic enrolment will see millions of people saving in a private pension for the first time. This will make pension saving the norm. Our proposals for State Pension reform[1] will mean that people will know what they can expect from the State when they retire. Their private pensions saving will build on this solid foundation.

We want to make it easy for people to make the right savings decisions and work towards achieving the retirement income they want, so it is vital that the pensions landscape provides a robust and suitable framework for automatic enrolment to succeed. We do not want individual saving to be undermined by a system that leads to people acquiring many small pension pots which they may lose or never consolidate to achieve a decent annuity.

For individuals, we need a solution that enables them to be confident that the money they and their employer contribute to their pension will go towards their retirement, and not end up stranded or lost in the system. We also want people to be able to keep track of their pension savings so they know how much they have saved and can make informed decisions about current and future pension saving. Research shows that one in six people have no idea where their pension is saved. Moving jobs was by far the biggest reason for this, with nearly 70 per cent of those using the Pension Tracing Service stating they had lost track of their pension due to moving on from a previous employer[2]. The lost income can be significant, with estimates putting the total value of unclaimed pensions at around £3 billion[3].

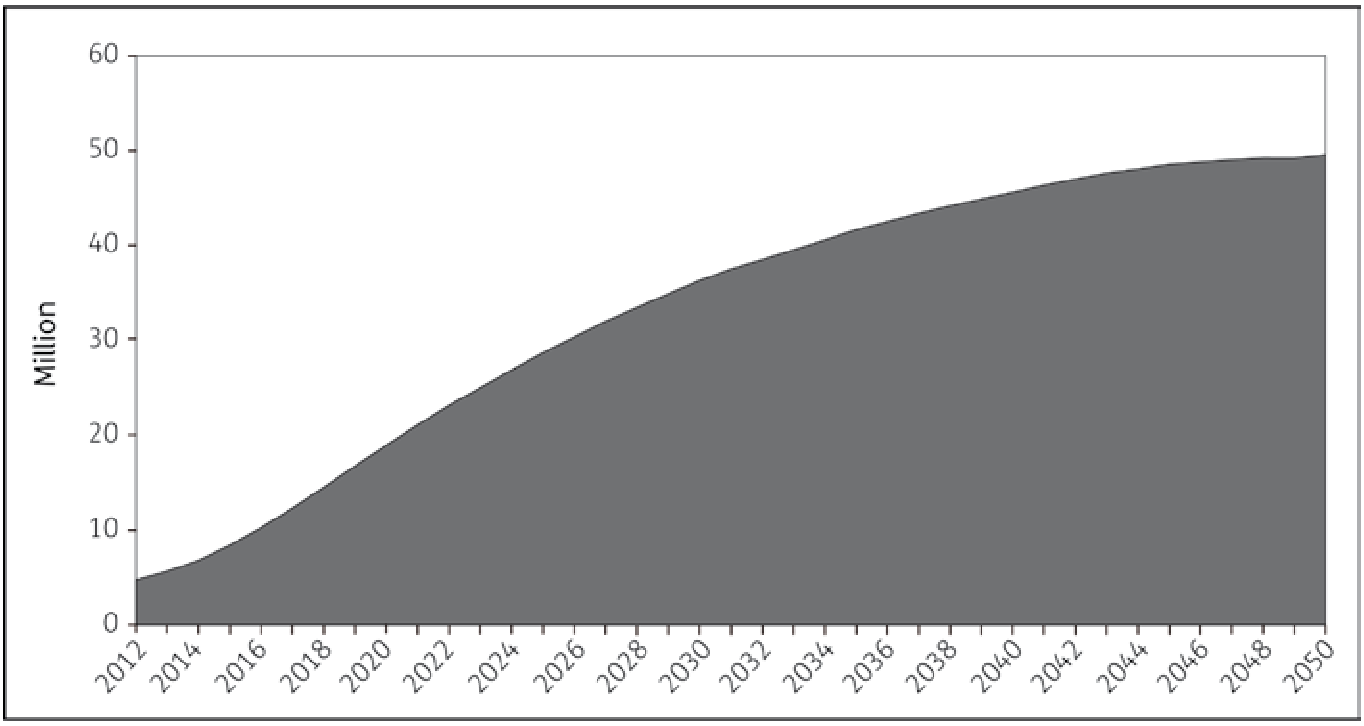
1 *A state pension for the 21st century* (Cm 8053, 2011).
2 Shury J and Koerbitz C, 2010, *The Pension Tracing Service: A quantitative research study to establish who is using the service, and their outcomes*, Department for Work and Pensions Research Report No 697, p.7 and 25.
3 Shury J and Koerbitz C, 2010, *The Pension Tracing Service: A quantitative research study to establish who is using the service, and their outcomes*, Department for Work and Pensions Research Report No 697.

Where individuals do keep track of pension saving we do not want them to be penalised when they try to convert small pension pots into income, particularly if they cannot trivially commute it into a lump-sum payment (either because they have already taken their lifetime trivial commutation or because they have a defined benefit pension in payment which takes them above the threshold[4]). Most annuity providers require a minimum pot of at least £5,000 or £10,000, and so individuals with a small pot (which they are unable to consolidate) may not have the same access to an open market option, and therefore competitive rates.

For industry we want to tackle inefficiency and ensure sustainability while avoiding placing unnecessary burdens on business. Administering multiple small dormant pension pots for a single individual is inefficient, and maintaining small dormant pots can be unprofitable if the revenue earned is insufficient to cover the costs of administering those pots.

We estimate that without change, there will be around 50 million dormant workplace defined contribution pension pots within the system by 2050, and that over 12 million of these will be under £2,000 (in 2012 earnings terms)[5]. This is the challenge we are seeking to address.

Figure 1: Projected total number of dormant pots under current arrangements



What the consultation said

Our consultation document set out the case for change, highlighting that without improvements to the current system we expect millions of small dormant pension pots to be created as a result of automatic enrolment.

4 Trivial commutation allows individuals with a pension fund of less than £2,000 to take the whole amount as a lump sum, providing they are at least 60 years of age. The member must make all such commutations within a period of six months before or 13 months after become entitled to the pension. Where the entirety of a person's pension benefits (added together) does not exceed £18,000, the entire sum may be taken as a trivial commutation lump sum.

5 DWP modelling using Pensim2.

It put forward three approaches to generate debate about how we might improve the transfer system to reduce the number of small dormant pension pots. The first approach suggested changes to the current voluntary transfer system to encourage members to initiate transfers and to make those transfers easier and more efficient.

The other approaches proposed aimed to overcome individual inertia through automatic transfers for small pots in defined contribution schemes. The second approach would bring together an individual's small pots into an aggregator scheme. The third involved small pension pots being automatically transferred when an individual starts a new job and stays in the new employer's scheme after automatic enrolment.

We asked a range of questions in the consultation about the preferred model and issues such as whether there should be opt-out, the role of advice, how to deal with the existing stock of small pension pots, the size of pots that should be transferred, and how to mitigate any risks to individuals.

Summary of consultation responses and Government response

Respondents universally agreed that the number of small pension pots would increase under automatic enrolment. They generally acknowledged that this was inefficient for administrators and could lead to poor outcomes for individuals who may lose track of their pension savings and be unable to secure a decent income in retirement. They also thought that multiple pots could act as a barrier to engagement.

Most respondents agreed that making improvements to the current voluntary transfer framework and addressing some of the barriers, would not be enough to achieve consolidation. And indeed, research consistently suggests that giving people more information or encouragement is unlikely to be enough to encourage them to make active decisions. However, respondents did acknowledge that improvements would be helpful. The pensions industry has created a working group to explore the scope for such improvements.

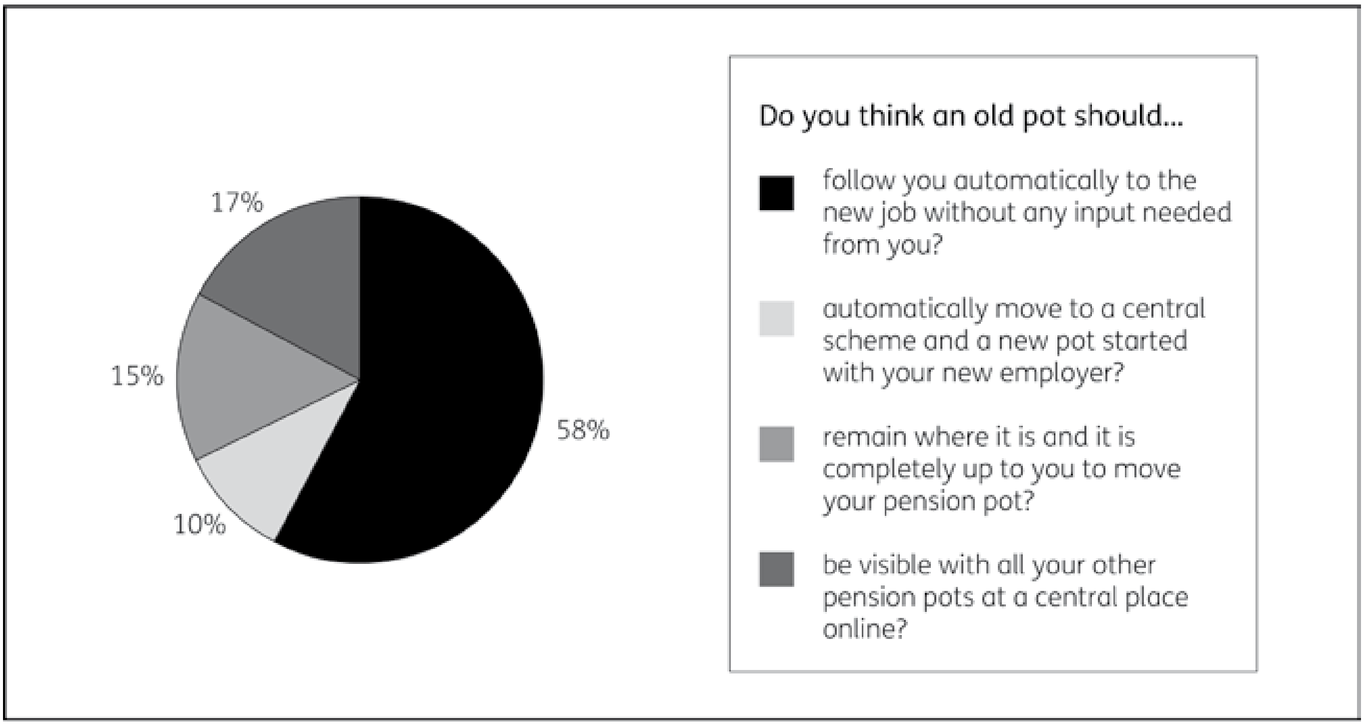
Government response
We are pleased to have the opportunity to work alongside the pensions industry to make more immediate improvements to the current voluntary transfer framework.

Over 90 per cent of respondents supported the automatic transfer proposals. When asked about the two specific automatic transfer approaches described in the consultation document, around 21 per cent expressed a preference for transfers to the new employer's scheme, 24 per cent supported a single aggregator, 19 per cent supported multiple aggregators and 18 per cent supported an aggregator but had no preference for single or multiple models. The remainder expressed no preference either because they saw equal merits in the different approaches, or because they did not favour automatic transfer.

However, new consumer research from the Association of British Insurers[6] with individuals showed that 58 per cent of respondents wanted their pot to move with them as they move employment, compared to just 10 per cent wanting their pot to automatically move to a central scheme, with a new pot started by the new employer. This is shown in Figure 2.

[6] Association of British Insurers, 2012, *Time to Act: Tacking our Savings Problem and Building our Future.*

Figure 2: Preferences for treatment of pension pot on changing employment



Looking at respondents' views on the aggregator model in more detail, there were suggestions that if multiple aggregators were used, they might be industry-specific. However, in the absence of an individual making an active choice, this would either, over an individual's working life, allow each employer to choose a preferred scheme (and so result in numerous aggregator pots and less consolidation for individuals), or would require an up-front allocation mechanism to ensure that an individual's pots always went to the same aggregator, adding complexity.

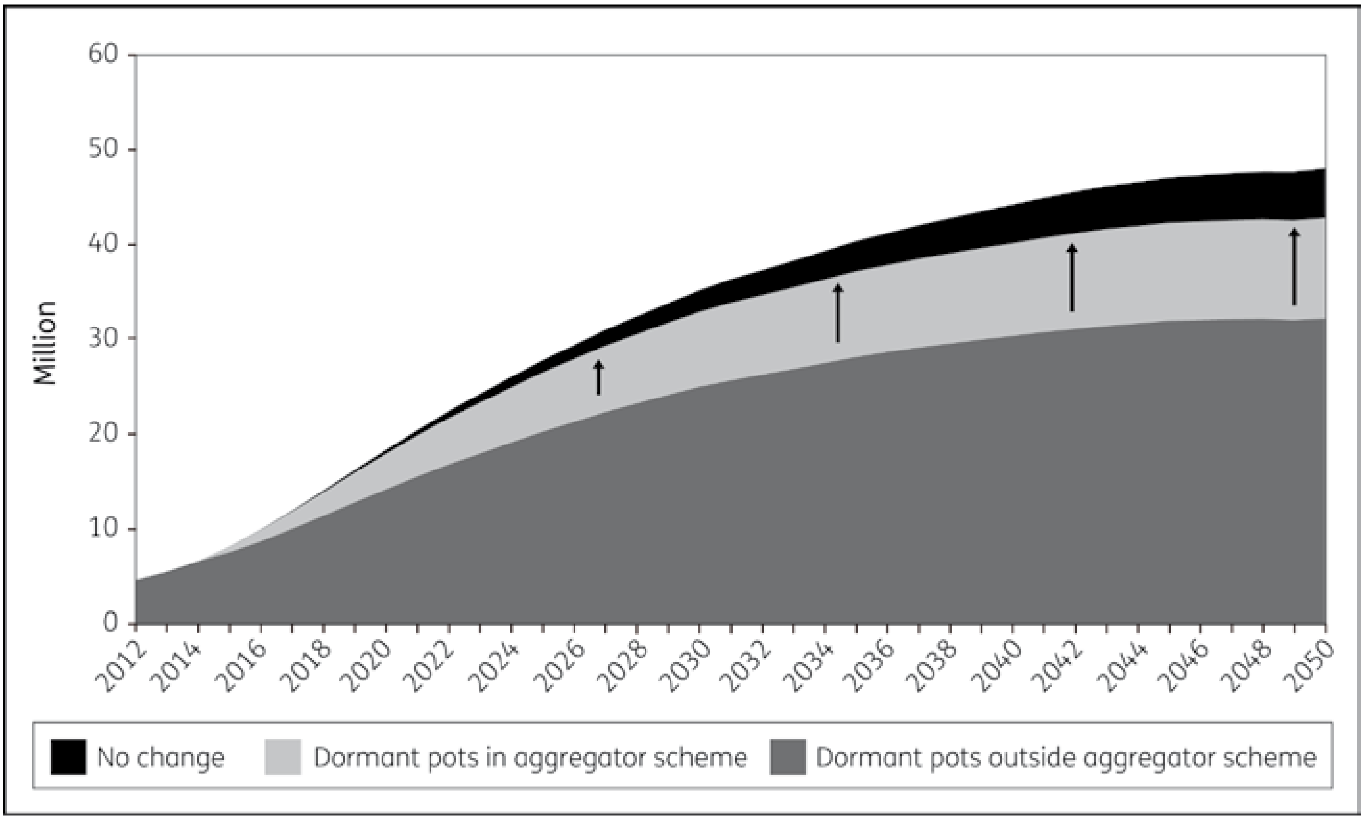
Some respondents acknowledged that the creation of an aggregator scheme risked market distortion and that there would be competition issues. Further work to develop the Impact Assessment that has been published alongside this document has improved our understanding of these issues. In particular, to avoid market distortion, it would be necessary to set a low pot size limit (probably around £2,000) for pots eligible for automatic transfer. This would significantly constrain the number of pots that would be transferred, minimising consolidation and leaving many individuals with a number of dormant pots. And regardless of the pot size limit for automated transfer, an aggregator system would leave members with at least one aggregator pot alongside the pot in their current scheme, thereby adding to the total number of pots. Together, these factors would significantly reduce the consolidation that would be achieved with an aggregator, making it harder for people to build up substantive pots and secure a decent income in retirement.

This is borne out in the analysis in the accompanying Impact Assessment.

The aggregator option requires the creation of a large number of new aggregator pots alongside the scheme individuals are actively contributing to (see Figure 3). This results in at least two pots, reducing the level of consolidation and resource saving. Savings are only generated when individuals have two or more pots transferred to the aggregator scheme, and we project that these will not materialise and outweigh the cost of the transfers until almost 15 years after the start of automatic transfers at the earliest, and potentially not until much longer.

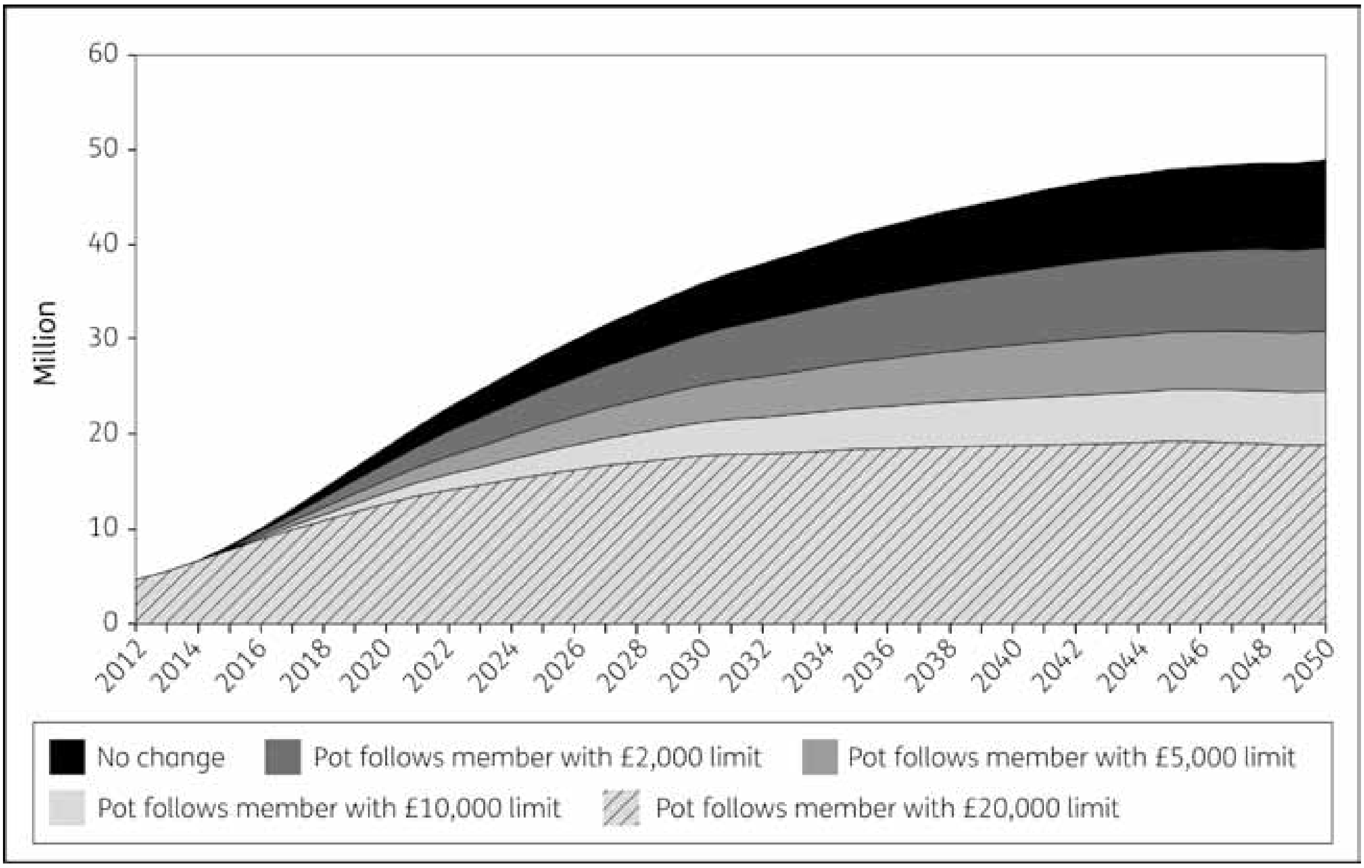
Under automatic transfers to the new employer's scheme, providers would see a cost of processing in the early years after go live, but over time this will be outweighed by the savings they make from having to administer fewer and fewer dormant pots. Savings could start to materialise about six or seven years after the start of automatic transfers. A higher pot size limit will result in greater consolidation and larger long-run savings[7].

Figure 3: Projected total number of dormant pots under an aggregator scheme with a £2,000 pot size limit



[7] At this policy development stage, our Impact Assessment does not include estimates of the costs of IT solutions to facilitate automatic transfers. However, we believe the costs should be relatively small in comparison to the long-term benefits.

Figure 4: Projected total number of dormant pots under automatic transfer to the new employer's scheme



With the transfer to a new employer's scheme, we recognise that there is a trade-off between a higher pot size limit which will achieve greater consolidation and a lower pot size limit which will reduce the risk of consumer detriment (for example where the receiving scheme performs less well than the transferring scheme). The Impact Assessment shows four illustrative pot size limits: £2,000, £5,000, £10,000 and £20,000 (see Figure 4). Further work will be needed to determine the optimum initial pot size limit for an automated transfer approach. We will also need to consider how this size limit might be reviewed in future.

We have also heard concerns about the greater risk of consumer detriment for some legacy schemes that may have preferential features, such as offering favourable rates of conversion to a scheme pension at the point of retirement. However, we would seek to mitigate this by considering whether certain schemes might be exempt from automatic transfers.

Government response

Department for Work and Pensions analysis shows that an aggregator model would achieve limited consolidation for individuals. A very low pot size limit would be required to avoid market distortion, limiting long-run consolidation. In addition, the creation of one or more dormant aggregated pots would be inefficient for the pensions industry. This option fails to deliver against two key reform objectives of promoting member engagement and tackling inefficiency.

By comparison, automatic transfers to the new employer's scheme compares favourably against our principles for reform with significant benefits for members, provided that effective safeguards can be put in place. Recent consumer research by the Association of British Insurers has shown that this is the preferred option for individuals. Department for Work and Pensions analysis shows that savings are realised sooner and are greater in the long-run. The benefits to industry could also be substantial if the cost of transfers can be reduced to such a level that they are cheaper than administering dormant pension pots.

On balance we consider that automatic transfers to the new employer's scheme offers the greatest benefits.

With an automatic transfer process, most respondents generally supported the following ideas:

- an opt-out from automatic transfer, analogous to automatic enrolment opt-out;
- that the automatic transfer of small pension pots should be unadvised;
- that the automatic transfer of defined benefit rights presented very significant challenges and therefore should not be included; and
- that legacy pots should not be included in automatic transfers.

Some respondents also raised concerns about the timing of implementation and thought that any automatic transfer solution should not be implemented until staging of automatic enrolment had been completed. And some respondents also raised concerns about how an automatic transfer solution might work where the individual has more than one job or there are gaps in employment.

Government response

We want to explore further with all interested parties how automatic transfers to the new employer's scheme might work and we would like to achieve change in this area as soon as practicable. However, we recognise the concerns about the timing and practical challenges of implementation. We therefore want to develop a model of automatic transfers that includes pots created in automatic enrolment schemes only.

We agree that defined benefit rights and legacy pots created before automatic enrolment should be out of scope at this stage, that the automatic transfer process for small pots should be unadvised business and that there should be a provision for opt-out.

We also agree that there is a need to explore a number of issues further in developing options for reform, including issues of consumer detriment, potential costs to industry, employers and Government, and questions about how the system might work where people have multiple jobs or gaps in employment. We recognise that it will be essential to work with all interested parties to develop more detailed proposals and understand how they might be implemented and funded.

We welcomed some respondents proposing solutions that were not set out in the initial consultation document.

A virtual amalgamation tool (where individuals can see all of their pension benefits in one place) was seen as an effective way to promote member engagement. Some respondents saw it as a solution in itself, whilst others saw it as paving the way for, or complementing, automatic transfer.

An alternative proposal was for a scheme to have the right to transfer a qualifying dormant pot once the member has left related employment. This was seen to enable the pensions industry to transfer unprofitable pots with minimal risk of consumer detriment. There could be a default scheme of last resort that would have a responsibility to take pots from any provider, although it was also suggested that this may not be needed as a market could develop to take these pots.

These models were proposed as potential alternatives to automatic transfers of dormant pots in the short term.

Government response
We would like to work with industry to explore the potential of a virtual tool further, particularly to help those with larger pots to see all their savings in one place. The virtual tool might enable those with a range of larger pension pots to engage with these. However we would see any virtual tool being additional to an automatic transfer solution for small pots.

We believe there are significant challenges with a model that would provide a right for schemes to transfer dormant pots. In particular there could be a lack of true amalgamation as dormant pots might simply be displaced from one scheme to another. Moreover, the choice to transfer would rest with the provider rather than the individual. This would result in a lack of clarity for individuals on whether or not their pot would be transferred. There is also a question of how affordable this option might be in the medium term if a provider of last resort were needed. Taking all these factors into account we do not propose that there should be a right for schemes to transfer dormant pots.

We did not ask questions about the abolition of short-service refunds, but some respondents suggested that micro-pots should be refunded under any automatic transfer solution. Views on what constituted micro-pots varied with amounts as low as £50 mentioned.

Government response
We remain committed to abolishing short-service refunds at the earliest legislative opportunity, but would like to consider further the idea of allowing micro-pot refunds.

With this in mind, we have started gathering evidence from the pensions industry and employer representatives on the costs and benefits of possible approaches with a view to developing, if possible, a micro-pot refund that will overcome the problem of very small pots costing more to transfer than they are worth.

To summarise, we are pleased that this consultation generated so much debate and new ideas, such as the virtual tool and allowing schemes to ‘push’ pots. We have carefully considered the merits of all these ideas, and are keen to work with the industry to explore some of these issues further.

The case for change and potential improvements to the current regulatory framework 1

In Chapter 2 of the consultation document we set out the scale of the small pots problem, current barriers to transferring small pots and explained why change is needed. In particular we sought views on the scale of the current problem and the current barriers to transfer.

Chapter 3 of the consultation document looked at a 'least change' reform option by considering possible ways to improve the current transfers system without wholesale changes to legislation or the regulatory framework. The system would, as a whole, remain voluntary and member initiated.

Consultation questions

Question:

1. We asked stakeholders if they had any evidence on the current problem of small pension pots.

What the consultation said

We believed there to be well in excess of a million dormant pots in defined contribution schemes with a value below £5,000, but we are keen to get more robust evidence to help us estimate how many small, dormant pension pots already exist[8].

[8] Department for Work and Pensions estimates, based on Association of British Insurers data, of the value of defined contribution pots annuitised and estimates of the total number of current defined contribution pension arrangements.

Responses to the consultation

There was almost universal agreement among respondents that small pots do indeed present a problem, and that their number will increase as automatic enrolment beds in. Some responses from pensions industry providers provided data which are consistent with our estimates of the issue currently.

In particular, a report from the Institute for Fiscal Studies jointly funded by the National Association of Pension Funds and the Economic and Social Research Council provided new analysis on the distribution of defined contribution savings and the scale of the current problem of small pension pots. It found estimates that there are already 1.1 million defined contribution pension funds[9] worth less than £5,000 that are no longer being contributed to[10].

It was clear that, when speaking of a small pot, most respondents were thinking of pots smaller than £5,000 in value, or even £2,000 (with pots below £2,000 being regarded as very small pots). In the context of transfers, respondents suggested that by the time a pot reached around £10,000 in value, and became more easily annuitisable, automatic transfer might not always be appropriate.

> "Our own analysis shows that approximately 20% of our total customers in DC workplace pension schemes have pots with values less than £2,000. We agree with the Department's view that the size of this issue will increase in the future as a result of automatic enrolment and recognise that the problem needs to be dealt with as soon as possible."
>
> **(Legal & General)**

Question:

2. We asked stakeholders if they agreed that the current barriers to transfer were correctly set out in the consultation document.

What the consultation said

We identified the current barriers to transferring and consolidating pension pots as:

- **Supply-side barriers:** primarily reluctance from providers and advisers to handle or accept smaller pension pots.
- **Transactional costs:** disproportionate costs, administrative problems, duties on trustees, complexity of transfer forms and the time taken to complete a transfer[11].
- **Demand-side barriers:** research shows a lack of engagement in pensions (at least partly because of complexity), especially among low to moderate earners[12], and individuals do not typically initiate voluntary transfers.

[9] Includes personal pension schemes.
[10] Crawford R and Tetlow G, 2012, *Fund holdings in defined contribution pensions*, Institute for Fiscal Studies Briefing Note BN127.
[11] Wood A, Young P, Crowther N, and Toberman A, 2011, *Transferring a pension scheme: Summary of research findings*. Available at www.dwp.gov.uk/docs/small-pension-pots-research-summary.pdf
[12] Clery E, Humphrey A, and Bourne T, 2010, *Attitudes to pensions: The 2009 survey*. Department for Work and Pensions Research Report No 701. Available at research.dwp.gov.uk/asd/asd5/rports2009-2010/rrep701.pdf

Responses to the consultation

Respondents generally agreed that we had correctly identified the key barriers to transfers.

However, some respondents identified other relevant factors. For example although Financial Services Authority rules do not absolutely require a person who wishes to transfer a pot to take independent advice, sometimes transferring and receiving schemes will not proceed with a transfer unless advice has been taken, leaving it up to the transferring member to find and pay for regulated advice. Respondents regarded this as at least as significant as the barriers already identified.

Another factor mentioned by respondents was the legacy issue. Earlier generations of pensions sometimes had restrictive terms and conditions such as market value adjustments and exit charges that might deter individuals from moving their pension pots.

> "There will also be significant numbers of people with some degree of hybridity in past pension contributions, such as guaranteed access to favourable annuity rates. It is important that members do not give these up without informed advised consent in any auto-transfer system."
>
> **(Trades Union Congress)**
>
> "If this window of opportunity is missed, any other pots that emerge later (for example small pots arising from contracting out through a personal pension) will be even more difficult to annuitise and risk being 'stranded' (too small to annuitise and outside the rules for cash withdrawals)."
>
> **(Age UK)**

Question:

3. We asked stakeholders whether any of the proposals set out would be an effective way to facilitate more transfers and reduce the number of small pension pots.

What the consultation said

In the consultation document, we identified a number of things that we could do in the current system to overcome the barriers that prevent individuals and schemes undertaking transfers between defined contribution schemes. These proposals included:

- **encouraging individuals to initiate transfers;**
- **making the transfer process simpler for members;**
- **improving individuals' access to schemes;**
- **reducing the fixed costs of administering small pots,** for example schemes have the option to stop issuing annual illustrations, but it is unclear how many schemes take advantage of this exemption[13]; and
- **promoting existing services,** for example, the Pension Tracing Service.

[13] Applies to savers who no longer contribute to the scheme and have accrued rights of less than £5,000.

Responses to the consultation

There was a general agreement that whilst these proposals could encourage individuals to transfer and amalgamate small pots, in themselves they were not enough to overcome the general inertia that led to individuals not actively transferring their pots.

> "Even if Government solved all the supply side and transactional barriers, volumes of transfers would remain very low and automatic enrolment would still cause a small pot problem due to the lack of individual engagement."
>
> **(Association of British Insurers)**

However a small minority considered amending the current system was the way forward.

> "We believe that revising, and improving, the current system is the most cost effective and readily implemented option of those considered. It is also the option that allows for the most flexibility. This solution can be tailored to deal with different types of pension scheme and different situations can be adapted to take account of other ongoing changes and can be taken on board by existing schemes with the minimum of disruption."
>
> **(Prudential)**

A minority of respondents commented on withdrawing annual statements or illustrations, saying that it would not be helpful as it would reduce what was already a low level of engagement with schemes.

Question:

4. We asked whether there are other ways to reduce costs further and make it easier for people to find and add to small, dormant pension pots.

Responses to the consultation

There was support from around a fifth of the respondents for some sort of virtual amalgamation of data that would allow members and their authorised agents to view their current and past pension pots.

Some respondents thought that the virtual pot was the only way to fully address member engagement, especially if it was accepted that not all pots (that is, defined benefit rights, including those which offer a cash balance subject to a guarantee) could be included in an automatic transfer solution.

One model suggested was the creation of a virtual hub whereby individual savers could access key information about their entire pension savings. Such a model would require providers and schemes to upload information such as member name, employer details, National Insurance Number, address, date of birth and pension pot value. It was also suggested that such a hub might also be able to produce annual pension statements and online valuations.

> "The benefit of this model is that it would not create unintended consequences such as changing the market and does not create any perceived or real consumer detriment associated with the models put forward in the Paper. We call on the DWP to develop its understanding as to how consumers would react in a virtual hub world."
>
> **(Association of British Insurers)**

Those respondents that supported a virtual option thought it would be more attractive than one which physically consolidated or transferred small pots because:

- there would be less risk of an implementation challenge for the industry;
- it would not impact on the distribution of pension pots in the market;
- it would not risk consumer detriment;
- it would take a holistic approach; and
- it would also help to ensure that all of the members' information was kept up to date throughout their working lives.

There was a split amongst respondents as to whether a virtual option would replace or be additional to measures to automatically transfer and amalgamate pension pots. However, the key message was the importance of devising a system where members could engage with their pension pots.

> "Engagement could be significantly increased by all providers and schemes supplying information to a central hub and therefore giving the public complete visibility of their pension position ... once pot data is brought together a road map could be established to achieve the necessary engagement, and where prudent, efficient physical consolidation."
>
> **(Scottish Life Royal London)**

NEST proposed an alternative model as a pre-cursor to an automatic transfer solution based on the concept of 'two rights and a responsibility'. Under this model, once the member had left the employment to which the pot relates, there would be a right for any registered pension scheme to choose to transfer that pot if it met certain conditions.

There would also be a right for any member, at any time, to request a transfer out of one registered pension scheme into another, including choosing an alternative destination scheme if their current scheme instigated a push. There would also be a responsibility placed on at least, and perhaps only, one scheme, meeting certain quality conditions, to accept **any** transfer instigated by another scheme.

We are aware that subsequent to the consultation another stakeholder suggested that a variant of this model could operate without a scheme that is compelled to take any transfer, and instead a market for transferred pots would develop.

There was also support, particularly from pension providers, for easing the current regulatory rules for transfers. These rules require the trustees of the ceding scheme to be satisfied that any transfer is in the individual's best interests.

There was some support for a move to more cost-effective administration and greater use of e-commerce to facilitate transfers although it was acknowledged that both of these would have high set-up costs.

A minority of respondents, primarily trust-based providers, took the view that retaining short-service refunds might, at least in part, mitigate the small pot problem.

Automatic transfers 2

In Chapter 4 of the consultation document we examined more ambitious reform paths by looking at two ways we could make the transfer process automatic, either by using one or more aggregator schemes, or transfer to the new employer's scheme. We proposed that an automatic transfer system would apply to all defined contribution workplace pensions used for automatic enrolment, both occupational and personal pensions.

Consultation questions

Question:

5. We asked stakeholders, taking account of our principles for reform, which of the two models they thought had the most merit.

What the consultation said

We proposed two models:

- **an aggregator system**: where an individual leaves the employer and their pot is under a certain size, that pot would transfer to an aggregator scheme, of which there could be one or more; or
- **transfer to new employer's scheme**: where an individual leaves an employer, their pot would automatically transfer to their new employer's scheme. This process would be supported by an electronic interface.

Responses to the consultation

In all, over 90 per cent of respondents supported the automatic transfer proposals. Just under a fifth of all respondents expressed no preference for aggregator or transfer to the new employer's scheme, either because they saw equal merits in both, or because they did not favour either model.

Automatic transfer to the new employer's scheme

Just over a fifth of respondents expressed a clear preference for the transfer to the new employer's scheme. Support for this model came primarily from providers, although some thought that such a model was not easily achievable in the current pensions' landscape. Those that did not favour this option pointed out the difficulties of transferring between widely differing pension arrangements.

Overall, the automatic transfer to new employer's scheme model was seen as delivering better engagement with retirement saving. Whilst the risk of consumer detriment was highlighted as a key concern with this model, there was general agreement among respondents that restricting automatic transfers between qualifying automatic enrolment schemes, and perhaps limiting the size of pots subject to automatic transfer, could reduce the risk of such detriment.

> "Aviva has long believed that the most appropriate way to facilitate transfers and amalgamation of small pots is to allow automatic transfers between auto-enrolment schemes so accrued savings follow people as they move from job to job … An aggregator approach will never achieve the stated 'one big pot' objective as members will have a current, active pension, and an aggregated fund. This may also fail to stimulate personal ownership and engagement with one actively growing fund"
>
> **(Aviva)**
>
> "We believe that the best option to deal with the issue is to proceed with a solution where a small pot follows the individuals' employment for several reasons:
>
> - it will aggregate the small pot into the members next pension scheme;
> - it best meets the required member outcomes by removing the barriers of lack of access to advice, lack of understanding and the complex administrative process that relate to transferring a small pot …
> - … it eliminates the requirement and costs associated with the set up and governance of a default aggregator scheme."
>
> **(Fidelity)**

Aggregator

Twenty-four per cent of all the respondents supported a single aggregator, 19 per cent supported multiple aggregators and 18 per cent supported an aggregator but had no preference for single or multiple models. The aggregator model was broadly favoured by respondents from the pensions industry and some consumer organisations.

> "NAPF members tend to prefer the aggregator model as it will be easier and less burdensome to deliver and will offer better protection for scheme members. Setting up automatic transfers into an aggregator would be a big change and it will be challenging, but it has a number of comparative advantages."
>
> **(National Association of Pension Funds)**

> "We strongly prefer the 'aggregator' model. We do not think the 'pot follows member from job to job' model is workable at present, and it would not meet our requirement of encouraging improvement in the marketplace."
>
> **(Age UK)**

Where an aggregator model was favoured, respondents often added the caveat that such a model would need to meet charging, investment and governance standards laid down by the Government. One respondent also suggested that all schemes should meet tough quality standards to minimise risk of consumer detriment.

But it was also highlighted that for individuals, an aggregator model would not necessarily lead to aggregation, as many individuals would end up with at least two pots.

> "An aggregator model will simply replace one pension institution with another. Over time, aggregation may lead to bigger pots and the existence of bigger pots may attract greater engagement. However, bigger pots can be created via a number of different models."
>
> **(Origo)**

Respondents who favoured an automated system for small pots advised caution over the implementation of any changes. In particular, they were concerned that introducing an automatic transfer system at the same time as staging small employers into automatic enrolment could cause confusion and make an already complex process more difficult.

> "We would strongly caution against jumping to a solution too quickly... both automatic transfer models proposed in the Paper could result in significant market change. Therefore the impact, as well as their costs, benefits and risks need to be fully understood before deciding on the appropriate solution."
>
> **(Association of British Insurers)**

Question:

6. We asked whether stakeholders had any other suggestions for a process to overcome the problems associated with small pots and improve transfers.

Responses to the consultation

A small number of respondents thought that a combination of the transfer to a new employer's scheme and the aggregator models might achieve better results. For example, one respondent suggested a hybrid model which would allow for automatic transfers to an individual's preferred scheme, but would also include an aggregator with a social obligation to accept transfers.

Another stakeholder proposed that small pots might be transferred to an Individual Savings Account type of product which would allow access to an income with the right to allow the withdrawal of a percentage of the capital in cash each year with effect from state retirement age.

Question:

7. Although the proposals in the consultation paper dealt with small pots in defined contribution schemes, we would be grateful for views on how defined benefit schemes should be treated and whether we should also consider applying any transfer solution to defined benefit rights.

What the consultation said

Whilst the proposals outlined in the consultation document only covered defined contribution pots, we were interested to obtain stakeholder views on whether they should extend to defined benefit rights as well.

Responses to the consultation

There was a general agreement that automatic transfers of defined benefit rights presented very significant difficulties which would not be easily overcome, if at all. Nearly all respondents who expressed a preference thought that defined benefit rights should not be included in any transfer arrangements. There was a concern that people who transfer out of a defined benefit scheme would risk losing valuable rights such as a guaranteed pension. They considered that the likelihood of the benefits of a defined contribution scheme being equal to or better than those of a defined benefit scheme to be remote, and that to transfer defined benefit schemes would impose additional administrative burdens.

> "This area should be handled with great care given that DB and DC are fundamentally different in nature. An apparently small benefit, for example £400 a year, would still require an equivalent pot of over £10,000 on an indexed basis. While this might make sense for an individual, the issue is far less straightforward than a DC to DC transfer."
>
> **(Association of British Insurers)**

However, there was a small body of support for automatic transfers of defined benefit rights, some on the condition that some way could be found to preserve those rights.

> "… we would not support automatic transfers unless some way can be found to preserve these rights. However, we believe that as an alternative to short-service refunds, defined benefit schemes should be permitted to make automatic transfers of up to £2,000 to an aggregator scheme."
>
> **(Age UK)**

Question:

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

What the consultation said

We considered that it was right to have an opt-out process in place.

Responses to the consultation

Very few respondents were opposed to opt-out. Most respondents took the view that, as an automated system would be analogous to the automatic enrolment arrangements, it would be appropriate to allow for opt-out.

> "Without the option to opt out of any transfer, members may transfer to a scheme which would result in a poorer income in retirement. This would go against one of the key reform principles and may be a future mis-selling issue. Therefore we agree that members should have the right to opt out."
>
> **(RPMI)**

The support for opt-out was split fairly evenly across two main options: a straightforward 'opt-out, pot stays where it is' option, and a choice for the member between accepting the automatic transfer and notifying their ex-employer (or scheme) of a different arrangement of his or her own choosing.

Some respondents thought it would be compatible with the drive towards greater member involvement to allow an individual to transfer their pot into an arrangement of their own choosing. For example, that individual may wish to manage their own investments via a self-invested personal pension.

> "... if the member has a very small pot (a calculation for the exact amount would need to be determined), then the member should have a reasonable period of time to arrange a transfer to some other pension vehicle of their own choosing and their own facilitating."
>
> **(Association of British Insurers)**

There was also some support for restricting opt-out according to pot size, with the smallest pots being automatically transferred without opt-out and only those over a certain size being subject to opt-out.

One respondent, who suggested a Super Trust aggregator, took the view that in such circumstances, an opt-out provision would not be desirable. This was because there would be protections in place to ensure that the pot was being transferred into a well-run scheme. They considered that an opt-out process could make the overall transfer more administratively more complex, and increase the likelihood of small pots.

Question:

9. Do you agree that individuals should not be required to take advice in an automatic transfer system, provided sufficient safeguards are put in place?

What the consultation said

We proposed that both models of automated transfer should be unadvised business, to ensure simplicity and reduce costs for individuals and schemes. But we recognised the need to put safeguards in place such as setting a maximum pot size for the transfer to a new employer's scheme model and setting key standards for the aggregator option.

Responses to the consultation

Respondents generally agreed that an advice requirement would be unnecessary or disproportionately costly when small pots resulting from automatic enrolment were being transferred. This was because the receiving scheme would itself have to satisfy the qualifying requirements to be an automatic enrolment scheme.

However, some respondents considered that as pots grow larger, members could benefit from taking advice. It was acknowledged that, whilst advice can make a significant difference to final outcomes, it would be uneconomic for members to take advice on smaller pots. There was a variety of views on what an appropriate starting point for advice might be. For example, it was suggested that the point at which people have better access to an annuity (currently around £10,000 to £13,500) or trivial commutation point (currently at around £18,000) might be an appropriate threshold.

> "Although the ideal situation might be that a financial adviser is involved in all cases, we have to be realistic that advice is uneconomic for customers/advisers with small pots. And the Retail Distribution Review will further reduce the supply of regulated advice, at least in the short term. People who cannot afford advice, or for whom it is uneconomic to take advice, should be able to transfer their pensions as safely and as easily as possible."
>
> **(Standard Life)**
>
> "Pots below £10,000 should be automatically transferred and the member should not be required to take advice; if individuals are required to take advice this would add significant complexity and in the vast majority of cases a transfer would not proceed given most individuals do not have a financial adviser."
>
> **(Sainsbury's)**

Some respondents were concerned that employers or trustees might fall foul of Financial Services Authority rules if advice were not given, and suggested that the rules in question should be changed, or that employers and trustees should be given explicit legal protection from sanctions provided they acted strictly in accordance with the Government's new transfer requirements.

It was suggested that one solution to the problem might be to set a pot size limit below which advice would not be required or recommended. Members with pots above that limit could be told that they might wish to seek professional advice before allowing a transfer to take place.

Question:

10. Do you agree that solutions to address the expected rise in small pots after automatic enrolment should also be designed to take account of the existing stock of small and dormant pension pots?

What the consultation said

We estimated that there might be more than one million small, dormant pension pots in the system. Whilst acknowledging that it may not always be in members' interests to transfer dormant pots (in particular where they have more favourable terms), we proposed that we do all we can to help people transfer legacy small pots.

Responses to the consultation

Only five respondents proposed addressing legacy pots along with the automatic enrolment pots, most commonly in combination with the single aggregator option.

> "The bank's strong preference would be for the small pots solution to encompass legacy deferred pots, not simply newly created small pots built up by active members going forward."
>
> **(Barclays Bank)**

However, the vast majority of respondents took the view that the complexities of older pots, which might offer various guarantees and benefits no longer available elsewhere, made it preferable to tackle the automatic enrolment small pots first. Work on legacy pots would then form a second phase after the automatic transfer system had bedded in.

> "We accept that initially it may be desirable to concentrate on the 'flow' of new pension savings until a new system has bedded down. However ... there are likely to be many existing small pots in unsuitable funds with high charges ... in due course we think existing stock should be brought into the system, subject to filtering out any funds to which guaranteed annuity rates or other special treatment apply."
>
> **(Age UK)**

There were also respondents who thought that legacy pots should not be transferred at all, in particular because of the risk of loss of guarantees on transfer.

> "We do not support any form of automated solution. However, were one to be advanced, it should only apply to automatic enrolment qualifying schemes which already have prescribed features set out in legislation. Legacy schemes, which may include guarantees, should not be automatically transferred. Guarantees are lost on transfer, so these schemes are rarely transferred."
>
> **(AEGON)**

An aggregator scheme for small pots

3

Chapter 5 of the consultation document asked for views on the specific features an aggregator might have, whether there might be more than one aggregator, and who might run it.

Consultation questions

Questions:

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

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

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

What the consultation said

The consultation document suggested an aggregator scheme would, over time, consolidate the small pots accumulated by an individual into one place, and have the following characteristics:

- **A willingness to accept the very smallest pots** – in order to address the issue of very small pot transfers not being accepted by schemes.
- **A simple transfer-in process** – to ensure that the default process is not overly burdensome for schemes.
- **Low charges and an appropriate investment approach** – to ensure an aggregator is appropriate for those whose pots are default-transferred in.
- **A simple member interface** – so that members are easily able to find pots and understand how much has been accumulated.

Responses to the consultation

The majority of respondents thought that these characteristics were correctly identified, but they also thought that communication and engagement with members were important. There was also strong support for an aggregator to meet the qualifying criteria for automatic enrolment schemes.

One respondent pointed out the difficulties in quantifying what a 'suitable investment approach' might be. Under the existing scheme design, trustees and consultants know their audience, but the aggregator model would be at arms length making it harder to identify and demonstrate the suitability of funds. They also suggested that value for money or good value might be a more appropriate measure than low charges, particularly due to the high cost of administering small pots relative to the income they generate.

A few respondents also said that there was the potential for large losses or sluggish growth in the early years of the life of an aggregator so that the initial franchise term would have to be significant. Otherwise it would be less likely that there would be alternative tenders at renewal time.

It was also thought that if, at renewal time, the existing aggregator lost its contract, there would be a sudden crystallisation of debts which could cause the company to fail.

> "The term over which the aggregator is appointed will need to be carefully monitored as it is not clear what would happen if an aggregator were to lose all funds under management while they have yet to make any profit. The loss of funds under management would crystallise debts and could result in the collapse of the provider."
>
> **(Friends Life)**

Some respondents suggested some sort of carousel front end to allocate pots to aggregators. For example, there was the suggestion that a pensions clearing house could act as an intermediary, instructing the ceding scheme to allocate the pot to one of three aggregators depending on whether the member already had a pot at any of the aggregators. If the member had none, the pots would be allocated at the discretion of the intermediary.

> "... when a member becomes deferred the clearing house as intermediary instructs the ceding scheme which is the appropriate aggregator for the pot to be transferred ... the clearing house can find out where the pot is being held and inform the member. If further information is required the clearing house can put the member in touch with the appropriate aggregator."
>
> **(NOW Pensions)**

There was also a suggestion that the aggregator scheme could offer a free and simple transfer-out process if the member wanted to make use of another scheme.

Question:

15. Should there be several aggregator schemes or one?

What the consultation said

A single aggregator scheme would involve pensions industry operators potentially bidding for the role for a fixed period, with the arrangements reviewed and renewed after that period.

With multiple aggregator schemes there would be a range of industry players involved. To avoid complexity for the transferring scheme, one destination for default transfers would be preferable.

Responses to the consultation

Of the respondents who expressed a clear preference for the aggregator model, just over 30 per cent supported a multiple aggregator, 40 per cent a single aggregator with the remainder expressing no preference. Overall, respondents considered that the single aggregator was simpler to understand and also the easiest to administer. It was also thought that the sheer scale of a single aggregator would allow for administrative economies and lower charges for members.

> "... if there are to be multiple aggregator schemes, there will be a need for a mechanism to ensure that transfers are controlled and instructions are passed between parties. We would suggest that such a mechanism has the potential to add an additional cost to any transfer process."
>
> **(Institute and Faculty of Actuaries)**

However, there were concerns that having a single aggregator would breach competition law and that it could grow so large as to distort the UK pensions market. Some respondents also thought that a single aggregator could end up as the default company scheme in its own right, thus further reducing employer engagement.

> "There are serious questions about market competition if a single aggregator solution were to be introduced. A typical employee moves jobs once every six years on average, this means that each one of us would have between ten and eleven jobs in a lifetime. This means that 10/11ths of an employee's pension pot could end up in the aggregator. This is a completely unacceptable regime from a competition perspective as the aggregator would enjoy a significant competitive advantage in terms of size."
>
> **(Confederation of British Industry)**

Multiple aggregators were seen as being more likely to promote competition and innovation and drive down costs, thus circumventing the market distortion effects of a single aggregator. The lack of regular re-tendering for multiple aggregators would allow providers to plan for the longer term, and employers and/or members would have a measure of choice over which aggregator to use. But concerns were expressed about how much genuine competition would result, at least once the initial selection exercise was over.

With multiple aggregators there was considered to be a risk of detriment to members and the Government if one or more aggregators failed. The stress of competition could lead to business models being flawed, thus increasing the risk of aggregator failure. Some respondents thought that subsequent mergers and acquisitions might well reduce the initial spread of aggregators.

Concerns were also expressed that multiple aggregators would not achieve true amalgamation of pots as there is the potential for members to end up with pots spread across several different aggregators.

> "This solution, however, does not address the issue of small pot consolidation. A multiple aggregator model would encourage many private providers to set up their own aggregator scheme – anecdotal evidence from CBI members confirms this – which would lead to pots being transferred to different aggregators and therefore not being consolidated in a single pot at any time."
>
> **(Confederation of British Industry)**

Question:

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

Responses to the consultation

There was a general agreement that it would be possible for the pensions industry to offer one or more aggregators. Given the sheer scale of the anticipated business, however, it was thought likely that there would be very few bidders for the aggregator option. Some respondents thought that an aggregator scheme might need to be very large to be commercially attractive, thus there would be scope for only a few such schemes.

> "A number of pension providers have entered the auto-enrolment market on a large scale with schemes that already exhibit some of these characteristics. Super Trusts would also exhibit all of these characteristics and the Government should encourage the development of this kind of provision to operate alongside NEST."
>
> **(National Association of Pension Funds)**
>
> "Theoretically anyone could sign up and deliver against the characteristics. However, the costs of aggregation should be shown separately from other parts of the business to prevent cross subsidisation at the expense of other pension savers."
>
> **(Which?)**

Question:

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

What the consultation said

NEST could potentially take on the role of aggregating small pots. But we would need to ensure there was no detrimental impact on its ability to deliver its core remit. It would also change the picture on the current restrictions on transfers into NEST.

Responses to the consultation

There was a general acknowledgment that NEST has some attractions as an aggregator, for example that it has been set up to serve low and middle earners and has a public service obligation.

But there was concern that extending NEST's remit could have an adverse impact on its active members, who could end up subsidising the small pots of non-active members. There were also concerns that extending NEST's role in this way would fall foul of European Union restrictions on State Aid, as there was no market failure which only NEST could address.

> "... there would need to be one aggregator that has a public service obligation to accept pots, however small. NEST is the obvious choice, as long as its role as an aggregator does not create costs that have to be borne by its other members."
>
> **(Trades Union Congress)**

Questions:

17. What is the best approach to defining a small pot for this option?
18. Should there be a transfer limit on pots below a certain size and if so, what should happen to the pot?

What the consultation said

We set out three potential approaches for setting the small pot default mechanism:

- **Default transfers compulsory for schemes if pot is under a certain size.** The Government would set a figure, balancing individual and scheme interests, either reviewing it periodically or indexing it.
- **Voluntary for schemes, they decide which pots they want to transfer.** Still a default process for members if the scheme decides to transfer. Short-service refunds would not be available as an alternative.
- **The Government sets a band and schemes have flexibility within that band.**

The administrative cost of transferring the very smallest pots may exceed the value of the pot, which also raises the question of whether there should be a minimum transfer level for the very smallest pots.

Responses to the consultation

Around two-thirds of respondents expressed a view on this issue. The majority were in favour of default transfers being compulsory if the pot is under a certain size. The next most popular option was for default transfers to be compulsory under a certain size but voluntary within a band. The least favoured option (chosen by only a fifth of those who expressed a preference) was for default transfers to be voluntary for schemes.

> "NAPF members are split on whether small pot transfers should be compulsory or voluntary. 57% say it should be voluntary and 43% compulsory. If the small pot is in a high quality scheme that meets the standards that would be expected of an aggregator then there is no immediate reason why the scheme should be forced to transfer that small pot elsewhere. However, the DWP would probably want to compel trust or contact-based schemes which are not good for deferred members (such as those which levy high charges for deferred members) to transfer small pots."
>
> **(National Association of Pension Funds)**

There was also support for pots not to be transferred if they were below a certain size on the basis that it would not be economical to do so. In particular there were calls for such pots to be refunded to the member and this is discussed in more detail in Chapter 5.

> "There could be an argument for the return to the member of contributions and that of the employer below a figure which makes processing uneconomic. If the administrative costs were to exceed the likely investment return thus delivering a negative growth of the pot then it should be returned."
>
> **(Which?)**

Question:

19. Given the default nature of the transfer, which of the member, the transferring scheme or the aggregator scheme should pay the default transfer costs?

What the consultation said

Requiring or enabling schemes to default transfer small pots would have a cost for the transferring scheme (push costs) and the aggregator scheme (pull costs). Ultimately the decision on who should bear the costs, be it transferring scheme, aggregator or member, would be finely balanced.

Responses to the consultation

Many respondents expressed the view that it would be unfair to make the member pay because the transfer was, in effect, imposed on them. There was support for making ceding and receiving schemes pay their own costs. But it was also emphasised that even if schemes did meet the cost of transfers, that would, in effect, be money from members' pots because ultimately it would be funded from members' management charges.

> "Even if the transferring scheme or aggregator scheme meets the costs, it would ultimately be passed on to members, who will pay for it implicitly through ongoing charges. This means that the members will pay for the default transfer costs but probably with a significant degree of cross subsidy between members who change employment frequently and those who change less frequently."
>
> **(Institute and Faculty of Actuaries)**
>
> "The member should certainly not be expected to bear the costs of the default transfer. If an aggregator scheme is chosen, the expected costs of transfer could be built into the annual management charge of that scheme (or schemes). If the pot follows person route is chosen, the transfer costs could be shared proportionately between the transferring and receiving schemes."
>
> **(Legal & General)**

Automatic transfer to a new employer's scheme 4

Chapter 6 of the consultation document set out a system where an individual's pension pot follows them from job to job. This would be a scheme-to-scheme process supported by an electronic interface with a minimal role for employers and individuals.

Consultation questions

Question:

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

What the consultation said

In the consultation document we set out two case studies to illustrate the effects that an automatic transfer to the new employer's scheme could have on an individual's pension fund.

Responses to the consultation

There was some support for the view that if a scheme was good enough to be a qualifying scheme for automatic enrolment purposes, the existing protections were sufficient.

> "If a scheme is deemed to be of the appropriate quality and value to qualify for auto enrolment, it should provide the safeguards required for the automatic transfer of a small pot. Whilst this does not address the legacy pot issue it ensures that the potential for member detriment is limited."
>
> **(Fidelity)**

However, many respondents were doubtful that the current safeguards were sufficient to address consumer detriment, for example where legacy pots were involved or where the specific needs of individuals (such as life styling near retirement age, where the receiving scheme is a young scheme with insufficient allocation of gilts) were taken into consideration.

> "It is currently uncertain as to whether schemes will meet the government's standards regarding governance and charges in relation to default funds. Whilst the government may have the power to regulate to cap these charges, if required, it is not clear to schemes or members if, and at what point, government action will be taken."
>
> **(RPMI)**

Question:

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

What the consultation said

We suggested a pot limit of £10,000 as this is the level where members have better access to the open market when purchasing an annuity. Once the pot reaches a set maximum, the transfer would revert to being member initiated.

Responses to the consultation

Some respondents thought that we should not impose an upper transfer limit because it would multiply pots. Once an individual's pot reached the transfer limit they would have to start accumulating a new pot.

> "If this option is chosen, the most sensible approach seems to be that a maximum should not apply. If a maximum applies, at some point the default transfers will stop and members will then start to build up a new pot in a separate scheme in isolation. That could result in the creation of an additional small pot and the member will potentially be left with a number of "medium" pots held in separate schemes. However, as we have already outlined, we have concerns on whether the automatic transfer of larger pots will be in a member's best interests. If the ultimate aim is to create a "big fat pension pot", default transfers where pensions follow people from job to job would have to be unrestricted. This suggests that it may not be an appropriate option and would have to be considered carefully."
>
> **(Legal & General)**

On the other hand, there were concerns that the larger a pot becomes, the greater the risk of consumer detriment if the transfer is made to a less advantageous scheme. It was accepted that this problem could be mitigated, though not entirely removed, by some sort of advice recommendation or requirement for larger pots.

Suggested maximum limits ranged from around £5,000 up to the trivial commutation limit, currently at around £18,000, although there was also support for setting a limit at around £10,000 to £13,000, the point at which it becomes easier to purchase an annuity on the open market. The highest figure proposed was £50,000.

> "We don't believe that an automated solution is in the interests of members. But if the Government pursues this approach, a maximum is essential. It should be set and retained at a low level to reduce the number of customers who could be adversely impacted and the size of per individual potential detriment."
>
> **(AEGON)**

Questions:

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

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

What the consultation said

We proposed an electronic process for this option. For the process to work effectively the cost of transfers would have to be less than the cost of maintaining the pot.

Responses to the consultation

Respondents thought that a combination of full name, National Insurance Number and date of birth could be used to successfully match members with their pots.

It was suggested that the process might work in the following way:

- the employer or scheme manager uploads information about an individual and their pot once that individual leaves their employment;
- the individual starts work with their new employer and is automatically enrolled into the new scheme;
- the new employer interrogates the database for details of the old pot;
- individual is informed of the transfer process and given the option to opt out;
- if they do not opt out, the employer contacts the scheme holding the old pot and requests the transfer and, within the period set out in regulations, the ceding scheme transfers the pot.

There was also the suggestion that the database might actively drive the transfer process, with respondents suggesting that the new employer inputs identifying information into the database, which would then make a match with old pots and prompt the old and new employers to initiate the transfer procedure.

In general, respondents from the pensions industry were fairly confident that they had the technical ability to devise and set up such a database. But maintaining such a database might not be commercially attractive for the industry and would come at a cost.

> "If chosen as the appropriate solution going forward, we have been very encouraged by the discussions had with a number of companies who have indicated that much of the infrastructure for such a database already exists. With further work and combining with Origo's Options Transfers for example, we believe that a pot follows member model could be delivered relatively quickly (issues of ownership and who pays aside)."
>
> **(Association of British Insurers)**

> "As well as the various regulatory and data protection issues there is also the question of cost. Set up and operation costs would inevitably be passed to scheme members thus reducing the pension pots of all scheme members and therefore any potential benefits arising from the introduction of the new regime."
>
> **(Prudential)**

Some respondents also assumed that the database would be run as a large scale government IT contract, and in this context thought that the Government had a poor track record on some similar projects.

Question:

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

What the consultation said

Where there is a large gap between employments, pots would remain dormant in the old scheme until the individual is automatically enrolled with a new employer.

Responses to the consultation

This was regarded by those that did not favour the model as a significant flaw in the automatic transfer to new employer's scheme model. However, it was generally agreed that the pot would have to stay in the ex-employer's scheme until such time as the member re-entered the job market or made some alternative transfer arrangement.

> "... it would seem appropriate for the pot to remain with the existing provider so they are no worse off. The details of the small pot would be uploaded to the central database as at the time of leaving and then only 'pulled' by the new scheme on take up of a new employment. The value of the pot at this point could be higher than the small pot limit but for the sake of solution simplicity we would recommend that the transfer should still proceed (albeit with a member opt-out facility)."
>
> **(Fidelity)**

Particular circumstances that would need to be considered further included where the individual:

- becomes self-employed;
- becomes unemployed;
- earns an income below the qualifying earnings threshold for automatic enrolment;
- chooses to opt out of automatic enrolment next time;
- moves to a public sector job or a private sector one with an open defined benefit scheme; or
- has more than one job at the same time.

Question:

25. What should happen to an individual's older dormant pension pots in this proposed process (those pots in defined contribution schemes), where pensions follow people from job to job?

What the consultation said

Two options were proposed. The first was to encourage members, through scheme information, to take their own action to transfer their old pots (for example using the Pension Tracing Service). The second was for the member's new automatic enrolment scheme to check a central database to see if the member had any other smaller pots in other schemes.

Responses to the consultation

While there was some limited support for addressing legacy pots alongside automatic enrolment pots, the majority of respondents felt that, given the complexity of many legacy arrangements, a decision on whether and, if so, how to arrange transfers for legacy pots should be deferred until after the automatic transfer process had bedded in.

Several respondents considered that such transfers, like those from defined benefit to defined contribution schemes, should always be voluntary and that the members should be required to take advice.

> "This solution should focus on small pots going forward (post commencement of auto-enrolment). Older dormant pots may require entirely different solutions and greater consideration of potential issues. Therefore in order to avoid delaying any form of implementation, older pots should not be included in any changes at this stage."
>
> **(Prudential)**

Short-service refunds

5

Annex A of the consultation document set out our thinking on the abolition of short-service refunds.

One of our key principles for pension reform is producing good retirement incomes by getting people saving and maintaining savings. Short-service refunds jeopardise persistent saving, especially in low-to-moderate earners and potentially undermine the aims of the reforms. Therefore, we have decided to make changes to the preservation requirements so that defined contribution occupational pension schemes can no longer operate short-service refund rules. We intend to do this at the earliest legislative opportunity. This will ensure savings remain in the pension system.

We do however recognise that changing these rules for defined benefit schemes would have a disproportionate cost and also believe that employers would not be encouraged to set up defined benefit schemes if we did not maintain the rules for these types of schemes. Therefore, short-service refund rules will be changed for defined contribution schemes, but will remain for defined benefit schemes.

Stakeholder responses

Although we did not ask any specific questions on short-service refunds, we did receive some feedback.

There was some support for delaying the withdrawal of short-service refunds until after the implementation of automatic enrolment had been completed and the new automatic transfer system was ready to be introduced.

There was also a wide body of support for retaining the current short-service refund arrangements. For example, it was considered that short-service refunds allow for better quality schemes to be delivered for members.

> "CBI is aware that government has concerns regarding the use of short service refund rules (SSRR). This is because it could lead to people inadvertently missing out on pension saving. Our view is quite the opposite. Evidence from CBI members suggests that SSRR do not undermine the policy aim to encourage greater saving. In fact, they help employers deliver better quality schemes for their staff. Because of this, the CBI believes that SSRR for trust-based schemes should not be abolished, even if a new small pots transfer system is introduced."
>
> **(Confederation of British Industry)**

There was also support for allowing refunds of micro-pots. This is because some pots, particularly those resulting from late opt-out under automatic enrolment, would be so tiny as not to be worth transferring. Views on what constitutes a micro-pot varied but it was broadly considered that a figure of £200 or less would probably be appropriate.

> "There could be some extremely small pots created under automatic enrolment, potentially even down to pots of one penny. So there is some merit in a de-minimis solution. This could be that where the pension pot is below £100 the employer may, at the employer's discretion, refund this to the individual through PAYE."
>
> **(Association of British Insurers)**

Summary of key themes from the Government response 6

- On balance, we consider that a system of automatic transfers to the new employer's scheme is our favoured approach.
- We recognise the concerns about implementation, so we want to develop a model of automatic transfers that includes pots created in automatic enrolment schemes only.
- We agree that defined benefit and legacy pots should be out of scope at this stage that there should be opt-out, and that the automatic transfer process for small pots should be unadvised business.
- We agree that there is a need to look at issues of consumer detriment and how the system might work where people have multiple jobs or gaps in employment.
- We would like to achieve change as soon as practicable and want to work further with all interested parties to develop proposals and understand how they might be implemented and funded.
- We will also work with industry to explore the potential of a virtual pot solution, particularly to help those with larger pots to see all their savings in one place.
- We will work alongside the pensions industry's new working group which will be looking at the scope to make more immediate improvements to the current voluntary transfer framework.
- We will abolish short-service refunds at the earliest legislative opportunity, but would like to explore with the pensions industry and employer representatives the idea of allowing micro-pot refunds in an automatic transfer solution.

Annex A
List of respondents

AEGON
Age UK
Alexander Forbes Financial Services
Altus Ltd
Aon Hewitt
Association of British Insurers
Association of Consulting Actuaries
Association of Pension Lawyers
Aviva
B & CE
Balfour Beatty
Barclays Bank
Bluefin Group
Buck Consultants
Capita Hartshead
Chartered Institute of Personnel and Development
Centre for Retirement Reform
Confederation of British Industry
Consumer Focus
Co-operative Group
David Webber
Engineering Employers' Federation
Eversheds
Fair Pensions
Federation of Small Businesses
Fidelity
Financial Services Consumer Panel
First Actuarial
Foster Denovo
Friends Life
Hargreaves Lansdown
HISL
HSBC
Hymans Robertson
IBM
Independent Trustee Services
Institute and Faculty of Actuaries
Institute of Chartered Accountants in England & Wales
Institute of Directors
Investment Management Association
JLT Benefit Solutions
Johnson Fleming
Keith Sully InterContinental Hotels Group
Kingfisher
Law Society of Scotland

Legal & General
Local Government Pensions Committee
Low Incomes Tax Reform Group
Lucida
Mercer
National Association of Pension Funds
National Employment Savings Trust
National Federation of Occupational Pensioners
NOW: Pensions
Origo
Pensions Administration Standards Association
Pensions Advisory Service
Pensions Management Institute
Pensions Trust
Pfizer
Phoenix Group
Price Waterhouse Coopers
Prudential
Punter Southall
Royal Mail Defined Contribution Plan
RPMI
Sacker and Partners
Sainsbury's
Scottish Life Royal London
Scottish Widows
Skandia
Society of Pension Consultants
Standard Life
Superannuation Arrangements for the University of London
Tax Incentivised Savings Association
Tesco
Towers Watson
Trades Union Congress
Which?
Whitbread
Wragge and Co

Annex B
Glossary of terms

Annex B – Glossary of terms

Active member	A member of an occupational pension scheme who is building up pension benefits from their present job.
Aggregator scheme	A scheme that could be used to consolidate an individual's small pension pots.
Annual statements/illustration	An annual statement showing contributions paid and the current value of an individual's pension fund. This statement must also include an illustration of the pension income expected in retirement.
Annual management charge	A charge levied annually by a pension provider on a member's pension fund to cover the costs associated with providing that pension scheme. The charge is usually levied as a percentage of the total fund value.
Annuity	Members of defined contribution schemes can use their accumulated fund after age 55 to purchase an annuity. An annuity is a contract with an insurance company that pays a regular income for the policyholder's lifetime.
Automatic enrolment	Employers will be required to make arrangements by which eligible jobholders become active members of a qualifying workplace pension scheme (an automatic enrolment scheme) with effect from the automatic enrolment date. Automatic enrolment is not applicable if the jobholder is already an active member of a qualifying scheme.

Automatic transfer	Making pension transfers the default action unless the individual indicates they would like to keep their pension pot in the scheme or transfer it to another pension scheme.
Cash equivalent transfer value	A transfer from an occupational pension scheme which is taken during the short-service refund period. This is the cash equivalent of the benefits when the worker's membership ends.
Charges (member charging)	A form of charge structure where the member of the pension scheme pays management fees. Also see Annual management charge.
Contract-based scheme	A defined contribution scheme purchased by an individual, either through their employer or individually from a pensions provider. It is owned entirely by the individual and the pension provider. Also see Trust-based pension scheme.
Deferred member	An individual who has left a scheme, but will get benefits when they retire.
Defined benefit scheme	An occupational pension scheme that provides benefits that are not based on contributions and investment returns and often on a formula involving how much a person is paid at retirement (or how much a person has been paid on average during their membership of the scheme) and the length of time they have been in the pension scheme.
Defined contribution scheme[14]	A pension scheme that provides pension scheme benefits based on the contributions invested, the returns received on that investment (minus any charges incurred) and the rate at which the final pension fund is annuitised. These can be an occupational pension or a workplace personal pension scheme. They are sometimes referred to as a money purchase scheme.
Eligible jobholder	A worker who is aged between 22 and State Pension age, earning more than the automatic enrolment trigger and who works or ordinarily works in the UK under their contract. They are eligible for automatic enrolment if they are not already a member of a qualifying scheme.
Financial Services Authority	The regulator for financial services firms with responsibility for personal pensions, including workplace personal pensions.
Guaranteed annuity rates	These set a minimum income that the pension scheme holder must offer the individual as an annuity when they retire, as a minimum income which is guaranteed.

[14] The legislation governing the definition of a defined contribution scheme has recently been amended by Parliament, but that amendment is not yet in force. The key difference is that after the new definition comes into force, defined contribution schemes will be schemes where the benefits are based **solely** on contributions plus investment returns.

Legacy pot	An existing pension pot where the individual no longer pays into the pot and has become a deferred member.
Lifestyling	Where an individual's pension fund is restructured so that money is gradually moved from higher to lower risk assets as their retirement date approaches.
NEST	The National Employment Savings Trust. A new multi-employer defined contribution occupation pension scheme set up for automatic enrolment.
Occupational pension scheme	A pension scheme taking the form of a trust arrangement, which means that a board of trustees is set up to govern the scheme. Benefits can be either defined contribution or defined benefit.
Open Market Option	A process that allows an individual to transfer their pension pot at retirement from one life assurance company to another to achieve a higher annuity rate.
Options	An electronic platform developed by Origo on behalf of the insurance industry to improve pension transfers.
Opt-out (automatic enrolment)	In automatic enrolment, once active membership has been achieved and the jobholder is in receipt of the enrolment information, the jobholder has a right to opt out of active membership and will be treated as having never been a member of the scheme.
Opt-out (automatic transfers)	In an automatic transfer process, this is an individual's right to ask for their small pension pot to be kept in the existing pension scheme or transferred to another pension scheme of their choice.
Pensions Regulator	UK regulator of workplace pension schemes.
Pension Tracing Service	A service offered by the Department for Work and Pensions to help individuals (or their representatives) trace their lost pensions. The Pension Tracing Service has access to a database that is a subset of the Pension Regulator scheme administration data to trace pension schemes. This contains information on over 200,000 occupational and personal pension schemes.
Personal pension	A contractual arrangement between an individual and a pension provider (such as an insurance company) which enables the individual to make provision for a pension on a defined contribution basis.
Pull costs	The costs that the receiving scheme incurs when an individual's pension pot is transferred into their scheme.

Push costs
The costs that the transferring scheme incurs when they transfer an individual's pension pot into their scheme.

Retail Distribution Review
The Financial Services Authority's review of the advice and sale of retail investment products.

Self-invested personal pension
An arrangement that forms all or part of a personal pension scheme, which gives the member the power to direct specifically how some or all of the member's contributions are invested (as opposed to simply choosing a fund or funds).

Short-service refund
In an occupational pension scheme, the member's right, after three months and up to two years of service, to a refund of their contributions or a cash equivalent transfer when they leave the pension scheme.

Stakeholder pension
A type of personal pension. They have to meet certain government standards to ensure they are flexible.

State Aid
A European Commission term. The State Aid rules are designed to regulate subsidies and to stop public authorities from distorting the market.

Stranded pension pot
A small pension pot that an individual is unable to access.

Super Trust
A scheme open to employees of non-associated employers.

Trivial commutation
Tax rules that allow individuals with pension savings of less than £18,000 to withdraw their pension savings as a lump sum from age 60.

Trust-based pension scheme
An employer-sponsored pension scheme that is managed by a board of trustees, alternatively known as an occupational pension scheme. Benefits can be either defined benefit or defined contribution. Also see Contract-based scheme.

Workplace pension
A pension scheme which is:
- an occupational pension scheme;
- a personal pension scheme where direct payment arrangements exist in respect of the members of the scheme who are employees; or
- a stakeholder pension scheme.

Workplace personal pension
A defined contribution pension scheme purchased by an individual, either through their employer or individually, from a pension provider. It is owned entirely by the individual with the contract existing between the individual and the pension provider.

It includes group personal pensions, group stakeholder pensions and group self-invested personal pensions.

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Department for Work and Pensions
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Caxton House
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London
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