

# Automatic pension transfers: estimated impacts under different pot size limits

October 2012

# Background

On 17 July 2012, the Government issued its response to a consultation on options to improve pension transfers and address the problems associated with small dormant pension pots<sup>1</sup>. In this, it outlined its interest in working with the pension's community to understand how a system of automatic transfers into the new employer's scheme might work.

The Government concluded that an alternative option of automatic transfers into one or more aggregator schemes would result in less consolidation. Two reasons for this were identified:

- Individuals would be left with a dormant aggregated pot alongside their new employer's scheme; and
- A low pot size limit would be required to avoid market distortion, limiting the number of pots eligible for automatic transfer.

The consultation response was accompanied by an Impact Assessment showing the results of DWP modelling of the different options<sup>2</sup>. The estimated impact of automatic transfers to the new employer's scheme was presented with four different pot size limits<sup>3</sup> - £2,000, £5,000, £10,000 and £20,000. The estimated impact of an aggregator scheme was only shown with a £2,000 pot size limit - on the basis that a low limit would be needed with an aggregator scheme to avoid market distortion.

This ad-hoc release presents the estimated impact of an aggregator scheme with £5,000, £10,000 and £20,000 pot size limits. The estimated impact of automatic transfers into the new employer's scheme with the same pot size limits are provided alongside, for ease of comparison.

The figures are estimated using the Department's Pensim2 model, a dynamic micro-simulation model used by the Department to project pensioners' incomes, and used to inform much of its work on pension reform. Note that the results presented here represent the results of modelling by the Department's analysts and do not constitute official statistics.

# Results

Tables 1-6 present the Department's estimates of the impact of automatically transferring dormant pots to an aggregator scheme or to their new employer's scheme, with a £20,000, £10,000 and £5,000 pot limit. Tables 1-3 show the estimated impact on the pensions industry, in terms of the number of transfers they will have to process, the reduction in the number of dormant pots they will have to administer, and the associated administrative cost savings (i.e. the saving from no longer having to administer dormant pots net the cost of the transfers). Tables 4-6 show the estimated impact on individuals, with reference to the number of dormant workplace DC pension pots that we project those retiring between 2050 and 2060 will have.

In modelling an aggregator scheme, the Department has estimated the impact of aggregating pots in a large existing scheme such as NEST as well as aggregating them into a newly set-up scheme. The results of both are presented, along with the mid-point between the two.

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<sup>1</sup> <http://www.dwp.gov.uk/consultations/2011/small-pension-pots.shtml>

<sup>2</sup> <http://www.dwp.gov.uk/consultations/2011/small-pension-pots.shtml>

<sup>3</sup> Pots over this size stay in their existing scheme and are not automatically transferred (although the individual can ask for a transfer if they wish)

For any given pot size limit, administrative savings are lower and take longer to materialize under an aggregator scheme. Even under the best-case scenario (where pots are aggregated into a large existing scheme), it is estimated that an aggregator scheme achieves only around a half of the estimated net present value (NPV) of automatic transfers to the new employer's scheme (see Tables 1-3).

This is because it does not achieve any consolidation unless and until an individual accumulates a number of dormant pots, and requires a large number of dormant aggregator pots to be maintained alongside the individual's current scheme – which a system of automatic transfers to the new employer's scheme does not.

The aggregator scheme achieves no consolidation when (and for as long as) individuals have only one dormant pot below the pot limit – where this is the case, they will be left with a dormant pot in the aggregator (rather than having it consolidated into their current scheme)<sup>4</sup>.

In some cases the aggregator scheme could actually increase the number of dormant pots individuals have. Under current arrangements (and if the pots move with individuals to their new employer), if an individual leaves and then subsequently returns to a scheme their pot will be dormant for the intervening period only. By contrast, if the pot is automatically transferred to an aggregator scheme, it would remain as a separate dormant pot when they begin to save in their original workplace DC scheme again.

In the longer-run, when individuals accumulate a number of dormant pots, the aggregator scheme may in some cases – for a given pot size limit – achieve more consolidation than automatic transfers to the new employer's scheme. For example, with a £5,000 pot limit, an individual with four dormant pots each containing £3,000 would have all of them consolidated into a single aggregated pot, rather than be left with two dormant pots each worth £6,000 were they automatically transferred to the new employer's scheme.

Overall, the results of DWP modelling suggest that, for any given pot size limit, the aggregator scheme will achieve slightly less consolidation than automatic transfers to the new employer's scheme. An aggregator scheme is projected to make individuals retiring between 2050 and 2060 slightly less likely to retire with no dormant workplace DC pots and slightly more likely to retire with two or more dormant workplace DC pots (see Tables 4-6).

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<sup>4</sup> The Department's modelling suggests that on current policies around one in six individuals will retire with only one dormant DC pot (see Table 2 in the Impact Assessment). A proportion of those who retire with more than one dormant DC pot will also have only one that is below the pot size limit – there will be no consolidation for these individuals either.

**Table 1: Industry impact of automatic transfers with a £20,000 pot limit**

	Automatic transfer to new employer's scheme			Automatic transfer to aggregator scheme								
				New aggregator scheme			Mid-point			Using large existing scheme, e.g. NEST		
	No. of transfers	Reduction in dormant pots	Cost	No. of transfers	Reduction in dormant pots	Cost	No. of transfers	Reduction in dormant pots	Cost	No. of transfers	Reduction in dormant pots	Cost
2015/16	0.5m	-0.5m	£40m	1.6m	0.0m	£180m	1.5m	0.0m	£170m	1.4m	-0.1m	£155m
2016/17	0.7m	-1.2m	£50m	1.9m	-0.1m	£210m	1.7m	-0.2m	£190m	1.5m	-0.2m	£165m
2017/18	1.1m	-2.2m	£65m	2.1m	-0.3m	£235m	1.9m	-0.5m	£210m	1.7m	-0.7m	£185m
2018/19	1.3m	-3.5m	£60m	2.2m	-0.7m	£245m	2.0m	-1.0m	£210m	1.8m	-1.3m	£175m
2019/20	1.4m	-4.8m	£30m	2.3m	-1.3m	£235m	2.0m	-1.6m	£195m	1.7m	-2.0m	£155m
2020/21	1.4m	-6.1m	-£5m	2.3m	-2.1m	£220m	2.0m	-2.5m	£175m	1.7m	-2.9m	£130m
2021/22	1.5m	-7.4m	-£35m	2.4m	-2.9m	£210m	2.1m	-3.4m	£160m	1.8m	-3.8m	£110m
2022/23	1.6m	-8.8m	-£65m	2.3m	-3.8m	£180m	2.0m	-4.3m	£130m	1.7m	-4.8m	£75m
2023/24	1.6m	-10.2m	-£110m	2.2m	-4.7m	£140m	1.9m	-5.3m	£90m	1.7m	-5.8m	£35m
2024/25	1.5m	-11.4m	-£160m	2.3m	-5.7m	£125m	2.0m	-6.3m	£70m	1.7m	-6.8m	£10m
2030/31	1.6m	-18.3m	-£410m	2.3m	-11.5m	-£65m	2.0m	-12.2m	-£135m	1.7m	-12.8m	-£200m
2040/41	1.6m	-26.5m	-£855m	2.1m	-18.8m	-£420m	1.9m	-19.6m	-£505m	1.6m	-20.4m	-£590m
2050/51	1.5m	-30.4m	-£1.25bn	2.1m	-22.8m	-£725m	1.8m	-23.7m	-£830m	1.6m	-24.5m	-£935m
<b>NPV</b>			<b>-£7.90bn</b>			<b>-£1.65bn</b>			<b>-£2.85bn</b>			<b>-£4.10bn</b>

**Table 2: Industry impact of automatic transfers with a £10,000 pot limit**

	Automatic transfer to new employer's scheme			Automatic transfer to aggregator scheme								
				New aggregator scheme			Mid-point			Using large existing scheme, e.g. NEST		
	No. of transfers	Reduction in dormant pots	Cost	No. of transfers	Reduction in dormant pots	Cost	No. of transfers	Reduction in dormant pots	Cost	No. of transfers	Reduction in dormant pots	Cost
2015/16	0.4m	-0.4m	£30m	1.4m	0.0m	£155m	1.3m	0.0m	£145m	1.2m	0.0m	£130m
2016/17	0.6m	-1.0m	£45m	1.6m	0.0m	£180m	1.4m	-0.1m	£160m	1.3m	-0.2m	£140m
2017/18	0.9m	-1.8m	£50m	1.7m	-0.2m	£195m	1.5m	-0.4m	£170m	1.4m	-0.5m	£145m
2018/19	1.1m	-2.8m	£45m	1.9m	-0.6m	£205m	1.7m	-0.8m	£175m	1.4m	-1.0m	£140m
2019/20	1.1m	-3.9m	£25m	1.9m	-1.0m	£195m	1.6m	-1.3m	£160m	1.4m	-1.6m	£120m
2020/21	1.1m	-4.9m	-£5m	1.9m	-1.6m	£190m	1.7m	-1.9m	£145m	1.4m	-2.3m	£100m
2021/22	1.2m	-6.0m	-£30m	2.0m	-2.2m	£180m	1.7m	-2.6m	£135m	1.4m	-3.0m	£85m
2022/23	1.3m	-7.1m	-£50m	1.9m	-2.9m	£160m	1.7m	-3.3m	£115m	1.4m	-3.8m	£65m
2023/24	1.3m	-8.2m	-£90m	1.9m	-3.6m	£130m	1.6m	-4.1m	£85m	1.4m	-4.6m	£35m
2024/25	1.3m	-9.3m	-£125m	1.9m	-4.4m	£120m	1.7m	-4.9m	£70m	1.4m	-5.4m	£15m
2030/31	1.3m	-14.8m	-£325m	2.0m	-8.8m	-£20m	1.7m	-9.4m	-£85m	1.4m	-10.1m	-£150m
2040/41	1.3m	-21.5m	-£695m	1.8m	-14.5m	-£295m	1.6m	-15.4m	-£380m	1.3m	-16.3m	-£465m
2050/51	1.3m	-24.7m	-£1.00bn	1.8m	-17.8m	-£535m	1.5m	-18.8m	-£640m	1.3m	-19.8m	-£745m
<b>NPV</b>			<b>-£6.40bn</b>			<b>-£0.80bn</b>			<b>-£2.00bn</b>			<b>-£3.20bn</b>

**Table 3: Industry impact of automatic transfers with a £5,000 pot limit**

	Automatic transfer to new employer's scheme			Automatic transfer to aggregator scheme								
				New aggregator scheme			Mid-point			Using large existing scheme, e.g. NEST		
	No. of transfers	Reduction in dormant pots	Cost	No. of transfers	Reduction in dormant pots	Cost	No. of transfers	Reduction in dormant pots	Cost	No. of transfers	Reduction in dormant pots	Cost
2015/16	0.3m	-0.3m	£20m	1.1m	0.0m	£120m	1.0m	0.0m	£110m	0.9m	0.0m	£95m
2016/17	0.4m	-0.7m	£30m	1.2m	0.0m	£135m	1.1m	-0.1m	£115m	0.9m	-0.1m	£95m
2017/18	0.6m	-1.3m	£40m	1.3m	-0.1m	£145m	1.1m	-0.2m	£125m	0.9m	-0.4m	£100m
2018/19	0.8m	-2.0m	£35m	1.5m	-0.3m	£160m	1.2m	-0.5m	£130m	1.0m	-0.7m	£100m
2019/20	0.8m	-2.8m	£20m	1.5m	-0.6m	£160m	1.2m	-0.8m	£125m	1.0m	-1.1m	£90m
2020/21	0.8m	-3.5m	£0m	1.5m	-1.0m	£155m	1.2m	-1.3m	£115m	1.0m	-1.6m	£75m
2021/22	0.9m	-4.3m	-£20m	1.5m	-1.4m	£150m	1.3m	-1.7m	£110m	1.0m	-2.0m	£65m
2022/23	1.0m	-5.2m	-£35m	1.5m	-1.8m	£140m	1.3m	-2.1m	£95m	1.0m	-2.5m	£50m
2023/24	1.0m	-6.0m	-£60m	1.5m	-2.2m	£120m	1.2m	-2.6m	£80m	1.0m	-3.1m	£35m
2024/25	0.9m	-6.8m	-£90m	1.5m	-2.7m	£115m	1.3m	-3.1m	£70m	1.0m	-3.6m	£20m
2030/31	1.0m	-10.9m	-£235m	1.5m	-5.6m	£30m	1.3m	-6.2m	-£35m	1.0m	-6.9m	-£95m
2040/41	1.0m	-15.8m	-£505m	1.4m	-9.4m	-£150m	1.2m	-10.3m	-£235m	0.9m	-11.2m	-£315m
2050/51	0.9m	-18.3m	-£750m	1.4m	-11.8m	-£300m	1.2m	-12.8m	-£405m	1.0m	-13.9m	-£510m
<b>NPV</b>			<b>-£4.60bn</b>			<b>£0.20bn</b>			<b>-£0.95bn</b>			<b>-£2.05bn</b>

**Table 4: Percentage of people retiring between 2050 and 2060 with dormant workplace DC pots - with a £20,000 pot limit**

	Automatic transfer to new employer's scheme	Automatic transfer to aggregator scheme		
		New aggregator scheme	Mid-point	Using large existing scheme, e.g. NEST
No dormant pots	14.5%	10.0%	11.0%	11.9%
one	43.7%	42.7%	43.0%	43.3%
two	27.4%	30.3%	29.6%	28.9%
three	10.5%	12.5%	12.1%	11.7%
four	3.0%	3.5%	3.4%	3.3%
five or more	1.0%	1.0%	0.9%	0.9%

Note: data are column percentages

**Table 5: Percentage of people retiring between 2050 and 2060 with dormant workplace DC pots - with a £10,000 pot limit**

	Automatic transfer to new employer's scheme	Automatic transfer to aggregator scheme		
		New aggregator scheme	Mid-point	Using large existing scheme, e.g. NEST
No dormant pots	12.3%	10.0%	10.5%	11.0%
one	33.6%	31.6%	32.3%	33.0%
two	27.9%	28.3%	28.1%	28.0%
three	15.6%	18.2%	17.6%	17.0%
four	7.0%	7.7%	7.5%	7.3%
five or more	3.6%	4.1%	3.9%	3.7%

Note: data are column percentages

**Table 6: Percentage of people retiring between 2050 and 2060 with dormant workplace DC pots - with a £5,000 pot limit**

	Automatic transfer to new employer's scheme	Automatic transfer to aggregator scheme		
		New aggregator scheme	Mid-point	Using large existing scheme, e.g. NEST
No dormant pots	11.3%	10.1%	10.3%	10.6%
one	26.4%	23.9%	24.6%	25.3%
two	25.3%	24.9%	25.2%	25.4%
three	18.0%	19.2%	18.9%	18.7%
four	10.0%	11.4%	10.9%	10.5%
five or more	8.9%	10.5%	10.0%	9.6%

Note: data are column percentages

## Notes

1. Based on PENSIM2. Assumes automatic transfers begin in 2015/16
2. It is assumed that the cost of a transfer is £105 and the cost of administering a dormant pension pot is £25 per annum. This is based on independent research carried out for the Department<sup>5</sup>. Because these costs reflect internal labour time, they are up-rated in line with average earnings growth.
3. Volumes rounded to the nearest 0.1m.
4. Costs expressed in constant (2012) prices and rounded to the nearest £5m.
5. Savings expressed as negative values.
6. NPV calculated over 39 years and rounded to the nearest £0.05bn. A discount rate of 3.5% for the first 30 years and 3.0% thereafter has been applied, in accordance with Green Book guidance.
7. Pot size limits set in 2012 and up-rated in line with the average earnings growth.
8. Percentages relate to individuals who reach retirement age between 2050 and 2060
9. Pots in the aggregator scheme which are not being actively contributed to are counted as dormant.

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<sup>5</sup> For more information see <http://www.dwp.gov.uk/docs/small-pots-automatic-transfers-impact-assessment.pdf>

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