Small Pots Working Group Report

A report to the Minister for Pensions and Financial Inclusion with recommendations to tackle the growth of deferred members with small pension pots in the Automatic Enrolment workplace pensions market

December 2020

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Ministerial Foreword – by the Minister for Pensions and Financial Inclusion

This report is a vital first step on a key issue. I thank the small pots Working Group for their efforts. Everyone accepts that automatic enrolment has been a success, but issues remain that we want to address in the near future. The growth in the number of deferred small pots and the impact on the consumer is an issue that we are determined to address.

Extending workplace pension saving within a labour market that is as dynamic as the UK's necessarily comes with challenges, in particular, the number of pension pots an individual might accumulate over their working life. Estimates suggest that on average an individual has in excess of ten jobs in their lifetime

It is vital that the pensions industry, regulators and Government work together to overcome these challenges. Given the risks that the growth of small pots presents to scheme members and their access to good quality pension provision, it is imperative that workable solutions are identified and successfully implemented. For this reason, I established a Working Group in September 2020 to assess and make recommendations to Government, as a first step, on ways to tackle deferred, small pension pots.

My ambition is that scheme members should be able to realise the best possible outcomes from their workplace pension savings. Consolidation of deferred small pots in the automatic enrolment market is a key part of this – but it will take time to develop and implement effective solutions. The Working Group's analysis and conclusions provides a framework to enable progress. It is clear from their work that more needs to be done by pension providers, working together with regulators and Government, to overcome administrative challenges. And I also support the work by providers and others on developing proof of concept trials to help move towards solutions. Alongside working with the pensions industry, the Government will consider the outcomes from the Work and Pensions Select Committee's examination of the issues. We will also carefully examine international practices to understand approaches most likely to work within the UK landscape. Taken together, this will provide a stronger foundation for change over the medium term.

Scheme members should benefit from an efficient, competitive and transparent workplace pensions system. This will continue to underpin our approach to consolidation of small pots and member protection, including charges being controlled effectively.

I am grateful to the members of the Working Group and the expert panels for their work and the valuable contributions during this process. I also value the input of the wider pensions industry and individuals, business and consumer groups who have contributed to this initiative. They have produced an impressive analysis of complex issues at pace, with a route to make headway. This is significant step forward in finding workable solutions to tackle small pots, which I am going to study in detail with the Department in 2021.

Guy Opperman, MP
Minister for Pensions and Financial Inclusion

Executive Summary

Introduction – Small Pots Working Group

In September 2020, the Minister for Pensions and Financial Inclusion set up a cross-sector Working Group chaired and facilitated by the Department for Work and Pensions (DWP) to make recommendations to the Government, as an interim step, on ways to tackle the growth of deferred, small pension pots in the Automatic Enrolment (AE) workplace pensions market. The group was invited in particular to focus on Master Trust schemes, launched to serve the employees of employers newly brought into workplace pension saving by AE, given the actual and projected increase of deferred members with small pots in this sector.

The Working Group has been encouraged by the broad level of support in relation to its conclusions and recommendations. The growth in the number of small, deferred pension pots is not in the interests of pension scheme members, pension providers or the tax-payer. It brings potential cost consequences for all parties and without action the situation will likely prove to be unsustainable. However, the most significant impact is that scheme members will not experience the best possible outcomes from their workplace pension savings.

In the Working Group's view, the strategic goal for the Government and the pensions industry, over the medium term, should be to make consolidation of deferred, defined contribution small pots the norm within the AE workplace pensions market. This would support an efficient, competitive and transparent workplace pensions system for the benefit of scheme members. It will necessitate automatic and automated solutions, which can complement member-initiated transfers and consolidation. Recognising the complexities and trade-offs involved in various consolidation options however, workable solutions will take time to develop and implement at scale.

This report provides recommendations for the pensions industry and Government to work together to develop and implement effective solutions. The first stages are for pension providers and their representatives, working with Government and regulators, to investigate and address administrative challenges, including how to enable low-cost mass transfers within the AE workplace pensions market and to test proof of concept proposals, following feasibility work. This is a pre-requisite to inform and build large-scale transfer and consolidation systems that are efficient at scale. It should be underpinned by in-depth analyses of member benefits; implementation matters and value for money assessments. This report suggests a framework, with a roadmap, to support progress.

Automatic enrolment

Automatic enrolment (AE) has succeeded in transforming workplace pension participation for millions of workers. Since its introduction in 2012, the policy has led to an increase in workplace pension coverage among eligible employees from 55 per cent in 2012 to 88 per cent in 2019.[1]

[1]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/892841/workplace-pension-participation-and-saving-trends-2009-2019.pdf

Extending workplace pensions to lower earners and people who move jobs frequently – without corresponding action on pension transfers and consolidation in respect of the mass market – has created an increased risk that an individual's pension savings could become fragmented into a number of deferred, small pension pots.

The Pensions Policy Institute (PPI) estimate that, without intervention the number of deferred pension pots in Master Trust schemes could increase from 8 million to as much as 27 million by 2035[2]. Many of these deferred pots are likely to be small, with the current average pot size within Master Trust schemes estimated to be around £1,000.

Deferred, small pots consolidation – making the market more efficient

The proliferation and growth in deferred, small pension pots within the AE workplace pensions market presents a number of risks for scheme members, pension providers and the reputation of AE.

For members of AE workplace pension schemes in particular this includes:

- the erosion of small deferred pots where certain combination charge structures are applied;
- scheme members losing track of workplace pension savings, with potential growth of avoidable dormant small pension pots;
- a disincentive to member engagement in saving and planning for later life; and
- the cost and inefficiency in the system, which could be passed onto the scheme members.

For pension providers, the risks are that:

- they could find that managing large numbers of small deferred pots is unsustainable; and
- ultimately, they could face being wound up if they fail to meet their responsibilities.

For the reputation of AE:

- charging out very small pots can attract unfavourable publicity;
- retaining very small pots by themselves could create the impression that AE is not worthwhile; and
- if fragmented deferred small pension pots result in sub-optimal workplace pension saving, due to the risks outlined, this could create future fiscal risks.

Some policies and changes in the market respond to some of these risks. In particular:

- the Department has indicated that action on 'charging out' is a priority as part of its response the 2020 Charges Review. Applying a minimum pot floor before flat member charges are levied would protect deferred members with small pots within providers operating this charging structure. A de minimis would need to be set at a level that balances this risk to members with the financial sustainability of schemes serving them; and

[2] https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf

- the introduction of Pensions Dashboards will enable individuals to access their pensions information online, securely and all in one place, thereby supporting better planning for retirement.

- Simpler annual benefit statements for defined contribution schemes used for AE will help enable members to better understand their pension pots through simpler and more consistent presentation of information and will support their retirement planning.

While these policies and changes respond to some of the risks, by themselves they would not reverse the trend in the growth of deferred small pots, protect all members from pot erosion – or remove the totality of costs in the system. This has consequent impacts on those consumers for whom AE was designed to serve, and the ability of the market to serve them. It also means regulation is necessary within the system to protect consumers which can add to complexity and cost.

Consolidation solutions present an opportunity to make the AE workplace pensions market more efficient and improve member outcomes. The key benefits are that consolidation could reduce member charges and provider costs as members would be paying for fewer pots and providers would avoid duplication involved in administration. In order to realise the cost/benefits of consolidation models for members, further work would be necessary to understand and limit the impact of transaction costs, in addition to the pensions industry's examination of administrative processes to enable mass transfers (which is further discussed in the following sections).

The current evidence base suggests that automatic transfer and consolidation systems will be necessary to complement member initiated transfers, given the latter is not expected to have a transformative impact in resolving the deferred small pots challenge for the mass-market. This is supported by international experience – including in Australia, the US and others – which reveals that scheme-led default consolidation solutions are needed to complement member enabled action.[3]

What is a 'small pot'?

In their July 2020 report, the PPI estimated that the average pot size within Master Trust schemes was approximately £1,000.[4] To further explore the size distributions of deferred pension pots, the Department carried out a data gather across the books of five of the largest defined contribution (DC) pension scheme providers, predominantly Master Trust schemes.

The data collected refers to August - September 2020 and encompasses 11.2 million deferred pension pots. The data suggests that almost three quarters (74 per cent) of all deferred pots in the sample are smaller than £1,000 whilst a quarter (25 per cent) are smaller than £100.

The data should not be interpreted as representative of the size distribution of deferred pots in the overall DC market, given its focus on a small number of large schemes. Qualitative feedback from

[3] PPI report 'How have other countries dealt with small, deferred member pots' – due to be published January 2021.
[4] https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf

members of the Working Group suggests that the scale of small, deferred pots varies across provider types – but the distributions presented offer a useful indicative view of the nature of the small, deferred pots challenge for some of the largest DC providers in the market.

Structural changes aimed at delivering consolidation will require considerable careful thought and analysis to develop and implement appropriate solutions, beyond the scope and short timescale of this Working Group.

- As part of the evidence development, a more granular analysis of the value and distribution of deferred small pots, starting with the PPI led Pensions Data Project, focussed on a small number of Master Trusts in the first instance, will help to provide a more comprehensive view of the small pots challenge at the member level and seek to show the extent to which individuals' pots are held within the same scheme or distributed across multiple providers. Beyond the Pensions Data Project, the Department will look to work more broadly across industry to continue to build evidence on the scale of the challenge; recognising that without a data solution this is not quick or easy;

- The value of small pots held by deferred members may also vary according to the type of pension scheme (if held in the Master Trust or contract based AE pensions market), and what constitutes 'a small pot' will vary according to the type of consolidation solution under consideration. This means that the definition of the value of deferred small pots will need to be re-visited as both the evidence-base and the precise consolidation solutions are further developed.

Prioritising consolidation solutions – guided by administration process reform

The evidence gathered through the Working Group and from international comparisons reveals that the core underlying administrative processes are fundamental to the successful delivery of high-volume, low-cost consolidation systems. In the Working Group's view analysis and development of core administrative process should inform decisions on consolidation solutions. The evidence and feedback from experts during this process has indicated that core processes will be similar, irrespective of solutions, albeit sub-processes will differ.

The industry and Government should prioritise progress on administration processes to enable large scale consolidation so that workable solutions can be developed. International evidence reveals that:

- Without unique identification numbers, centralised transfer and consolidation systems are less effective;
- Systems of transfer and consolidation are easier for employers to comply with when there is a central platform; and
- Unified data standards ensure a less costly and speedier transfer system.[5]

[5] PPI report 'How have other countries dealt with small, deferred member pots' – due to be published January 2021.

Whilst changes to administrative processes and systems will likely require considerable industry investment, some of the building blocks and learnings are emerging. The Pensions Dashboards Programme (PDP) is developing data standards for enabling find and view dashboards services. While this is being created for a specific purpose and context, it provides the pensions industry with a starting point to build-out from for the purposes of underpinning future large-scale deferred small pot consolidation.

The pensions industry should focus initially on identifying, developing and testing what combinations of data provide sufficient matching capability, as a proxy for a unique reference. Developing matching capability will be vital in enabling providers to verify the identity of the person whose pot(s) will be transferred is the same as the identity of the person whose pot will receive the transfer.

Learnings from both the PPI-led Pensions Data Project and also from the Pensions Dashboards Programme's provider testing over 2021/22 should be maximised, where relevant, in terms of identifying and building suitable data matching capability. The latter will not, however, directly assist with scheme member verification given Pensions Dashboards current service delivery model relies on user consent for the find and view service. In the context of automatic transfer and consolidation of deferred small pension pots, pension providers would need to verify and match 'ownership' on behalf of the scheme member without consent at scale, with proportionate safeguards.

Member-exchange proof of concept trials involving low value small pots within Master Trust schemes to test the concept should be developed and prioritised by the pensions industry, starting with a feasibility report in summer 2021 after in-depth scoping work. This has the potential to provide the industry with useful learnings in relation to testing data-matching capability and processes, including the costs within the transfer system. It will also afford the opportunity to gather consumer feedback from those whose pots have been consolidated.

Consolidation models have been prioritised by the Working Group for further exploration in terms of the impact on deferred small pot consolidation and the wider finances of the AE industry, but final decisions should be informed and developed following the pensions industry's investigation and examination of administration processes and systems. There are two non-mutually exclusive automatic transfer and consolidation models that should be prioritised for low value small pots – the default small pot consolidation scheme ('default consolidator' including the various design choices) and the automatic pot follows member model. These models, which are discussed in-depth in Chapter four of this report, could complement member-initiated consolidation.

The pensions industry should establish time-bound operational groups involving pension providers; regulators; and Government to start investigating and addressing administrative challenges which will be necessary to underpin mass transfer and consolidation systems that can be delivered at scale within the AE market. These should start with a focus on Master Trust schemes as the evidence suggests deferred small pots are more of a challenge here. However, any approach developed will need to be workable for the industry as a whole.

The report identifies micro pots as particularly small pots that constitute a sub-set of the wider small pots challenge, typically in the range of £50 to £250, although in some cases even smaller. Through exploratory analysis of Real Time Information (RTI) employee pension contributions data from HMRC, building on provider-conducted member survey information, a more detailed understanding of some of the potential main drivers that result in micro pots are emerging. This suggests that for the majority of small deferred pots it is employment ending and transitions to new jobs that drives growth of small pots, rather than active decisions to discontinue saving. A detailed explanation of this analysis is provided in Chapter two. While there does not appear to be a sufficiently robust evidence-case to justify recommending changes at this stage, the Working Group explored the trade-offs, including the potential advantages and risks relating to proposals including: extension to the opt-out window; refunds; and the effectiveness of current guidance / process. The Working Group recommends these areas are kept under review in light of the developing evidence base concerning micro pots and the opportunities to improve understanding of member behaviours and motivations.

Working group approach

The Terms of Reference for the Working Group are included at Annex A, these asked the Working Group to:

- examine the scale and nature of deferred, small pension pots to scope the problem that needs to be addressed, looking at the whole AE market, with a particular focus on Master Trust schemes at this point;

- gather evidence, engaging with consumer, employer and other interested parties, with the aim of building consensus on the priority options to tackle the problem; and

- provide reasoned recommendations to the Department's Ministers as an interim step, on the most appropriate option or combination of options, with an indicative roadmap of the issues and actions (including pilots and trials) for industry, delivery partners in the supply chain and Government to help inform the Department's consideration of next steps.

The Working Group was asked to consider key guiding principles in weighing up conclusions and recommendations, with a focus on enabling value for scheme members. The principles, which are contained in the Terms of Reference, have underpinned the analysis, conclusions and recommendations.

Throughout its consideration of the small pots issue the Working Group has placed great importance on avoiding any risk that potential solutions might undermine the enormous success already achieved by the AE regime.

The Working Group has actively engaged with interested parties throughout the process and has itself been supported by a range of expert panels, representing a broad cross-sector of interests. The panels have represented: consumer groups; Master Trust pension schemes; contract-based pension schemes; employers and organisations representing delivery agents and technical experts, including payroll bureaux and software firms.

As part of its engagement with the expert panels the Working Group carried out an evidence gather, supported by the Department, which was aimed at obtaining and summarising information about the different consolidation models; the administrative processes necessary to underpin mass-market solutions and the trade-offs involved in choices and sequencing of activity.

The Group also carried out a number of small-scale member surveys concerning the risks associated with small deferred pots and the various models of consolidation which provided information about members' perspectives. The member survey outputs have strengthened the foundation for future member-focussed research. A summary of insight gathered from the member surveys is provided in Chapter two and further methodological details are included in Annex E.

The Department has produced detailed analysis concerning small pots and micro pots to enable the Working Group to examine the scale and nature of deferred, small pots in the AE market based on available data. The available information has been included as part of this report. The Working Group members have also been provided with headline information in the PPI report 'How have other countries dealt with small, deferred member pots', which has been helpful in understanding broader international insights and perspectives.

In addition to evidence and feedback gathered during the process, the Working Group benefitted from insights and input from a roundtable 'challenge' session on 18 November. This was attended by the Minister for Pensions and Financial Inclusion with industry business leaders, trustees and pensions experts. This enabled emerging conclusions and recommendations to be shared, discussed and further tested. This has helped to inform the Working Group's final recommendations, which are contained in this report.

The Working Group members and the Department have been highly appreciative of and impressed by the degree of engagement; enthusiasm and thoughtful input that has been provided throughout this process, particularly given the short periods involved, consistent with the Terms of Reference and timescales for this project.

Summary of Recommendations

The Small Pots Working Group identified the following conclusions, recommendations and actions for the pensions industry and Government to work together to develop effective solutions, with the aim of delivering better value for scheme members. We are calling on the pensions industry including pension providers, their representatives and delivery agents, working jointly with Government and regulators, to take forward these recommendations over the medium term:

- The pensions industry, Government and regulators should continue to explore and enable opportunities for member-initiated consolidation, with proportionate member safeguards, particularly in respect of deferred, small pots above a certain value. This can complement other interventions that will be necessary for deferred low value pension pots. Technology and tools, such as Pensions Dashboards that allow members to view all pots with different providers in one place, could facilitate more consolidation in the future.

- Member-led consolidation alone, however, is unlikely to change the trend in the growth of defined contribution (DC) deferred, small pots. The pensions industry, working jointly with Government, should prioritise action on enabling automatic and automated large-scale low-cost transfers and consolidation for the AE mass-market. Member safeguards should provide proportionate protection, but not act as a barrier.

- Where pension providers are holding multiple pots within charge-capped default funds for the same deferred members, the direction should be to consolidate those pots. Recognising, however, that it is not always possible or desirable (for example because of member consent associated with scheme terms and conditions), we recommend pension providers should in the interim work towards implementing a single consumer facing view (within a single member portal, with information on their pension pots). It could be achieved, following scoping work in 2021/22, through adoption of industry best practice and regulatory guidance.

- The pensions industry should establish operational focussed groups, to investigate and address administrative challenges which will be necessary to underpin mass transfer and consolidation systems that can be delivered at scale within the AE market. Consideration will need to be given to the appropriate governance structure to ensure effective transparency and reporting arrangements. The groups should focus on the following areas, with the aim of making available an initial publicised update in summer 2021.

  a) Activity should be prioritised on scoping the core minimum viable administrative processes, including:
     - Developing and testing data that would provide sufficient matching capability, compliant with data sharing legislation, (as a proxy for a unique reference) to verify the identity of the person whose pot(s) will be transferred is the same as the identity of the person whose pot will receive the transfer. Opportunities to build out from data-matching in relation to Pensions Dashboards; the PPI's work on the Pensions Data Project and industry good practice should be maximised.

- Developing and adoption of common standards is a key underlying element to support effective consolidation. The Pensions Dashboards data standards[6] would provide a starting point to build out from, which could then be tested by providers ahead of confirming standards which could be codified by the industry.

- Identifying requirements for a low-cost bulk transfer process. This should start with an end to end review of the current individual transfer process to identify where cost occurs in the system and where friction can be removed – however mass transfers which are non-member led may necessitate new approaches to achieve low-cost delivery, while maintaining proportionate safeguards for members.

b) Member-exchange proof of concept trials involving low value small pots within master trust schemes to test the concept should be developed and prioritised, starting with a feasibility report in summer 2021, following in-depth scoping work:

- This should involve trustees and finance directors to test if they are prepared to run proof of concept trials and if it can provide sufficient learning for purposes of a real-world context and outcomes, with consideration of legal and other factors;

- Proof of concept trials offer opportunity for learning through testing administrative processes in the context of mass transfers and consolidation.

  - This includes, the prospect to investigate and test matching capability; use and development of data standards; the costs in the transfer process, in addition to end to end customer journey mapping and the appropriate safeguards necessary for members, with potential qualitative feedback gathered from those whose pots were consolidated.

  - In order to build beyond the proof of concept trials and ensure learnings are more broadly applicable, it requires the involvement of a wider group of stakeholders, including contract-based providers, consumer representatives and regulators.

• Consolidation system models can be prioritised, but final decisions should be informed and developed following the pensions industry's investigation and examination of administration processes and systems through an operational group. There are two automatic transfer and consolidation models that should be prioritised for low value small pots – the default small pot consolidation scheme ('default consolidator' including the various design choices) and the automatic pot follows member model. These models are discussed in-depth in Chapter four.

  - We recommend that the Department, working with the pensions industry, should start to develop an initial costs/benefit analysis in the latter half of 2021 to help to further assess the models, including how these models complement Pensions Dashboards and reflect learning from the work on administrative processes to help better understand the VFM considerations, as far as evidence allows.

[6] https://www.pensionsdashboardsprogramme.org.uk/2020/12/15/data-standards-guide/

- The pensions industry, working with the Department, should develop customer journey mapping in relation to the models to understand the end to end process and to provide a deeper appreciation of the impacts, mindful of changes to the operating and delivery context.

Chapter 1 - Introduction

Automatic Enrolment – normalising workplace pension saving

Automatic enrolment (AE) has succeeded in transforming workplace pension coverage among the eligible working-age population. Since its introduction in 2012, the policy has led to an increase in workplace pension participation among eligible employees from 55 per cent in 2012 to 88 per cent in 2019[7]. And as a result of this, in 2019/20, it is estimated an extra £18.8 billion per year was saved into workplace pensions.[8] AE has extended workplace pension coverage to the mass market, including young people, low earners and women – many for the first time.

Key to the success of AE has been the evidence-based approach which underpins the policy and the broad consensus that the policy has been based on which has been supported by successive governments. The successful design, development and implementation of AE has resulted from the commitment and support throughout the delivery supply-chain, in particular partnerships involving Government, regulators, employers, payroll firms, intermediaries and the pensions industry.

The deferred small pots challenge – resulting from automatic enrolment

Making workplace pension saving the norm, including for lower earners and people who move jobs frequently created an increased risk that an individual's pension savings could become fragmented into a number of deferred, small pension pots.

This challenge was a known issue during the design and development of AE prior to its implementation. Following recommendations by the 2010 Making Automatic Enrolment Work review[9], the Government introduced the earnings trigger and a postponement period in the AE framework. Taken together this helps to ensure that many who would benefit from the policy are not excluded, while also ensuring that very tiny levels of pension contribution resulting from enrolling those who leave quickly after commencing employment are minimised. However, extending workplace pension enrolment to sectors of the labour market with high employee churn and employers using short term contracts, without corresponding action on pension transfers and consolidation in respect of the mass market, has meant that there is a consequent growth in deferred, small pension pots within the AE pensions market.

In their recent report the Pensions Policy Institute estimate that, without intervention the number of deferred pension pots in Master Trust schemes could increase from 8 million to as much as 27

[7]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/892841/workplace-pension-participation-and-saving-trends-2009-2019.pdf

[8] https://www.gov.uk/government/publications/automatic-enrolment-review-of-the-earnings-trigger-and-qualifying-earnings-band-for-202021/review-of-the-automatic-enrolment-earnings-trigger-and-qualifying-earnings-band-for-202021-supporting-analysis

[9] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/214585/cp-oct10-full-document.pdf

million by 2035[10]. Many of these deferred pots are likely to be small, with the current average pot size within master trust schemes estimated to be around £1,000.

The proliferation and growth in deferred, small pension pots within the AE workplace pensions market presents a number of risks for scheme members, in particular this includes:

- the erosion of small deferred pots where certain combination charge structures are applied;
- scheme members losing track of workplace pension savings, with potential growth of avoidable dormant small pension pots;
- a disincentive to member engagement in saving and later life planning; and
- the cost and inefficiency in the system, with dis-benefits for pension providers and members.

Some policies and changes in the market – including Pensions Dashboards – respond to some of these risks. The Department has indicated that action on 'charging out' is a priority as part of the 2020 Charges Review consultation. However, this will not reverse the trend of the growth in small deferred pots or remove the totality of costs in the system. And this has consequent impacts on those members for whom AE was designed to serve, and the ability of the market to serve them.

Consolidation of deferred small pots, therefore, presents an opportunity to make the market more efficient and reduce costs for members. It should be expected that a high number of small pots are held within a small number of pension providers, predominantly those providers – including Master Trusts – who entered the market since 2012 and made considerable investment to serve small and micro employers to meet their AE obligations.[11] These providers have contributed to the transformation of workplace pension participation among those savers who were historically not well served by the market.

Consolidation of small deferred pots presents an immediate benefit for members: if costs can be removed they will only be charged a flat fee once in respect of unified deferred small pots, (which are currently held by different schemes). If the totality of costs can be reduced within the AE pensions market, then there is greater opportunity for pension providers to reduce charges over time and improve quality for the member.

Large scale automatic and automated consolidation solutions are necessary, but implementation will involve a journey if members are to continue to benefit from a thriving and sustainable market. There are a number of factors which impact on schemes financial sustainability including: capital and administration costs; the charges structure; and the general levy. On top of this, AE remains in its infancy which means average balances within schemes are relatively low so that revenue from charges is in many cases not sufficient to cover costs on that pot, resulting in cross-subsidy. Addressing this of course involves trade-offs, which means striking the right balance between providing value for members and enabling the market which serves them to continue to thrive in order to meet member needs.

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[10] https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf

[11] https://www.pensionspolicyinstitute.org.uk/media/3270/20190919-the-dc-future-book-2019.pdf

Why are we looking at this now?

The Department for Work and Pensions (DWP) previously looked at the challenge of small pots extensively in 2011, and considered potential solutions to this problem, with legislation being introduced via the 2014 Pensions Act to implement automatic transfers. However, in 2015 it was decided that it was not the right time to ask the pensions industry to absorb the new swathe of regulation that would be needed to make such further reforms work effectively. Suggesting that the market needed time and space to adjust to the other reforms underway and these areas would be revisited once there has been an opportunity for that to happen.[12]

On 22 September 2020, the Minister for Pensions and Financial Inclusion launched the small pots Working Group and signalled that now is the right time to look at the challenge of small pots again as enabling consolidation presents a significant member opportunity for greater personal ownership which will help people to understand and maximise their savings. The Minister made clear that members interests should be put at the heart of this work.

There is a desire, across industry and Government, to address the small pots challenge over the medium term and to reduce the costs and inefficiencies in the market for members and providers through action on transfers and consolidation.

Role and remit of the Small Pots Working Group

The Working Group, launched by the Minister, was set up to examine the scale and nature of deferred, small pots, looking at the whole of the AE pensions market but with a particular focus on Master Trust schemes at this stage. A further objective of the Working Group was to gather evidence with the aim of building a consensus on the priority option, or combination of options, that build on the NOW: Pensions sponsored Pensions Policy Institute report findings[10], in addition to other evidence to help tackle the growth of deferred member, small pension pots.

The Working Group involved experts from within the pensions industry; consumer and member; employer and payroll / software organizations and representatives, in addition to trade union representatives. The group was supported and informed by a range of expert panels representing a wide range of interested parties. The expert panels comprised: Master Trust pensions schemes; contract based pensions schemes; single employer based pension schemes; employer representatives' member / consumer representatives; and implementation / technical practitioners, including payroll professionals.

The Working Group approach

The initial stages focussed on clarifying the policy challenge and understanding the available evidence on the scale and nature of deferred small and micro pots. This included identifying areas for further analysis, including international evidence. As part of this stage, the Working Group chairs held evidence gathering sessions with the expert panels to gather input from a cross-section of interested parties. This stage included an evidence survey gather, supported by the Department's analysts, with expert panels on the various consolidation models and underlying administrative processes, in addition to input on combining / sequencing models.

[12] https://questions-statements.parliament.uk/written-statements/detail/2015-10-15/HLWS238

As part of the second stage the Working Group members focussed on assessing and considering consolidation options and processes needed to enable large scale consolidation systems, this included assimilating feedback from the evidence gather. This was augmented through a series of further meetings with expert panels, which provided opportunity to consider each consolidation option in greater depth, as well as clarify matters and identify emerging themes. This identified the need to continue to take a bottom up approach, in terms of determining practical implications; processes and delivery to implement models at scale. A member survey evidence gather was carried out which helped to identify areas for potential further research.

As part of the final stages the evidence and input was assembled and assimilated to help develop and assess the themes; emerging arguments; and to distil conclusions. It included further in-depth assessment of options against the guiding principles. This also provided opportunity to distil further research questions and develop the forward research plans and roadmap to inform the subsequent phases for the next steps of this work.

In addition to evidence and feedback gathered during the process, the Group benefitted from insights and input from a roundtable 'challenge' session. This was attended by the Minister for Pensions and Financial Inclusion with industry business leaders, trustees and pensions experts. This enabled emerging conclusions and recommendations to be discussed and tested, which helped to inform the Group's final recommendations in this report.

The input and evidence received as part of this process has been reflected in this report, which includes how it has helped to inform and shape the conclusions and recommendations. The Working Group has been encouraged by the broad degree of support it has reached in developing its conclusions. This is intended as a framework to support the next phases of the work, including in-depth debate and examination of consolidation models, following the first stages on administrative processes. We would like to thank all individuals and organisations for their valuable input through this process. A list of those involved in the expert panels is at Annex C.

Small pots working group guiding principles

The Small Pots Working Group agreed on guiding principles and working assumptions which any potential policy solution would be assessed against.

These principles were set out to allow the Working Group to consider and prioritise the options and associated issues and actions to balance costs and benefits for scheme members, pension providers and employers.

<u>Working Group principles</u>

- Build on the success and behavioural insights of AE, and optimise retirement outcomes
- Promote value and transparency for savers;
- Minimise administrative burdens for pension providers and employers (including SMEs)
- Support competition and a vibrant pensions market for members;
- Fit with the direction of HMG's existing pension policies and reforms, including Pensions Dashboards; and
- Maximise affordability and sustainability for members, employers, pension providers and tax-payers.

In considering the policy challenge and the principles the Working Group identified more detailed working assumptions, which helped frame and develop the thinking. These included a key assumption that any solution should augment AE, protecting and locking in its success and not lose gains achieved. Consideration was given to the importance of Value for Money (VFM) outcomes for members, as well as aiming that solutions should support savers on their engagement / saving journey; whilst promoting trust within the pensions industry among savers.

Chapter 2 - Small, deferred pots challenge

This chapter sets out the small, deferred pots challenge. Evidence from a range of sources is presented including: published Departmental and external research; new analysis conducted by the Department; and insights from the Working Group's stakeholder engagement activities, together with structured input from expert panels supporting this project. The combination of this evidence is used to investigate the scale and nature of the small, deferred pots challenge; the drivers of trends; and the implications for both individuals and scheme providers.

Defining the scale and nature of the problem

Extent of deferred pots (current and projected)

The number of deferred, DC pension pots has grown substantially since the introduction of AE in 2012. Departmental modelling conducted in 2012 estimated that AE was expected to create around 50 million deferred pension pots by 2050, around 12 million of which would be under £2,000 and 33 million under £10,000.[13] Eight years on, the PPI now estimate that the number of deferred DC pension pots in Master Trust schemes alone is approximately eight million with the ratio between active and deferred pots reaching 50:50 in April 2020.[14] Not all of these deferred DC pension pots are necessarily small. However, as below sections will go on to demonstrate, a substantial proportion are and findings from recent analyses indicate that many deferred pots are extremely small (less than £100). Whereas modelling developed at the time of AE's introduction used larger pot values (e.g. £2,000, £10,000) to delineate the parameters of the small pots challenge, the latest evidence on pot size distributions suggests a proliferation of substantially smaller pots than those that may have initially been foreseen.

The majority of individuals who are automatically enrolled join a Master Trust scheme and are more likely to be in the AE target group of low earners and possibly change jobs more frequently than other savers.[15] Analysis of Declaration of Compliance data published by The Pensions Regulator (TPR) demonstrates the substantial role that Master Trust schemes have played in AE.[16] As at March 2019, 84 per cent of employers declaring compliance with their AE duties did so using a Master Trust scheme. This also accounted for a majority (61 per cent) of eligible employees. As well as their size, we might expect that these newer DC providers are likely to be highly concentrated on serving sectors of the labour market comprising employers with business models which are built on shorter term employee contracts.

Whilst both the scale of Master Trusts in terms of AE and their role in pension provision for higher turnover sectors of the labour market suggest that they will account for a substantial proportion of deferred pension pots created since 2012, data from other DC pension scheme providers indicates that the rise in deferred pots is not limited to Master Trusts alone. For example, analysis

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[13] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/191697/automatic-transfers-consolidating-pension-savings.pdf

[14] https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf

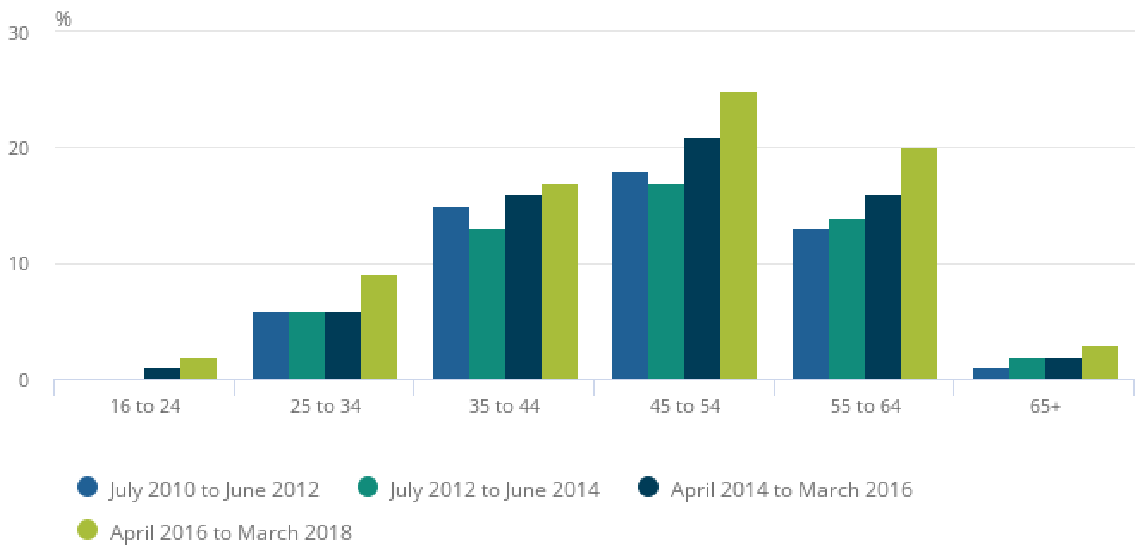
[15] https://www.pensionspolicyinstitute.org.uk/media/3270/20190919-the-dc-future-book-2019.pdf

[16] https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/automatic-enrolment-commentary-analysis-2019.ashx

published by Corporate Adviser in 2020 found that all 30 providers in their sample (comprising both Master Trusts and GPP schemes) had seen the ratio of active to deferred members decrease significantly in 2019.[17] In December 2019, they estimated the ratio of active to deferred pots including all schemes in their sample at approximately 12:10.

The increasing prevalence of deferred DC pension pots over the period of time since the introduction of AE is also reflected in trends observed in survey data. Using data from the Wealth and Assets Survey (WAS), analysis conducted by the Office for National Statistics (ONS) in 2018 demonstrates that the share of people with deferred defined contribution pensions has increased across all age groups between July 2010 and March 2018 (Figure 0.1).[18]

Figure 0.1. Proportion of individuals with preserved defined contribution pensions, by age band, Great Britain, July 2010 to March 2018.



Source: Source: Office for National Statistics – Wealth and Assets Survey

Looking forward, the PPI's modelling suggests that without policy change the number of deferred pots in Master Trust schemes could grow from eight million to 27 million by 2035 without intervention and assuming no linking of pots where a member saves multiple times with the same scheme (Figure 0.2).[19] The number of active pots is projected to increase slightly (to nine million) largely driven by the Government's ambition to change certain AE eligibility criteria which the modelling assumes is implemented in the mid-2020s. An important part of further developing projections such as these, will be to continue monitoring observed trends in the growth of deferred pot numbers. The trends observed to date indicate fairly rapid growth of deferred pots since the introduction of AE. However, it is important to bear in mind that the AE market is still relatively young and that longer term trends in pot numbers will likely be influenced by changes in the

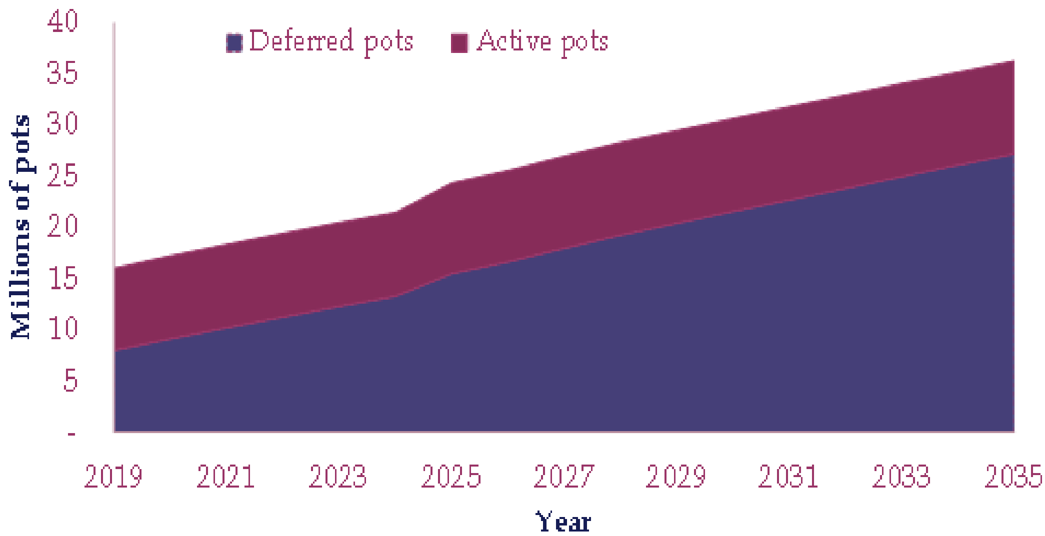
[17] https://corporate-adviser.com/ca-master-trust-gpp-report-reveals-sector-growth-performance-and-asset-allocation/

[18] https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/pensionwealthingreatbritain/april2016tomarch2018#preserved-pension-wealth

[19] https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf

market as it matures (e.g. trends in scheme consolidation), provided schemes operate internal consolidation.

Figure 0.2. Projected number of pots among master trust schemes by year, by deferred and active pots, without policy change.



Source: PPI modelling from "Policy options for tackling the growing number of deferred members with small pots" (2020)

Deferred pots by size

Thus far, we have discussed estimates of and trends in the overall extent of deferred pension pots. However, given the risks associated with small, deferred pots (outlined in Chapter one and in greater detail below), it is vital to investigate the distribution of deferred pots by size so that we can understand how many pots may be subject to these risks.

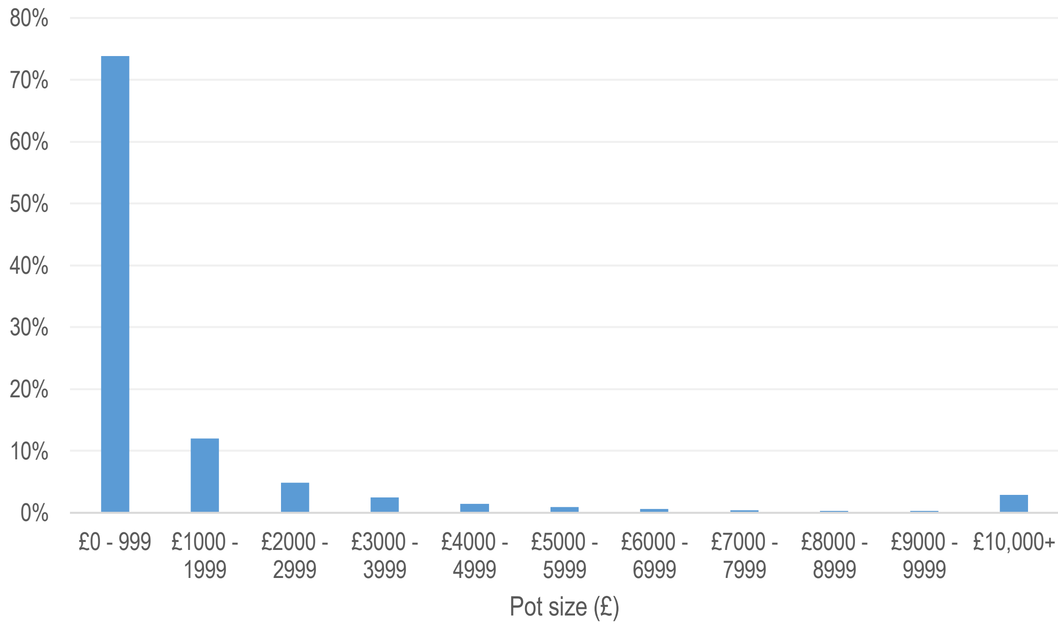
In their July 2020 report, the PPI estimated that the average pot size within Master Trust schemes was approximately £1,000.[20] To gain a more granular understanding of the distribution of small pots, alongside the work of the Working Group, the Department's analysts requested and received data on the size distributions of deferred pension pots across the books of five of the largest DC pension scheme providers. These were predominantly Master Trust schemes. Figures 0.3 and 0.4 show the distribution of deferred pension pots across schemes who responded to the request, by pot size. The data refers to August - September 2020.

In total, the data presented encompasses 11.2 million deferred pension pots. The data should not be interpreted as representative of the size distribution of deferred pots in the overall DC market given its focus on a small number of large schemes. Qualitative feedback from members of the Working Group suggests that the scale of small, deferred pots varies across provider types but the distributions presented below offer a useful indicative view of the nature of the small, deferred pots challenge for some of the largest DC providers in the market. The data in Figure 0.3 suggests that

[20] https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf

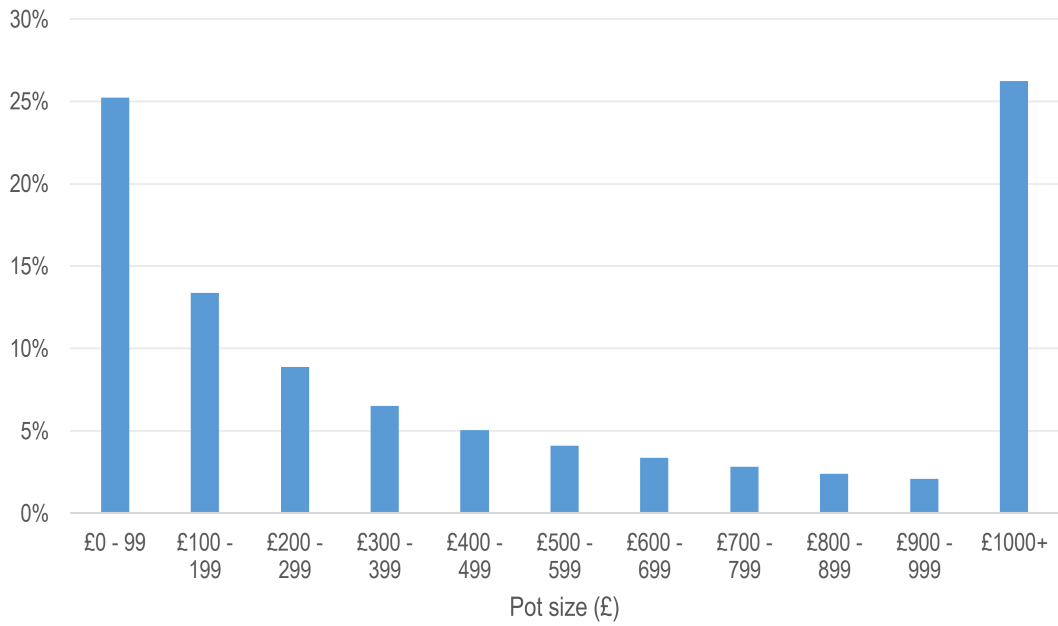
almost three quarters (74 per cent) of all deferred pots in the sample are smaller than £1,000 whilst Figure 0.4 suggests that a quarter (25 per cent) are smaller than £100.[21]

Figure 0.3. Distribution of deferred pension pots in sample of DC schemes by £1,000 size band.



Source: DWP DC scheme data request.

Figure 0.4. Distribution of deferred pension pots in sample of DC schemes by £100 size band.



Source: DWP DC scheme data request.

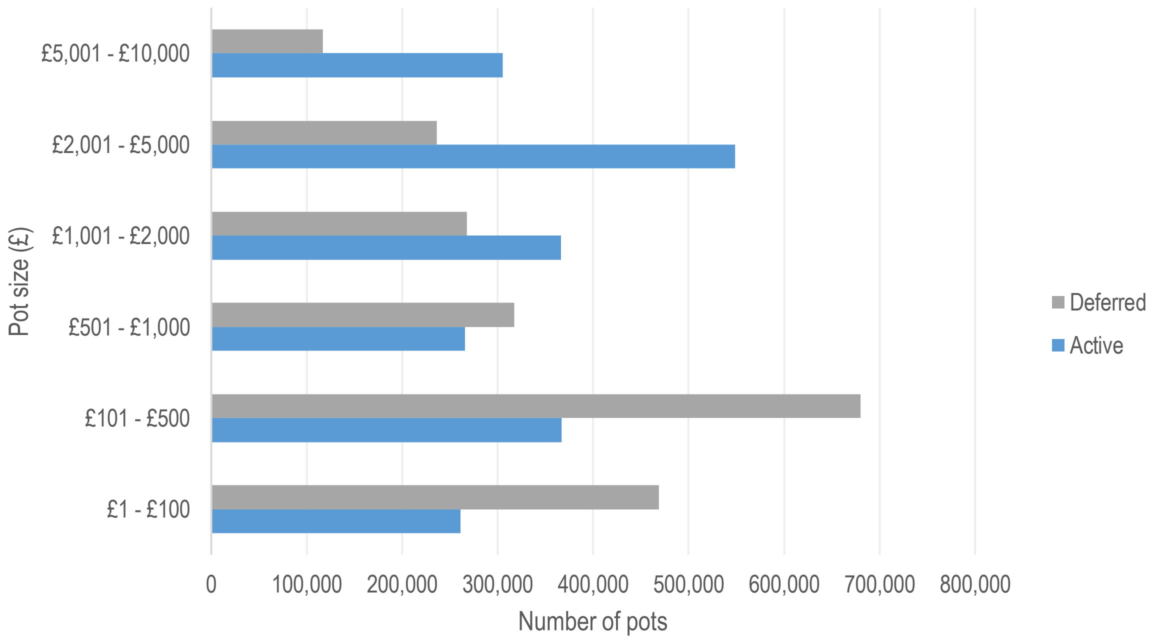
Whilst the Department's data request does not currently provide information on the distribution of pots below £100, a data gather with scheme providers conducted by the Pensions and Lifetime Savings Association (PLSA) in summer 2020 asked DC scheme providers for information on the

[21] Please note, while the sample size for Figure 0.3 is 11.2 million, one provider was excluded from Figure 0.4 due to missing data, resulting in a smaller sample of 8 million pots.

average balance of deferred pension pot below £100. The PLSA data gather had a different sample composition to the Department's scheme data (Figures 0.3 and 0.4) in that, for DC providers, it largely focussed upon smaller Master Trust, GPP and single employer schemes. In total, the PLSA data gather comprised eight DC scheme providers and due to its small size should also not be interpreted as representative of the wider DC market. Results of the data gather show that the mean and median balances of deferred pots below £100 among the majority of DC schemes included in the PLSA's sample were between £40 and £50, indicating that the distribution of pots below £100 was skewed slightly towards the lower end. Through conversations with the Working Group, some larger Master Trust schemes have indicated that they too recognise this pattern in their own books. One large Master Trust supplied data showing they have 243,000 pots of "£0 to £49" and 185,000 pots of "£50 to £99".

Due to its focus on smaller Master Trust, GPP and single employer schemes, the PLSA data gather offers some insight into the extent of small, deferred pots across a slightly more diverse section of the DC market, albeit findings should not be generalised beyond the eight providers who responded to the data gather request. Despite the differences from the Department's scheme data request in terms of sample composition, at an aggregate level, the prevalence of small, deferred pots appears to persist. Figure 0.5 shows that of the approximately two million deferred DC pension pots of less than £10,000 captured by the PLSA data gather, over half (1,148,703) were worth £500 or less whilst active pots captured in the survey were likely to be larger.

Figure 0.5. Active and deferred pension pots below £10,000 by size band from PLSA data gather sample of eight DC providers – August 2020.



Source: PLSA scheme provider data gather.

2012 analysis conducted by the Institute for Fiscal Studies (IFS) using Wealth and Assets Survey (WAS) data, which predates the introduction of AE (collected between July 2006 and June 2008), found that at that time 35 per cent of all DC pension pots (active and deferred) reported in WAS (or a total of 3.9 million DC pension pots in Great Britain) contained less than £5,000.[22] 16 per cent of DC pension pots reported contained less than £2,000, equivalent to approximately 1.8 million pots below this size in Great Britain.

The Department has conducted further analysis of WAS data revealing that in WAS wave 5 (July 2014 to June 2016), the percentage of reported active and deferred occupational DC pots smaller than £2,000 was 35 per cent (or 2.6 million) following the first two to four years of AE By round 6 of the survey (April 2016 to March 2018), the percentage of reported occupational DC pots smaller than £2,000 had increased to 42 per cent.[23] While sources and approaches differ, this evidence all points to small deferred pots being a widespread, and increasing, challenge for the pensions industry.

Drivers of trends

The introduction of AE has led to a rapid increase in the number of small deferred pots, as demonstrated in the analysis presented above. As at September 2020, approximately 10.4 million individuals had been automatically enrolled into a workplace pension.[24] The increase in the number of small deferred pots is a function of this significant rise in DC pension saving and the fundamental workings of AE policy: employers are responsible for choosing a qualifying pension scheme in which to enrol their employees. It is likely that many individuals who have been automatically enrolled have accrued deferred pots as a result of moving jobs, and being automatically enrolled by their new employer into a different scheme, effectively leaving their old pot behind.

At the outset of AE in 2012 members leaving a Master Trust or other occupational scheme in the first two years were given a refund of contributions unless they requested a deferred pension. This eliminated a lot of the early deferred members, who would have had very small pots as contributions began in 2012 at a starting level of 2% of qualifying earnings, with phased increases only reaching the current 8% in April 2019. The Pensions Act 2014 removed this facility to refund contributions, with the last refunds happening in September 2017.

In 2012, the Department estimated that employees work for 11 employers on average during their working life (with a quarter working for more than 14 employers).[25] More recent estimates from external research studies suggest that people aged 18 - 34 may expect to have an average of over 12 jobs in their lifetimes.[26] The ONS estimate that around nine per cent of people changed jobs each year between 2000 and 2018 on average, reaching a high of 10.9 per cent in 2018,

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[22] https://www.ifs.org.uk/bns/bn127.pdf

[23] The Department's analysis of WAS wave 5 and round 6 data is limited to individuals' two largest occupational DC pension pots reported in the survey.

[24] https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/automatic-enrolment-declaration-of-compliance-report

[25] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/184965/small-pots-automatic-transfers-impact-assessment.pdf

[26] https://www.recruitment-international.co.uk/blog/2017/11/millennials-likely-to-have-12-jobs-in-their-working-lives-research-finds

further demonstrating the extent of churn in the labour market.[27] Whilst in some cases new employees may be automatically enrolled into schemes where they already have an existing pot[28], the estimated frequency of job moves combined with the large number of providers in the DC market (from which employers are free to choose) makes the accrual of several small pots through changing jobs a likely reality for many savers. Whilst the full scale of the ongoing labour market impacts of the Covid-19 pandemic is still to be determined, observed increases in unemployment will drive a short-term increase in the number of deferred pots when individuals saving into a pension scheme lose their jobs and cease to actively make pension contributions.

Alongside change in employment, it is also possible that some small, deferred pots are a product of members ceasing to save into a scheme for other reasons. The latest Departmental estimate from the 2019 Employers' Pension Provision (EPP) survey indicates that nine per cent of employees who were automatically enrolled in the 2018/19 financial year decided to "opt-out" within one month.[29]. Data from the 2017 EPP survey suggests that 16 per cent of employees who had been automatically enrolled in the 2016/17 financial year had ceased active membership by the time of survey,[30] including those doing so outside of the opt-out window. The survey indicated that around two thirds (67 per cent) of these employees who ceased saving did so because they had left their job. The remainder may have ceased saving either through a change in their eligibility for AE or as an active choice to stop. Whilst individuals who choose to opt-out from AE during the designated one-month opt-out window can receive a full refund of their contributions, after this window, individuals who cease active membership (through active choice or otherwise) will usually have their contributions to date held in the scheme until they retire, therefore creating a deferred pot.

Micro pots

Some attention was paid within the Working Group to the issue of so called "micro pots" - pots perceived to be of a few pounds, accrued by people who are automatically enrolled but do not wish to save and who didn't send in their opt-out form in time.[31] Insight gathered though the expert panels of the Working Group suggested that individuals missing the opt out window and then being unable to access their funds was seen a significant source of member complaints for some master trust schemes. However, others members of the panels felt the extent of the issue may have been unduly magnified by a small number of loud voices (member complaints). One scheme (with a reported 900,000 active members and 500 "active cessations" per month) shared complaints data, showing that they received approximately 100 complaints per month regarding the opt-out process. Another scheme stated that between the start of 2020 and October, of the

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[27]https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/compendium/economicreview/april2019/analysisofjobchangersandstayers

[28] In these cases, some providers, for example NEST, automatically reunite the member with their former pot

[29]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/883289/automatic-enrolment-evaluation-report-2019.pdf

[30]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/717607/employers-pension-provision-survey-2017.pdf

[31] https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf

2,506 members who ceased membership outside of their opt-out window, 709 (28%) of them did so within a month of the opt out window closing.

To further investigate the issue of “micro pots” in the context of the broader drivers of deferred pot creation, the Department conducted exploratory analysis using Real Time Information (RTI) employee pension contributions data from HMRC and a slightly adapted methodology based on analysis of stopping-saving rates most recently published in the Automatic Enrolment Evaluation Report 2019.[32] Detailed information about the approach, assumptions and caveats are set out in Annex E. Due to these assumptions and caveats, estimates within this section should be treated as indicative. Furthermore, the analysis does not attempt to define and directly estimate the number of micro pots.

The analysis counts the number of individuals making “active decision cessations” with a short length of time between the first and last month of pension saving in the data. In the existing stopping-saving analysis, an “active decision cessation” is someone who:

- Has stopped saving;
- Did not leave their employment or become ineligible for automatic enrolment; and
- Whose last pension contribution was not within 6 weeks of their first pension contribution.

These three conditions taken together suggest that such an individual has chosen to stop saving and they have done this once the opt-out period has formally ended. It is worth noting that the definition does not relate to when the employee requested to their employer to stop saving, since such information is not reported through RTI; it means that the last tax month with a recorded pension contribution is, for example, two months after the first tax month with a recorded pension contribution.

Figure 0.6 shows the distribution of active decision cessations by length of time saving during the first six months.[33] This figure shows a clear peak in the number of active decision cessations made after three months of saving. This pattern is seen consistently over time as well as in the overall average over the time series. It is for this reason that we have selected this three-month period as our primary definition of “early cessations”.

Using this definition of an “early cessation”, we find that on average over the period April 2014 to June 2020, the number of early cessations is:

- **10%** of the number of all cessations (ranging 8% to 13% in different financial years);
- **21%** of the number of opt-outs (ranging 16% to 25% in different financial years).

The analysis is carried out in relation to eligible employees at staged employers. Over this period, the staged introduction of AE and subsequent re-enrolment duties for different employer sizes, create substantial change in the number and type of employees being automatically enrolled, and opting-out or ceasing saving. We have indicated the variation in the early cessation measure this leads to by giving the range of figures above for different full financial years during this period.

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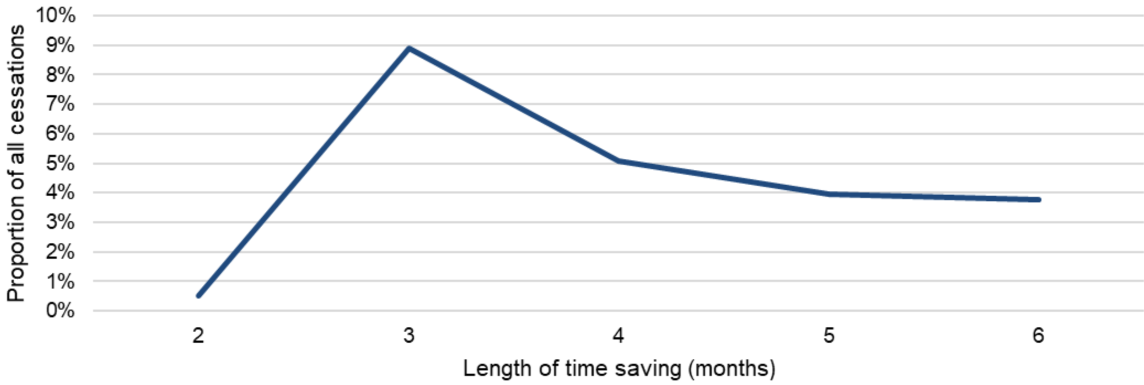
[32] https://www.gov.uk/government/publications/automatic-enrolment-evaluation-report-2019

[33] It is important to note that as this analysis is based on a previous methodology using an effective opt-out window of 6 weeks, the proportion of cessations after 2 months is likely to be an under-estimate.

Figure 0.6. Proportion of all cessations which fall in the first six months of saving – average April 2014 to June 2020, eligible employees at staged employers.



Source: DWP estimates derived from HMRC Real Time Information (RTI) data
Notes:

- Cessations in this graph refers to "active decision cessations", i.e. active decisions to stop saving after the opt-out window. This is measured in RTI by when contributions are actually made, not directly when employees inform employers.
- Length of time saving means the number of tax months between the first and last month of pension saving, inclusive of both first and last month. An individual may not have made a pension contribution in every month during that period.
- Each data point shows the number of cessations made after a particular length of time saving as a proportion of the total number of cessations of any length of time saving, including those more than six months.
- The analysis only identifies cessations where the last pension contribution was at least six weeks after the first pension contribution. Therefore, the proportion who cease saving after two months shown above is likely to be an under-estimate.

An “active decision cessation” in this analysis, as described above, means an employee who stopped saving after the opt-out window and who did not become ineligible or end their employment. It is therefore only one way an individual can stop saving into a pension. The most common reason for stopping saving is due to employments ending. Looking at all employees who stopped saving after up to three tax months saving (the same period used for “early cessations”), the number who stopped saving due to their employment ending was around eight times larger than the number of “early cessations” (active decisions to stop saving in this period after the opt-out window).

As noted in the caveats, the data used in the analysis does not include any information on amounts saved, or whether the contributions were paid into an existing pot into which the employee had saved before the 18-month period to which the data refers. However, to provide additional context the analysis investigated available data on the income band of employments where early cessation took place. Almost half of early cessations (among eligible employees at staged employers from April 2014 to June 2016) are for employees in the income band earning £10,000 - £19,999 annually.

Overall, this initial exploratory analysis of RTI pensions data, indicates that following the opt-out period there is a second peak in members choosing to stop saving into their pension at three months. This provides some support to the hypothesis that there is a minority of savers who miss the opt-out window. It is not possible with available data to conclude precisely what number or proportion of deferred pots are created due to individuals stopping saving soon after the opt-out period ends. Whilst the number of “early cessations” is not insignificant either in proportion to the number of opt-outs or total number of cessations, the analysis suggests that the number of small, deferred pots created through employment ending far outweighs those created through an active decision to stop saving. This suggests that tackling overall deferred pots is the priority and this will not be fixed through a focus on tackling late opt-out.

Members of the Working Group also discussed the possible role of scheme members stopping saving following automatic re-enrolment[34] as a driver of micro pot creation. Although the overall number of savers being re-enrolled will be small in comparison to the number being initially enrolled, the 2017 EPP survey indicates that among those re-enrolled, rates of opt-out (33 per cent) and cessation (24 per cent) appeared to be higher than those at initial enrolment (although these estimates only include savers employed by the large and medium sized employers who had reached re-enrolment at the time of the survey).[35] This is not surprising as everyone who was automatically re-enrolled would have previously opted out or ceased active membership. Whilst investigating the extent of micro pots associated with the re-enrolment process is not within the scope of the analysis presented in this report, evidence pointing towards higher rates of stopping saving (relative to initial enrolment) suggests that future work to understand the drivers of deferred pot creation may benefit from exploring the role of re-enrolment.

The implications of small, deferred pots

Small, deferred pension pots carry potential risks of poor outcomes for individuals and inefficiency for the pension industry in terms of administering them. One of the key concerns for individuals is the risk of pot values being eroded by charges over time where a scheme's charging structure includes a flat-fee. Use of a flat-fee alongside a percentage Annual Management Charge (AMC) is a common charging approach within Master Trust schemes: a review of information on charging published on provider websites suggests that at least four schemes are using or plan to move to such an approach. Analysis conducted by the PPI demonstrates how a £100 pot, deferred at age 22, with an annual flat-fee charge of £20 and an AMC of 0.25% would be eroded to zero well before the member reaches State Pension age (age 68).[36] A pot of £500, deferred at age 22 would be worth around £100 by age 68 under this charge structure.

The possibility of individuals forgetting about or being unable to track down a small, deferred pot is a further concern. PPI estimated in 2018, that there were around 800,000 pension pots in the UK where providers had lost contact with the scheme member.[37] Whilst evidence on the impact of small, deferred pots on decumulation and retirement outcomes is scarce, analysis of decisions around retirement income (albeit limited to the current cohort of retirees) indicates that pot size plays a role. For example, Financial Conduct Authority (FCA) analysis of Retirement Income Market Data found that in 2019/20, almost nine in 10 pots fully withdrawn at first access were below £30,000 in value.[38] Whilst for pots larger than £30,000, drawdown was the most common method of access.

Engagement in workplace pensions remains low across a large proportion of the general population of savers according to the latest research. The Financial Conduct Authority's (FCA)

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34 Every three years, staff who were automatically enrolled but opted out of or ceased active membership of a pension scheme more than 12 months before an employer's re-enrolment date must be automatically re-enrolled into the scheme. Again, they have the choice to opt-out.

35 https://www.gov.uk/government/publications/employers-pension-provision-survey-2017

36 https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf

37 https://www.pensionspolicyinstitute.org.uk/media/2855/201810-bn110-lost-pensions-final.pdf

38 https://www.fca.org.uk/data/retirement-income-market-data

2017 Financial Lives Survey found that almost half (45 per cent) of people state that they do not give their pension ‘much thought’ until they are two years from retirement - commonly citing a lack of time.[39] The survey found that only 18 per cent of those with a DC pension had given ‘a lot of thought’ to how much they should be paying into their pension whilst 39 per cent hadn’t considered this at all. This evidence on relatively low levels of member engagement suggests that we cannot rely upon engagement alone to encourage members to consolidate pots. Feedback from members of the Working Group indicates that many stakeholders perceive small pots to be a disincentive to member engagement in saving and later life planning. Whilst some cited the increased hassle and complexity of keeping track of and accessing multiple pots as a key driver of this, there is also an argument that the low value of deferred pots when held separately could result in less engagement compared to the greater value of a single consolidated pot. Evidence from the FCA’s Financial Lives Survey does suggest that some forms of engagement tend to increase with pot size. However, it should be noted that the pot values at which the highest levels of engagement are observed are unlikely to be achieved through small pot consolidation alone: contribution levels being the most important determinant of pot size.

Evidence suggests that the financial implications of managing small, deferred pots present a direct risk to scheme providers with cost inefficiency and scheme financial viability also posing knock-on poorer outcomes for some types of individual savers in particular. PPI analysis estimated that if an AMC at the highest permissible rate was charged (0.75%) the costs associated with running a scheme, with no additional flat-fee, would require an average pot size of around £2,300 for the provider to breakeven (to be spending less or the same amount on administering the pot as the member pays in fees). When this is reduced to nearer the industry average AMC of 0.5% or equivalent, the required average pot size to breakeven (without use of combination charges) grows to just under £4,000.[40] Small pots, which make it difficult for providers to breakeven, will need to be cross-subsidised by members with larger pots, subsequently reducing these members’ returns. If left unchecked, the PPI’s projections (Figure 0.2) suggest that by 2035 we will reach the point of one active pot having to support three deferred pots. With such rapid growth, the small pots issue has the potential to seriously de-stabilise the Master Trust framework that supports most employers with their AE statutory duties.

Through a number of small-scale member insight surveys conducted by members of the Master Trust and Contract-Based Expert Panels, the Working Group has also begun to gather evidence on awareness of and attitudes towards small, deferred pension pots amongst current savers. Whilst this early evidence cannot be interpreted as representative of the general savings population, the findings provide some valuable indicative evidence of trends and tendencies in member awareness and understanding of deferred pot ownership as well as an initial view of the risks perceived by members and their preferences in terms of consolidation approaches. It should be noted that, given the short timeframe within which the research was carried out, sampling for the surveys generally relied upon use of existing member panels or representatives. With this approach to sample selection, we would anticipate a degree of selection bias. A number of the participating organisations noted that the sample achieved was likely to be skewed towards individuals who were more engaged with pensions.

[39] https://www.fca.org.uk/publication/data/data-bulletin-issue-12.pdf

[40] https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf

From the member surveys conducted by the five participating organisations which reported back to the Working Group, the following key themes were identified:

- Levels of knowledge and awareness of pension holding appeared to be relatively strong across the samples of members contacted which is counter to wider evidence covered earlier on attitudes and awareness of saving and evidences the challenges within these surveys of selection bias. In all of the surveys, a majority of individuals reported knowing the number of separate pension pots they owned (ranging from 65 per cent to 83 per cent). Reported ownership of deferred pension pots was very common (ranging from 58 per cent to 85 per cent) and across all of the surveys, a majority of individuals who owned a deferred pot had at least a rough idea of its balance.

- The surveys broadly indicated relatively low levels of reported understanding of the member risks around small, deferred pot ownership and subsequently only limited concern around these. This is striking given the likely higher levels of engagement within this particular survey population. Across all of the surveys, a majority of respondents (ranging from 53 per cent to 80 per cent) reported knowing very little or nothing about the possible risks of owning one or more inactive pension pot. Among those who did have small, inactive pots, the strong tendency appeared to be that either members had not thought about the issue at all or they were not worried about it. A minority of respondents (generally less than one in four) reported being worried or greatly worried.

- Results from across the surveys suggest that the level of concern about practical challenges of keeping track of pots (not forgetting and losing them) tends to be similar to that of potentially losing money through charge erosion. Two of the surveys indicated that charge erosion was the most common member concern whilst the remaining surveys found this to be pots being forgotten or lost.

- Responses from the surveys indicated that having a pension pot follow a member on moving employer remains popular amongst savers, perhaps at least partly driven by the concept being easy to explain.[41] However, alongside the popularity of the Pot Follows Member concept, the surveys also indicated some preference for greater member responsibility. This needs to be treated with caution due to the relatively engaged nature of these respondents, as compared to the population of savers within AE more generally.

- As part of the surveys, respondents were given a statement explaining how an individual who chooses to stop saving after the opt-out window won’t usually receive a refund of their contributions and that these will instead be held in the pension scheme until the individual retires. Prior awareness of the treatment of pension contributions in this scenario was shown to be mixed across the surveys. In all surveys, the majority of respondents had at least partial awareness of this but a significant minority (ranging from 34 per cent to 46 per cent) were unaware. When individuals were asked how worried they would be about their contribution being held in a small, deferred pot in this scenario responses were similarly

[41] Previous research conducted by Aviva indicated that, of 4,000 private sector workers and 760 businesses (surveyed for the 2012 Working Lives report), 61% of staff members and 70% of companies said ‘pot follows member' consolidation would benefit workers saving towards retirement. Source: https://www.aviva.com/newsroom/news-releases/2012/07/uk-pot-follows-member-approach-in-the-best-interest-of-consumers-16971/

mixed and across the surveys those reporting they would be worried or greatly worried tended to be in the minority (ranging from 28 per cent to 40 per cent).

The Working Group have identified that further development of the evidence base on member perspectives will help to ensure that consolidation solutions are developed in line with saver preferences and best protect their interests. Suggested next steps are set out in Chapter seven.

The international evidence base

As part of the Small Pots Working Group, the PPI has been sponsored by the Master Trust Expert Panel, convened by the Department, to conduct an international study, exploring whether other countries have had similar challenges related to small deferred pots, and how these have been dealt with. The study includes analyses of the trade-offs related to the policy approaches other countries have taken and draws out relevant lessons for the UK arising from international experience. This will contain three in-depth case studies on Australia, Ireland and the USA, and eight country profiles on Belgium, Chile, Denmark, Israel, Mexico, New Zealand, Norway and Sweden.

Findings and material from the upcoming PPI report on "How have other countries dealt with small deferred member pension pots?" has been used in this report, including the references in subsequent chapters, with the kind permission of the PPI. This has allowed the Working Group to consider this as part of their consideration and analysis of the evidence base, alongside other evidence. The PPI expect to publish the full report in January 2021.

Chapter 3 – Member-led solutions – analysis and recommendations

This chapter discusses the member-led solutions that the Working Group considered. These are solutions to the small pots challenge that require a member to engage with their pension savings and make an active choice or decision about their pension provider or consolidation of their deferred pension pots.

Pensions Dashboards

Once up and running, Pensions Dashboards will enable people to access their pension information in a clear, simple form, and in a secure and single place online. They will bring together an individual's pension information from multiple sources, including their state pension, which can then be accessed at a time of their choosing to support their financial planning.

On 28 October 2020, the Pensions Dashboards Programme (PDP) published its second Progress Update Report[42] which sets out a timeline for the development of dashboards. This explains that staged on-boarding of pension schemes and providers will start from 2023, with the current and upcoming phases of the programme to include:

Working Group Findings

Pensions Dashboards will help to increase individual awareness and understanding of pension information and in some cases reconnect people with their lost pension pots. However, individuals will still have to engage and take action to look up their schemes and to decide to consolidate their deferred small pots using the existing routes. We already know that engagement with pension saving is low and one of the reasons AE has been so successful is because it is a policy that is built on inertia. For example – in the Financial Lives Survey, 45% of people (DC pot holder respondents) state that they do not give their pension 'much thought' until they are two years from retirement- commonly citing a lack of time[43]. The current evidence-base suggests that a similar approach to AE, which incorporates automatic and automated transfer and consolidation solutions is likely to be most successful to tackle growth of deferred small pots at scale – in particular given

[42] https://www.pensionsdashboardsprogramme.org.uk/2020/10/28/pdp-progress-update-report-october-2020/

[43] FCA- Data Bulletin (2018) https://www.fca.org.uk/publication/data/data-bulletin-issue-12.pdf

current evidence as discussed in Chapter two indicates that there are a substantial number of low value small pots (below £1k and less than £100).

Pension Dashboards have the potential to drive low levels of consolidation within the AE workplace pensions market but alone are very unlikely to provide the whole answer to deferred small pots consolidation. Findings from the PPI's international research (due to be published in January 2021) suggest that comprehensive dashboards are good complements to existing policies with Australia, Denmark, Israel and Sweden all operating member dashboards in conjunction with other solutions. That is why, when considering options to tackle small pots, one of the guiding principles used was that any solutions should work alongside and complement pensions dashboards as they will form part of any long-term solutions.

> *"Pensions Dashboards will be instrumental in helping the small pot problem. This is because it will enable savers to locate pensions, making it easier to save more and consolidate them. Completing both the legislation and the implementation programme for dashboards should be the first priority".*
>
> ***ABI - Contract Based Expert Panel***

There are some useful synergies between consolidation solutions and Pensions Dashboards, in terms of data matching and data standards. There is an opportunity to learn from PDP's work on data standards and data matching including the provider testing activity scheduled in over 2021/22. There is also an opportunity to learn from the PPI Pensions Data Project in respect of data matching capability. Taken together these areas provide a valuable starting point to work towards common data standards / matching capability required to underpin mass transfers. This is discussed further at Chapter six.

Voluntary Pot Follows Member

In the pot follows member model, when an employee moves jobs their pension pot moves with them to the new employer's scheme (provided a number of certain parameters are met). Within this solution, there are two design choices, a voluntary model or an automatic model which is discussed in Chapter four.

Under the voluntary design, when starting a new job, the employee would be asked to provide details of their former pension provider to the employer, and to confirm whether or not they wish deferred funds to be transferred to their new provider if it is different to their existing scheme. This would then continue with all future employments. If no choice were made, within a specified time period in which the employer has to meet their AE obligations, the member would be enrolled into their employer's scheme and their previous pot would be left with the former pension provider.

Working Group Findings

The Working Group broadly agreed that the voluntary pot follows member model is not consistent with the AE design principle of inertia and there is a risk that a large proportion of members will not take any action. This is in contrast to the automatic transfer pots follows member model which would align with AE principles as discussed in Chapter four. The voluntary pot follows member model could mean greater member ownership, but only by those who are engaged with their pension savings. It requires greater pro-activity and would likely have limited take-up. As discussed above, any large scale solution to tackle the small pots challenge, needs to involve default/automatic consolidation. Therefore, the voluntary pot follow member model is not recommended, given its reliance on member action.

> In response to voluntary pot follows member model:
>
> *"Given what we currently know about people's engagement with pension choices it seems likely that take up will be low".*
> ***Which? - Member / Consumer Expert Panel***

Lifetime Provider

In the lifetime provider model, members generally remain with the same provider throughout their working life and employers are required to send pension contributions to each of their employees' chosen pension scheme. Specifically, in the voluntary design, members would be given the opportunity to continue saving with their former scheme when they start new employment, this would continue throughout their career. However, they could decide with a new employment to start a new scheme if desired.

There are also at least two other ways to design the lifetime provider model, this includes the automatic and the carousel design choices. In the automatic lifetime provider, employees would automatically remain with their current provider when starting a new employment, unless they opt to change to their new employer's scheme.

In the carousel lifetime provider, an employer automatically enrols employees according to a carousel rather than choosing the scheme. The employee would be able to choose their pension provider from a list of approved providers, and if no active choice was taken then an individual would be automatically enrolled into a provider's scheme from the approved list. They would continue to be enrolled in this scheme for all future employments, unless they made an active decision to change scheme.

Working Group Findings

One of the positives of the voluntary lifetime provider model is that it could be attractive to those members who are engaged and puts this type of member at the heart of the process. Some members of the group also felt that like the other large scale consolidation solutions set out in Chapter four, if work to get the underlying administrative processes in place was undertaken, then this could potentially reduce some of the administration costs around contributions being allocated to a number of different schemes. However, despite these positives a number of the Working Group felt that the voluntary lifetime provider model would not help the deferred small pots challenge for those automatically enrolled members who are not sufficiently engaged to supply their previous scheme details or make a decision to join the new scheme offered by their employer. This risk could potentially be mitigated by introducing the automatic or carousel design, however there are additional implementation challenges with a lifetime provider model.

In response to lifetime provider model:

"This option would have a significant positive impact on member engagement. The pension member, rather than the provider or the employer is at the heart of the system. Members would have their pension for their retirement".
Hargreaves Lansdown - *Member of Contract Based Expert Panel*

In response to lifetime provider model:

"The success of the AE policy is in no small part due to its 'nudging and inertia' aspects. These benefits would be lost and 20 years' worth of successful policy development (i.e. the AE policy) would be given up".
Creative - Member of Master Trust Expert Panel

A lifetime provider solution would introduce a fundamental change in how workplace pensions operate and could result in losing the benefit of inertia, which AE has been built on, unless an approach was developed that did not rest on new employees having to provide existing pension details to new employers. In addition, it would also be complex and place an increased administration burden on employers and payroll as they would need to deal with paying contributions into multiple schemes.

While employers are not a homogenous group, feedback from some members of the Working Group expressed a reasonably strong preference for scheme-led consolidation solutions (which are discussed further at Chapter four) while surfacing serious concerns with the lifetime provider model due to the impact and change on the market as well as the burden it would place on the employer, in particular the administrative burden for employers who may need to send contributions to different providers for different member contributions.

In response to lifetime provider model:

"Prioritising consolidation and member exchange models to help savers avoid the risks of small pots is an ambition that employers support. They want the lifetime provider model off the table because it would be much more complicated and expensive, and welcome the working group recommending further analysis of other options".

CBI – Employer Expert Panel

The payroll community feedback, represented through the expert panels, was clear that this would necessitate considerable new investment costs and potential multi-year implementation for employers, including small employers; pension providers and payroll to create and service systems to meet the consequent administration arrangements.

In response to lifetime provider model:

"Would have a huge impact on payrolls and bureaux who would have to upload multiple files to multiple providers. There is no standard file upload process currently so every pension provider asks for slightly different formats".

BCS - Implementation / Technical Expert Panel

The lifetime provider model also creates potential serious risks to current workplace pensions provision. The model would effectively break the connection with the employer, which could weaken their engagement with the workforce in terms of retirement provision. This could impact on employer-led retirement planning for their workforce. It could also mean employers could be discouraged from going 'beyond the minimum' as the ability to tailor the scheme to meet the needs of their particular workforce. This model would also not be feasible for single employer trust schemes and the employer would be required to replace their single employer scheme. The development of a new regulatory framework would also be required to ensure that lifetime providers could fulfil the role that providers nominated by an employer do today, for example: ensuring contributions are paid regularly; monitoring automatic enrolment compliance; and following up late payments.

A lifetime provider model could also cause competition issues, with consequent risks of 'selection', if it resulted in increased competition for the most economically valuable members. Currently some providers accept all employers, some accept employers and apply a connection charge and some providers make business decisions about which employers and sectors to serve. If the model were to also result in selection and filtering of members as a result of providers making business choices about who to serve, it could present risks to the existing supply for scheme members. This could in turn present risks to scheme member choice and access to value for money workplace pension provision for some types of member; however other types may find they have increased choice. It is not certain if supply would remain viable for those scheme members who historically have been viewed as the hardest to help in terms of workplace pension saving, including: lower earners; women; and younger people. In addition, this could potentially necessitate additional safeguards to protect consumers from unsolicited marketing. The Working Group's view was that this model would present real risks to the viability of the market to continue to meet the needs of the group for whom AE was designed, although it could have benefits for more engaged and better off members.

The PPI international research study referenced in Chapter two (and due for publication in January 2021) finds that Australia currently operates a default consolidator for some small pots and a voluntary lifetime provider model, however they are now in the process of implementing an automatic lifetime provider model. Some members of the Working Group could see the benefit of a default fund consolidator in conjunction with a lifetime provider as they felt it genuinely builds on the foundation of AE. However, it is also recognised that Australia has a different pension system to the UK. They already have a central data platform, unique identity numbers and a national pensions reporting data standard which took considerable investment and time to implement. This will likely make the transition to an automatic lifetime provider model easier than in the UK.

Introducing a lifetime provider model where there is already an established AE pensions market anchored in the employer role would present substantial implementation changes. It would also change the nature of the current pensions market structure in quite fundamental ways. Given this, it would involve wider considerations, concerning the sort of pensions market structure that is most desirable; the role of the employer within this structure; and the nature of the institutional framework governing workplace pension saving, which goes beyond looking at this model through the lens of addressing deferred DC small pots.

In response to lifetime provider model:

"Doesn't solve the small pots problem, risks reducing pension provision by good employers, makes life difficult for employers with no real consumer benefit".

Nest Member's Panel - Member / Consumer Expert Panel

Conclusion and recommendations

Member-led solutions will only work where a member is engaged with their pension savings and is willing and confident in making a choice. This is more likely to be where an individual has a larger value pension pot than the average deferred, small pot. While personal choice and engagement should be encouraged by the use of Pensions Dashboards, relying solely on member engagement to drive large scale consolidation of small pension pots, is not sufficient. As a result, the following is recommended:

- The Pensions industry, Government and Regulators should continue to explore and enable opportunities for member-initiated consolidation, with proportionate member safeguards, particularly in respect of deferred, small pots above a certain value. This can complement other interventions that will be necessary for deferred low value pension pots. Technology and tools, such as Pensions Dashboards that allow members to view all pots with different providers in one place could facilitate more consolidation in future.

- Automatic and automated consolidation solutions for the mass-market will be necessary to complement member-led solutions in order to address the stock and trend in the growth of deferred members with small pots.

- The voluntary lifetime provider model is attractive as it potentially puts the member at the heart of the solution, but again as this is member-led it is not likely to achieve large scale consolidation. The automatic and carousel lifetime model does not support the principles underpinning the success of AE, it would require significant change to the current pensions market structure, it is unlikely to change member savings behaviours and it could impact negatively on the employer role. Therefore, it is recommended that other large scale solutions are explored in the first instance.

Chapter 4 – Scheme-led solutions – analysis and recommendations

This chapter outlines the scheme-led solutions that the Working Group considered. These are solutions to the small pots challenge that involve automatic (on the basis it can be done without member consent) and automated (done at low cost and scale) consolidation rather than the member having to take action. The models explored include: same scheme consolidation; member exchange; automatic pot follows member; and the default small pot consolidation scheme(s) (which has also been referred to as 'default consolidator' and 'master pot' within the industry). It should be recognised that certain solutions – for example, pot follows member and the default consolidator – are not mutually exclusive.

All of these models rely on, viable administration processes for mass transfers and consolidation, based on a member opt-out being in place, (this is discussed further in Chapter six), with proportionate safeguards in respect of scheme members. All models would benefit from in-depth cost / benefit analysis to be undertaken as part of the next steps in order to get a better understanding of the impacts on different parts of the pensions market and scheme membership.

Same Provider/Scheme Consolidation

Members can have multiple inactive small pots held within the same pension provider, if they have been automatically enrolled by a different employer to the employer that originally enrolled them. If the provider has a large number of inactive pots, matching the records and consolidating the deferred pots, insofar as possible and practicable, could reduce inefficiencies and costs of administration, with consequent benefits for members. The PPI estimates suggested same scheme consolidation could result in a reduction of between 20% and 50% of deferred pots[44] – the range of outcomes is wide due to treatment of records by different providers and significant uncertainty in assumptions around multiple pots within the same provider. We anticipate that further development of the evidence base, including the PPI-led Pensions Data Project will be helpful in refining these estimates.

Working Group feedback suggests that while some providers link a returning active member to the inactive pension pot, this practice is not commonplace within the AE pensions market. Same provider/scheme consolidation involves returning active members being re-enrolled into their deferred pot, so that they never have more than one pot per provider.

Multiple inactive pots may, however, be held within different schemes (where different legal structures apply); different investment funds; and/or with different charging structures offered by the same provider. In these circumstances merging pots held within the same provider would not necessarily be straightforward or optimal for the scheme member. Without member consent, consolidation of deferred small pots held within the same provider may not be achievable, depending on the provider's terms and conditions associated with the scheme.

[44] https://www.pensionspolicyinstitute.org.uk/media/3545/20200723-deferred-members-final-report-for-the-website.pdf

Working Group Findings

While on its own it is unlikely to have the scope to achieve major change, as it is believed that many members will accrue more than one deferred, small pot which they will never re-join it could complement member-initiated consolidation and automatic large scale consolidation solutions as part of a combined response to the challenge, which could be prioritised.

While current data is not available on the scale and nature of unconsolidated deferred small pots held within the same provider, the PPI Pensions Data Project is expected to provide this information for some Master Trusts in 2021.

This is a solution that could be particularly focussed at Master Trusts as they tend to target particular sectors, making it more likely that many savers will be enrolled into the same scheme through different employers, (for example this would include circumstances in which a scheme member who experiences redundancy is subsequently automatically enrolled into the same scheme by a new employer). Some providers already practice consolidation where multiple pots are held in respect of the same member, but others have highlighted barriers to doing so. Some of the issues identified, in addition to those outlined above, include:

- The need for the scheme to seek member consent to consolidate pots;
- The need to hold separate pension pots/accounts within a scheme for compliance and verification purposes and to make reconciliation easier to resolve contribution errors; and
- Bespoke employer pricing, meaning it may be more straightforward to keep pots separate where there are different pricing levels. This is not an issue for single charge Master Trusts.

Some providers link a member's records so that the member receives a consolidated picture of their savings. There was agreement within the Working Group that for those providers who do not currently combine pots, they should work towards producing a single member view/portal, even if multiple pots are held behind the scenes. Some providers will be able to move to a single view relatively quickly, but for others it may take longer and further work will need to be undertaken to fully consider the issues and impacts. Also, opportunities to learn from those Master Trusts who currently link records should be maximised where relevant and appropriate to share good practice within the industry.

B&CE's approach to multiple member accounts

"Wherever possible, members should have a single account and multiple accounts should be consolidated. Multiple accounts may occur when members re-join the scheme, potentially from a different employer to the employer that initially enrolled them. If all key identifier information matches between two different accounts, B&CE merges separate records into a single account. This cautious approach is taken as it is very difficult to separate the records if it transpires that the accounts relate to different individuals.

Where key identifier information does not provide a full match, B&CE will try to merge the accounts by contacting the member to verify their identity".

Nest's approach to multiple member accounts

"Nest operates a 'pot for life' policy: once a member has an account with us, they will keep saving into the same account regardless of the employer they work for. This is more efficient for the member and for Nest, helping to keep costs low, and makes for a better customer experience.

When a member is enrolled we have an 'exact match' process, meaning if their data matches that of an existing member they are automatically merged into a single pot. Occasionally we find that we have a member with matching data fields saving in separate accounts. If we find that 3 of 4 key data fields – gender, name, NI Number and DOB – are matching, the 'appear to be one member' process is activated, and we write to the member to verify whether in fact both accounts belong to them. Response levels to this type of outbound communication are not high: in the region of 30k accounts have been matched via this process in the lifetime of Nest.

After carefully considering the risks and benefits to members, we have therefore begun running some automation of matching where there is sufficient matched data. The first such exercise doing this matched 35k members (70k records), with all the attendant benefits to members. In progressing this Nest has been very conscious of the risk and cost of wrong matches and has proceeded within a tightly defined risk appetite. As data capture improves (for example the capture of mobile phone numbers via member engagement campaigns), any residual risk of wrong matches will further reduce".

Member Exchange

In the member exchange model, pension providers would use a trusted third party pseudonymised data service to conduct a regular exercise and identify 'matches', where they hold a deferred, small pot and another provider has the same member making active contributions. The proposition is that a ceding provider would contact the deferred member to inform them that they will be transferring the deferred pot over to the active provider unless the member opts-out. This is similar to automatic pot follows member.

Working Group Findings

The group agreed that member exchange would support the principle of AE as it also works on the basis of inertia. It is similar to automatic transfers / pot follows member but would not achieve the same scale as pot follows member, if it were to be limited to Master Trusts. However, further consideration would need to be given to matters including legislative and operational factors. In addition to looking at this in the context of trust based schemes, consideration will also need to be given to contract based schemes concerning transfers without consent. Trustees / Independent Governance Committees (IGCs) would need a common Value for Money (VFM) assessment framework in order to enable pension pot exchanges without potentially creating unacceptable risk to the member or unacceptable burden on the Trustee/IGC.

However, a member exchange model would remove some of the downside risks that are found in the pot follows member model, for example – it removes the employer from being involved in the process to obtain ceding scheme data, and therefore reduces the risk of error. A pilot provides the potential to explore member engagement and other matters further to carefully and safely consider opportunities and risks of this model.

Member exchange may also be quicker to implement than pot follows member, however thought needs to be given regarding what conditions / parameters would be required, including legislative powers, to enable transfers between schemes and satisfy data protection legislation and Trustee fiduciary obligations and those of the scheme funder which may or may not be aligned.

In response to the member exchange model:

"This could work only for a segment of the Master Trust market – for auto-enrolment providers. And only where trustees are comfortable schemes meet the Value for Money test".
Aegon -Master Trust Expert Panel

As discussed in Chapter two, a large number of very small pots (below £1k with many of those less than £100) appear to be concentrated within a small number of Master Trust schemes. Voluntary small-scale proof of concept trials involving a small number of Master Trusts and low value small pots should be prioritised as an action, following detailed feasibility work. An objective of the exercise would be to test the willingness of scheme trustees and finance executives to conduct exchanges within certain parameters, consistent with their legal obligations and imperatives. As part of the feasibility work it is vital that trustees and finance executives should be involved in the development as well as decisions on the exercise.

This proof of concept could provide a significant opportunity for learning and to understand more about – pot identification; data matching; member attitudes; and transfer costs. As participation would be voluntary, trustees will be engaged in a detailed and careful scrutiny which is potentially costly. This will help understand and provide key learning on what costs might look like in the future on a larger scale. The insight could also be of value for not only the member exchange solution, but pensions dashboards and deferred, small pots consolidation learning in general. Appropriate safeguards would need to form part of the exercise, including member opt-out; exclusion of scheme pots with guarantees, and the ability to correct errors to restore the members pot(s) to their original position if required.

Effective and appropriate governance would need to be in place for the proof of concept trials. In order to build beyond the proof of concept trials and ensure learnings are more broadly applicable, it would require the involvement of and reference to a wider group of stakeholders, including contract-based providers, consumer representatives and regulators.

In response to member exchange model – proof of concept

"A pilot will expose the issues that may trouble trustees in giving agreement, and will enable us to understand the true scale and potential of the matching. We hold an innate belief that many of our deferred members have an active pot at another auto enrolment provider and many of their deferred members an active pot with us, but until we do the pseudonymised data matching, we can't prove the extent of this".
NOW: Pensions - Master Trust Expert Panel

Member exchange proof of concept could look at:

- **Are schemes (trustees and finance directors) prepared to be involved in member exchange on a voluntary basis?**
- **What extent can the proof of concept test real world outcomes i.e. to what extent could it be scaled up?**
- **What learning can it provide around required data standards and the transfer process including the member journey and costs?**
- **What are member's reactions after their pot has been transferred?**

Automatic Pot Follows Member

In this model, when an employee moves jobs their pension pot moves with them to the new employer's scheme, provided certain parameters are met: pot size; duration deferred; and value for money / fiduciary duties. The new pension provider would search for deferred pension pots and automatically consolidate them into their active pot. Individuals would be given the opportunity to opt out and not have their deferred pot transferred.

Working Group Findings

There was considerable support for pot follows member from some of the Working Group, especially from the single employer, implementation and member expert panels. The automatic model uses insights and learnings from the smart design of AE, unlike the voluntary model (as discussed in Chapter three). Some members of the Working Group, however, tentatively supported the automatic model on the basis that a pot threshold for entering the pot follows member process would be required. Any pot threshold would need to be established reflecting scheme economics and the cost of transfers.

The Working Group agreed that the pot follows member model would be dependent on pensions dashboards (however this could be built out from and alongside) and work to get the underlying administrative processes right – for example, this would include matching capability, finding functionality and use of common data standards (this is discussed in Chapter six).

Formerly, the Government introduced legislation to enable automatic transfers in the Pensions Act 2014. However, this policy was stopped in 2015[45] when it was decided it was not the right time and that AE needed time and space to become embedded but that, it would be revisited once there had been an opportunity for this to happen. Some of the other concerns were around the risk of security and scams. In addition, moving inactive pots at a historic and mass-scale would necessitate low cost administration, common data standards and the potential for members to be moved from a low charging to a high charging scheme.

Changes to the operating and delivery context, in addition to legislative and regulatory changes would alter some of the risks, in particular:

- The charge cap has been implemented in relation to AE workplace schemes
- Implementation of Master Trust Authorisation and supervision regime. Protections have also improved in contract based schemes.

There is still a risk of pot erosion if a member moves employer and transfers to a new scheme that has higher charges, and there are questions / concerns around: the role of the employer; the security risk; and the cost of individual transfers. However, given the changes in the operating environment and scheme quality / governance since this was last considered it is felt some of these risks could be mitigated, for example, by requiring set conditions / parameters to be met before a transfer is agreed. This model should be considered further by exploring the core administration processes in more detail and carrying out analysis of costs and benefits as far as evidence allows.

[45] https://questions-statements.parliament.uk/written-statements/detail/2015-10-15/HLWS238

In response to automatic pot follows member model:

"The risk to members is that they could find themselves moving from a well-run scheme to a less good one.

Although charge caps and standards for default investment funds reduce this risk, it is not eliminated, there is a wide variation in the risk/reward characteristics of different AE funds. Compared with 'member exchange' there is no oversight from a trustee or similar independent source to assess suitability".

Financial Inclusion Commission - Member / Consumer Expert Panel

In response to automatic pot follows member model:

"We believe that the industry should move to automatic transfers (pot follows member) as the chosen option.

Much of the important work needed for this to be a success, e.g. data standards and identity verification, will have to be addressed as part of the pensions dashboards project in any case. Automatic transfers as a concept is easily understood by customers and this will lead to more consolidation, which we believe is in members' interest and will build on the success of Automatic Enrolment. Other options are likely to lead to less consolidation and poorer outcomes for customers in the long run or would increase cost ad disruption to the industry".

Royal London - Contract Based Expert Panel

Default Small Pot Consolidation Scheme – Long Term Savings & Short Term Savings Models

In the default small pot consolidation scheme (default consolidator) there are two models. The long term savings model (also referred to within the industry as 'Master pot') and the short term savings model and within those models there are different design choices. In all models regular contributions from earnings still go into employee's active scheme (the current employer's chosen AE scheme). The default consolidator is only used for deferred pots.

Long Term Savings Model

In the long term savings model, everyone would have a default small pot consolidation scheme which would be a default scheme and only deferred pots would be transferred and consolidated into it. An advantage is that it could be delivered in a way that is consistent and builds on the current private pensions landscape, albeit the defaulting processes would need to be designed and implemented, and existing transfer costs are too high as it stands. A default scheme works with savers behaviours and low-levels of engagement, consistent with the principle of building on the success of AE.

There are design choices on how the default would operate. It could be the first scheme into which a worker has been enrolled, or a carousel which could provide member choice. A multiple scheme model would require an assessment of the costs/benefits to establish if a commercially run model would be feasible.

For all models we would need to consider the associated impacts on member outcomes, efficiency, potential requirements on the taxpayer, and competition across the defined contributions pensions market.

Short Term Savings Model

In the short term savings model – the deferred pots are held within a government authority and would be reunited with the active pot once identified. This would operate outside the current pensions system. It would present government funding implications. Holding deferred pots as cash in a separate authority could remove unconsolidated inactive pot costs, but would be inefficient for providers and members. It would also remove investment opportunity. A short term deferred pot 'holding tank' would not benefit from member engagement opportunity a default consolidator model offers.

Working Group Findings

A number of members of the Working Group felt that the long terms savings default consolidator model is likely to be an optimal approach, although an in depth value for money analysis would help support future decisions. The model has attractions, as members with a deferred pot below a certain amount can be defaulted into the chosen design model. There was also broad agreement that this option aligns with the AE principle of inertia and preserves employer centricity insofar as the active pension pot would remain with the employer's existing pension provider. This model is, therefore, unlikely to significantly change the role for the employer in terms of meeting their AE obligations (in term of selecting a pension provider; collecting and making pension contributions on behalf of eligible workers). It also provides a level of personal choice for those who are engaged and willing to make a choice.

The long term savings model presents significant competition impacts that would require further in-depth consideration, depending on the precise design choice. For example, if there were one consolidator across the whole market this could come to dominate the market; and if there were multiple, competing consolidators, it may become more attractive to be a consolidator than a provider. We would need to explore as far as possible the market impacts of the first scheme, carousel and government funded single scheme design, and ways they could be mitigated.

The consequences, in some of the variations, of separating the assets from the scheme collecting the contributions would also need to be understood. For example, it may impact on the aspiration to move away from dual charges. Some members of the Group also expressed reservations about allowing a consolidator to operate in the market as 'just a consolidator', without enabling employers to fulfil their AE duties through them.

A positive of the long term savings model is that assuming the default consolidator scheme is of high quality, this could overcome concerns about consolidating and moving funds into a scheme with worse terms, and if members are free to specify their own consolidator then this could introduce a degree of member choice.

Some members of the Working Group were supportive of the short term model and felt that it could be relatively easy to implement alongside pensions dashboards, compared to some of the more complex designs. However, there were mixed views concerning the extent to which a ‘state approved’ model could help aid member trust.

A number of Working Group members felt that the short term model that sits within a government authority is likely to have the biggest distortion / impact on competition in the market. This is because it would remove a large part of the market away from commercial providers. Also, there would be a number of issues around holding deferred pots as cash, as described above.

In response to Default Small Pot Consolidation Scheme model:

"There are potentially significant implications for competition if the consolidator model meant that the consolidator(s) came to dominate the market, or made it less attractive to participate in the provider market. How would these challenges be overcome?".
ABI - Contract Based Expert Panel

Other options suggested and discussed, though not identified for prioritisation:

- **Transfer very small pots / micro pots into an ISA** – where there are very small deferred pots, these could be transferred (including the employer contribution) to an approved ISA so that savings are retained in an established, tax privileged savings environment.

- **Reduce the regulatory burden of small pots** - in Belgium, instead of refunding small pots, the authorities have attempted to alleviate the costs of their administration by reducing regulatory burden, with lower levels of regulatory reporting and exemption from Annual Statements for deferred pots below a certain size.

- **Transfer very small / micro pots to the State Pension** – where there are very small deferred pots, these could be transferred to the state to fund an increase in the State Pension. This could support scheme members experiencing AE during the early years of its operation.

Overall the Working Group felt that the default consolidator – especially the long term savings model – could support many of the guiding principles agreed to assess solutions to tackle the small pots problem and could be considered the most optimal design choice. There are still a number of unknowns that need to be explored with this model and therefore the default consolidator should be prioritised for further consideration and cost / benefit analysis. This would also involve considering how this model could address the stock and flow of deferred small pots.

Conclusion and recommendations

Scheme led consolidation solutions are required to tackle the small pots challenge and drive large scale consolidation. This is because, as discussed in Chapter three, member-led solutions can only achieve a limited amount of change, due to many members being relatively unlikely to engage in the consolidation process. Therefore, scheme-led solutions that work because of inertia for the majority of savers need to be considered.

As discussed in Chapter six, work needs to be undertaken to get the underlying administration systems and processes right, as this will form the bedrock for low-cost, effective large scale scheme led consolidation solutions. Therefore, while work to explore costs and benefits, including the heterogeneity across members on consolidation models and the impact on the wider finances of the AE industry should be prioritised, final decisions about which large scale consolidation solution / or combination of solutions should be informed by outcomes on the administration process and data standards work. Also, before any decision is made on a large scale consolidation solution, customer journey modelling will need to be carried out to see how the different models impact scheme members and providers. Further work will also need to be done to determine what new legal powers may be needed to facilitate the desired solution. The Working Group's recommendations are:

Same Provider/Scheme Consolidation

- Where pension providers are holding multiple pots within charge-capped default funds for the same deferred members, the direction should be to consolidate those pots. Recognising, however, that it is not always possible or desirable (for example because of member consent associated with scheme terms and conditions), we recommend pension providers should in the interim work towards implementing a single consumer facing view (within a single member portal with information on their pension pots). It could be achieved, following scoping work in 2021/22, through adoption of industry best practice and regulatory guidance.

Member Exchange

- The pensions industry should establish operational focussed groups, to investigate and address administrative challenges which will be necessary to underpin mass transfer and consolidation systems that can be delivered at scale within the AE market. As part of this, member-exchange proof of concept trials involving low value small pots within Master Trust schemes to test the concept should be developed and prioritised, starting with a feasibility report in summer 2021, following in-depth scoping work:
    - This should involve trustees and finance directors to test if they are prepared to run proof of concept trials and whether it can provide sufficient learning for purposes of a real-world context and outcomes, with consideration of the legal framework; competition and other factors; and
    - Proof of concept trials offers opportunity for learning through testing administrative processes in the context of mass transfers and consolidation.

- This includes, the prospect to investigate and test matching capability; use and development of data standards; the costs in the transfer process, in addition to end to end customer journey mapping and the appropriate safeguards necessary for members, with potential qualitative feedback gathered from those whose pots were consolidated.

- In order to build beyond the proof of concept trials and ensure learnings are more broadly applicable, it requires the involvement of a wider group of stakeholders, including contract-based providers, consumer representatives and regulators.

Consolidation Models

- Consolidation system models can be prioritised, but final decisions should be informed and developed following the pensions industry's investigation and examination of administration processes and systems through operational focussed groups.

- There are two non-mutually exclusive consolidation models that should be prioritised for deferred small pots in the AE workplace pensions market: the default deferred small pot consolidator and the automatic pot follows member models.
  - We recommend that the Department, working with the pensions industry, should start to develop an initial costs/benefit analysis in the latter half of 2021 to help to further assess the models, including how these models complement Pensions Dashboards and reflect learning from the work on administrative processes, to help better understand the value for money and other considerations, as far as evidence allows
  - The pensions industry, working with the Department, should develop customer journey mapping in relation to the models to understand the end to end process and to provide a deeper appreciation of the impacts, mindful of changes to the operating and delivery context.

Chapter 5 - Micro Pots

This chapter discusses the issue of micro pots, which are created by individuals who stop saving shortly after the opt-out window or because of employment ending. Views from a range of stakeholders across the Working Group and expert panels are presented. The combination of this evidence is used to investigate the scale and nature of the micro pots challenge; the drivers of trends and the implications for both individuals and scheme providers.

Micro pots – definition and current data on scale of the problem

The report identifies/defines micro pots as particularly small pots that constitute a sub-set of the wider small pots challenge, typically in the range of £50 to £250, although in some cases even smaller. Through exploratory analysis of RTI data and building on provider member survey information we have started to develop a more detailed understanding of some of the main drivers that result in micro pots. This suggests that for the majority of small deferred pots it is employment ending and transitions to new jobs that drives growth of small pots, rather than active decisions to discontinue saving. (This was discussed in detail at Chapter two).

While there does not appear to be a sufficiently robust evidence-case to justify recommending changes at this stage, the Working Group explored some of the trade-offs, including the potential advantages and risks, relating to proposals including: extension to the opt-out window; refunds; and the effectiveness of current guidance/process. The Working Group recommends these areas are kept under review in light of the developing evidence base concerning micro pots and the opportunities to improve understanding of member behaviours and motivations.

Extending or removing the opt-out window

Guidance set out by The Pensions Regulator (TPR) explains how the opt-out window works and states that staff who have been enrolled into a pension scheme have one calendar month during which they can opt-out and get a full refund of any contributions.[46]

The Working Group discussed two policy proposals regarding the opt-out window when looking at how to reduce the numbers of micro pots; the first consideration was around the option to extend the opt-out window, and the second was to remove the ability to opt-out altogether, making AE compulsory.

Working Group Findings

There was a broad range of views across the expert panels, with some in favour of changing the opt-out period and some with reservations on the impact to members' pension savings and subsequent retirement outcomes.

- Responses from the Implementation panel were generally not in favour of changes to the opt-out window. Some respondents highlighted that extending the opt-out period may have negative implications for other savers as this may mean a further delay before pension contributions are invested.

[46] https://www.thepensionsregulator.gov.uk/en/business-advisers/automatic-enrolment-guide-for-business-advisers/7-assessing-and-enrolling-staff/opting-out

- The Master Trust panel had varying opinions on changing the opt-out window. Some respondents argued that the impact of incremental increases to the opt-out window would be small whilst others proposed extensions to enable savers to have more opportunity to notice the deductions in their pay check. Some panellists also expressed views that extending the opt-out window would simply shift or extend the missed opt-out period, rather than addressing the problem.

> *"An increase in the opt-out window would increase the time all new members are spent in cash, which could have detrimental impacts and create negative perceptions".*
>
> ***TISA - Contract Based Expert Panel***

> *"We think the opt-out window under automatic enrolment could be extended to three months (to cover contractual enrolment too). This might help avoid the proliferation of micro pots".*
>
> ***Willis Towers Watson - Contract Based Expert Panel***

> *"If the opt- out window were to be extended the implications for such a change should be assessed by Government for example a consideration of the impact on employers and payroll systems if the opt-out window were to cover two different tax periods".*
>
> ***FSB - Employer Expert Panel***

Permit refund on micro pots

Another option discussed was for the Government to permit refunds on micro pots. Following changes to the legislation on short service refunds which came into force on 1 October 2015, new members of occupational pension schemes with money purchase benefits are only entitled to a refund of their contributions if they opt-out of their pension scheme within 30 days. Prior to this, members who left an occupational pension scheme within two years of joining could be offered a refund of their contributions or a cash transfer to another scheme. The government introduced these changes to remove short service refunds for money purchase benefits, as this was contrary to the policy objective of increasing workplace pension participation[47]. There were different views concerning refunds which were surfaced during the Working Group initiative. In the Master Trust expert panel, some members suggested that offering refunds below £100 could increase member trust whilst others felt that this option would be at odds with AE core principles. Further, refunding pension contributions could discourage private pension saving among lower earners and would be inconsistent with the norming effect that AE has created around pension saving. This would go

[47] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/197845/pensions-bill-ia-annex-e-short-service-refunds.pdf

against the key working assumption that any solution identified by the Working Group should augment AE (as explained in Annex A – Terms of Reference).

In some situations, it is evident that refunding small pots directly to members is likely to reduce future retirement incomes, and this predominantly appears to impact on women, ethnic minorities and lower earners. Evidence on international experiences gathered by the PPI supports this, showing that on moving jobs, around 30% of US employees choose to take all of their 401(k) savings as a lump sum.[48]

> *"On moving jobs, around 30% of US employees choose to take all of their 401(k) savings as a lump sum. In 2015, around US$92.4bn (£70.6bn)3 was lost due to full lump sum withdrawals*
>
> *The US model results in significant funds, particularly those belonging to women, ethnic minorities and lower earners, leaving the pension saving system and ultimately reduces future retirement incomes".*
>
> ***PPI report 'How have other countries dealt with small, deferred member pots'[50]***

Working Group Findings

It was suggested that refunding micro pots could be attractive to single employer trusts. However, it would lead to savers losing the value of their employer contributions and some employees would struggle to build up their pension pots over their careers. There were also some mixed views on this from various panels.

> *"Given the negative externality of small pots because they are subsidised by other members, then if someone started saving against their wishes then it seems like it is everyone's best interest to allow their micro pot to be refunded. Of course, we don't want to encourage people to dip into their savings because of a temporary change of circumstances, and so the criteria to allow it should be strict, e.g. refunds can only happen within 6 months and provided that not more than £x has already been saved.*
>
> *If the refunding of micro pots were allowed then it's not clear what the need would be to increase the opt-out window, and of the two options we prefer refunding".*
>
> ***Which? - Member / Consumer Expert Panel***

Overall, a key observation across all six expert panels was that allowing savers to refund their micro pots would be inconsistent with continuing to normalise workplace retirement savings. Despite the majority agreeing with this, some panel members expressed opinions that this option should not be easily dismissed. The point was also made that the Working Group should look at a

[48] PPI report 'How have other countries dealt with small, deferred member pots' – due to be published January 2021

package of solutions around the refund option, as well as considering how to stop micro pots at their source and preventing their creation.

> *In response to short service refunds:*
>
> *"Refunds would remove many small pots in a way that satisfies consumers and is efficient for providers. But it would lead to money being taken out of pensions; and a number of small pots, if consolidated, would give some provision for retirement. Furthermore, there are considerations about the treatment of employer contributions and the tax implications".*
>
> ***ABI -Contract Based Expert Panel***

Customer communications and expectations

The Working Group considered whether the current opt-out process and the communication involved was effective in ensuring that members understood this process fully, or whether the issue was partly down to the lack of engagement many members have with their pension. Recent analysis conducted by the Institute for Fiscal Studies, found evidence that high workplace pension participation rates persist across groups with different levels of financial security. The study provided further evidence of the power AE's defaulting aspect and noted that whilst many individuals may make an active choice not to opt-out, some may not know they can or may not know how to.[49] In light of high pension participation rates amongst more financially insecure groups, the IFS report considers whether making the opt-out process easier and/or more prominent could be beneficial. It highlights the possible option of a reminder to those with low earnings, when they are informed about having been automatically enrolled, that it is likely to be worth clearing costly debts (such as a credit card debt or being behind on certain bills) before saving for their retirement.

Overall there may be scope to improve communications to give members a clearer understanding of the opt-out process, however, further work would need to be undertaken to explore the benefits, risks and trade-offs of doing so.

Conclusion and recommendations

Whilst there does not appear to be a sufficiently robust evidence-case to justify recommending changes in regard to micro pots at this stage, the Working Group recommends the areas discussed above are kept under review in light of the developing evidence base concerning micro pots and the opportunities to improve understanding of member behaviours and motivations.

The PPI Pensions Data Project, currently underway, will help with this by providing insight into members' savings behaviour across a subset of Master Trusts. This will provide clarity on aspects such as; how many pension pots people have, the size of those pots and, in due course, how often they move across different providers

[49] https://www.ifs.org.uk/publications/14850

Chapter 6 - What systematic and administrative processes are necessary to support large-scale transfer and consolidation solutions?

This chapter sets out the Working Group's consideration of the role of certain administrative systems and processes which have been identified as integral to underpin low-cost, effective large-scale automated transfer and consolidation systems. Evidence from a range of sources is presented, including expert panel survey responses, in addition to insight from the PPI's report – '*How have other countries dealt with small, deferred member pots'*[50] alongside preliminary analysis and stakeholder engagement conducted by the Department of how countries who have experienced multiple, deferred pension accounts have responded to this challenge.

Requirement of underlying administrative processes

In order to consolidate pension pots under the current arrangements and through any of the consolidation solutions discussed in this report, a pension provider must be able to:

1. Identify a small pot deferred pot within their scheme that is eligible for consolidation;
2. Identify a destination for the pot to be consolidated;
3. Establish the correct identity of the owner of the pot being consolidated, so that all parties to consolidation have certainty of the identity of the owner; and
4. Transfer the small pot to the chosen consolidator, following appropriate due diligence, (in particular ensuring the correct member accounts are matched and consolidated)

For pension providers to be able to do this on a sufficiently large scale in a cost-effective manner, significant improvements are required to current underlying operational administrative processes, which support existing member initiated consolidation activity. Without industry investment in improving current administrative processes the preferred large-scale transfer and consolidation systems (identified at Chapter four), would not be financially viable within the current AE workplace pensions market.

An effective large scale transfer and consolidation solution will rely on processes, including:

- A proxy unique identifier / matching capability – to enable pension providers to verify that the identity of the person whose pot(s) will be transferred is the same as the identity of the person whose pot will receive the transfer;
- Unified data standards - data standards are an essential part of the transfer / consolidation process as they create a documented / common agreement concerning the definition, format, transmission of data that will enable the correct identification of the member; scheme and pension pot and exchange of this information between pension providers;
- In addition, a central hub may also be beneficial or potentially necessary to manage the flow of contributions, it can support employers under certain consolidation models, albeit the set up costs and time involved in establishing this system are significant; and

[50] PPI report 'How have other countries dealt with small, deferred member pots' – due to be published January 2021

- Low-cost transfers – achieving low-cost transfers will be supported by the preceding elements, however, low-cost high volume transfers will also depend either on factors in the current process that can be changed to reduce friction in the transfer process or the fundamental creation of new approaches to enable large scale automatic transfers, while maintaining proportionate safeguards for members.

Recognising the fundamental role of administrative processes – including matching capability and data standards – there would be significant value in the pensions industry prioritising activity to establish what minimum viable core systems and processes should look like to enable consolidation to be achieved safely at scale within the AE workplace pensions market. While initial cost/benefit analysis of the preferred scheme-led models (identified at Chapter four) can proceed, more in-depth and detailed work on this should be informed by what is possible and deliverable in terms of developing and implementing improved administrative systems and processes. Without adopting a bottom-up approach, starting with a focus on processes, there are significant risks that consolidation models and the detailed design choices associated with them might not be deliverable on a cost-effective basis nor achieve the desired outcomes.

As part of the work in this area, this report recommends the pensions industry should establish operational focussed groups to investigate and address the administrative challenges, working with regulators and Government. It will be important that relevant experts are involved in this activity from across the pensions industry, including IT and operational managers; payroll specialists, in addition to trustees or Independent Governance Committees and finance directors.

Given many of the underlying core administration processes will be common, irrespective of the preferred consolidation models. scoping work to establish minimum viable administrative processes to support consolidation will result in learning which will help to inform detailed design decisions, including the deliverability and estimated overall value for money. This would then support the pensions industry and Government to make a decision on the preferred option from those models identified at Chapter four. Following this, further consideration could then be given to whether those models would benefit from adapting to provide the most proportionate and cost effective solution to the challenge.

Unique identification number

A unique identification number often underpins optimal mass consolidation systems. It provides the matching capability to enable pension providers to verify that the identity of the person whose pot(s) will be transferred is the same as the identity of the person whose pot will receive the transfer.

> *"Without a unique identification number system for scheme members, national transfer or consolidation systems will be difficult to operate. This is because without a unique identifier, significant resources are required to ensure that the correct pots are consolidated".*
>
> ***PPI report 'How have other countries dealt with small, deferred member pots'***[50]

"There would need to be a system to verify that the identity of the person whose pot is being consolidated is the same as the identity of the person whose pot the pot in question is being consolidated to. This was one of the major unsolved problems with pot follows member".

B&CE -Master Trust Expert Panel

Although within the UK pensions system there is no unique identification reference number, there are several unique identifiers that could be used or adapted to provide an effective matching capability, such as the national insurance number (NINO)[51] or the Unique Taxpayer Reference (UTR). These systems are already used in relation to existing member initiated and scheme bulk transfers (for example following a scheme wind-up or market exiting process), or where multiple pots in the same scheme are merged.

Whilst available evidence within the PPI report[50] demonstrates the benefits of a unique identification number, there are still deficiencies with those systems.

Mexico case study

"The insecurity of the national identity number has resulted in account duplication. While the tax identity number is intended to be unique to each individual, administrative processes do not prevent people setting up new numbers when they move employers, and therefore, people can accrue multiple pots within the AFORES system. In September 2020, there were 67.5m accounts within the workplace DC system, compared to 58m workers. While instituting a more rigorous system for personal identity numbers would help to solve the problem, the process would be very expensive".

PPI report 'How have other countries dealt with small, deferred member pots'

Due to the challenges of implementing a unique identifier within the current landscape, industry should focus initially on developing and testing data types (including NINO and/or UTR) to understand what combinations of data provide sufficient matching capability, as a proxy for a unique reference. Developing matching capability and ensuring its compliance with data protection law will be vital in enabling providers to verify the identity of the person whose pot(s) will be transferred is the same as the identity of the person whose pot will receive the transfer. Given of course that this system will not be fool proof so consideration would be required on member protections and the need for a safety net.

[51] Whilst the national insurance number could be used to develop matching capability it is important to note that it is not a unique identifier and cannot be fully relied upon as, for example, there are cases of duplication within the system. The UTR does not provide universal coverage. This means that matching processes will likely be challenging, however learnings from initiatives, including the PPI Pensions Data Project, provide a highly useful starting point for the pensions industry.

The member exchange proof of concept trials, preceded by feasibility work, could provide the industry with useful learnings in relation to testing data-matching capability and processes, including the potential costs.

While Pensions Dashboards will be asking schemes to match attributes relating to the verified identity of a user to their pensions, learnings from the Pensions Dashboard Programme in terms of its development of data standards and the use of those standards for data-matching, as part of its planned pension provider testing activity during 2021 may assist in identifying good practice.

Industry Data Standard

Common data standards are fundamental to support low-cost and large-scale transfers given that they provide agreed and documented approach to the definition, format and transmission of data to enable the correct identification of the member, scheme and pension pot. The PPI report '*How have other countries dealt with small, deferred member pots*' identified that: "unified data standards ensure a less costly and speedier transfer system."[50]

The Pensions Dashboards Programme (PDP) is developing data standards for purposes of enabling find and view dashboards services. While this is being created for a specific purpose and context, it provides the pensions industry with a starting point to build-out from for the purposes of enabling future large-scale deferred small pot consolidation. Given the PDP expects to validate data standards, following publication through user testing over 2021-22, including with pension providers this could be informative in terms of understanding what combinations of data types are most effective, if applied to a small pot transfers and consolidation context.

A priority for the pensions industry, working with government and regulators, during 2021 will be to establish what additional data standards, beyond those contained in the PDP data standards are necessary to support deferred small pot consolidation, acknowledging there may also be some standards within the PDP data standards which will not be necessary to support consolidation of deferred small pots. The Working Group therefore considered that the PDP data standards could provide a foundation for the development and usage of common standards which will be necessary for consolidation.

Learnings from the PPI Pensions Data Project and same scheme small pot consolidation practices could also help to inform this work. In the past trade / representative organisations have been helpful in promoting and sharing best practice. The member exchange proof of concept trials provides further opportunity to test combinations of data standards, following early feasibility work.

The Working Group's view is that sufficient adoption of data standards would be necessary if mass market consolidation solutions are to be effective, particularly for the whole AE workplace pensions market, and the ownership and ongoing responsibility for maintenance of these standards would also be critical. As a starting point, if the pensions industry develops standards necessary to support large scale transfers – building out from the PDP standards – these could then be owned, codified and promulgated within the industry. If a large proportion of deferred small pots are held by a small number of schemes this could then potentially enable sufficient adoption to support consolidation systems. If this did not achieve sufficient compliance levels, legislation may be necessary.

In Australia, SuperStream took about 4 years to fully develop and to iterate out all of the problems, and around US$1.5billion (£1.15bn) between 2012 and 2018. This funding came from pension providers through levies.

SuperStream is an overarching data and payment standard used by the tax office (alongside other sources of information, to match data and ensure the correct contributions are being made) pension schemes (to transfer pots between themselves) and employers (to make contributions). SuperStream was designed with the intention of ensuring transfers are speedier and more efficient.

PPI report 'How have other countries dealt with small, deferred member pots'

Low-cost transfer system

To support large scale consolidation across the pension landscape, it is important that pension providers are able to efficiently transfer members at a decreased cost. Currently, transfers can be costly and time consuming for providers, partly due to the insufficient adoption of common industry data standards.

The Department for Work and Pensions 2012 Impact Assessment on Small Pots and Automatic Transfers estimated that the marginal cost of the most straightforward transfer through Origo Options was approximately £50 each for the ceding and receiving provider (£105 in total)[52]. The cost was found to be predominantly made up of internal time, but also included the cost of making the transfer itself (through BACS or CHAPS).

Feedback received in response to the expert panel surveys indicated that this cost has reduced since 2011 – in some cases to approximately £20 to cede or receive a transfer. However, this level of cost remains too high in the context of large scale consolidation model(s), especially considering the value of pots which are likely to be within scope.

To achieve the desired consolidation, we will need to transfer people around on a massive and historic scale. Already the number of small deferred pots exceeds 8 million. Before we can start moving transfers like this we must create a quick and efficient transfer process. That is not a small task, but is one that will not only facilitate pot consolidation but also bring a vast improvement to customer experience compared to today.

NOW: Pensions - Master Trust Expert Panel

[52] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/184965/small-pots-automatic-transfers-impact-assessment.pdf

Speedy transfers prevent small, deferred pots from remaining in schemes of origin for long periods of time and receiving multiple charges. Transfers facilitated by a central system which uses uniform data (accompanied by a unique identification number system) will also make the process less costly for pension providers who will not have to spend significant time and resources confirming the identity of members and the correct destination scheme and pot.

PPI report 'How have other countries dealt with small, deferred member pots'

Many pension providers, administrators and schemes are signed up to a voluntary initiative to standardise data gathering and reporting in respect of pension transfers. The STAR initiative seeks to improve transparency of transfer times through voluntary accreditation and removal of friction in the processes, thereby reducing the length of time to process transfer requests and lowering costs. The framework STAR is implementing is aligned with their desired outcomes to improve the customer experience and ensure members can move to a platform that better meets their needs.[53]

The key priority for large scale transfers and consolidation of deferred small pots will be a separate and focussed review by the pensions industry of the end to end transfer process to identify where cost occurs in the system and where friction can be removed while retaining proportionate safeguards. Mass transfers which are non-member led may necessitate new approaches to achieve low-cost delivery and outcomes, while maintaining proportionate safeguards for members. Reduction in the cost of transfers will also result in benefits to members who could otherwise see a reduction in the value of their pots due to the administrative and transaction costs normally involved. This could start with looking at the end to end transfer process between Master Trust schemes, as part of the member exchange proof of concept, which could then provide learnings for the AE market more generally. Schemes and delivery agents that have carried out bulk DC to DC scheme transfers could also provide learnings, for example where an employer has changed their provider, or where the scheme has changed.

Conclusions and recommendations

Large scale cost-effective consolidation of deferred small pension pots will only be possible if current administrative processes are modernised across the AE workplace pensions market. This includes: the adoption of common data standards; effective matching capability; and the removal of undue friction to enable low-cost transfers with proportionate member safeguards.

- The pensions industry should establish operational focussed groups to investigate and address the administrative challenges which will be necessary to underpin mass transfer and consolidation systems that can be delivered at scale within the AE market. Consideration will need to be given to the appropriate governance structure to ensure effective transparency and reporting arrangements. The groups should focus on the following areas, with the aim of

[53] https://www.joinstar.co.uk/

making available an initial publicised update in summer 2021.

- Activity should be prioritised on scoping the core minimum viable administrative processes, including:

  - Developing and testing data that would provide sufficient matching capability, compliant with data sharing legislation, (as a proxy for a unique reference) to verify the identity of the person whose pot(s) will be transferred is the same as the identity of the person whose pot will receive the transfer. Opportunities to build out from data-matching in relation to Pensions Dashboards; the PPI's work on the Pensions Data Project and industry good practice should be maximised;

  - Developing and adoption of common standards is a key underlying element to support effective consolidation. The Pensions Dashboards data standards would provide a starting point to build out from, which could then be tested by providers ahead of confirming standards which could be codified by the industry; and

  - Identifying requirements for a low-cost bulk transfer process. This should start with an end to end review of the current individual transfer process to identify where cost occurs in the system and where friction can be removed – however mass transfers which are non-member led may necessitate new approaches to achieve low-cost delivery, while maintaining proportionate safeguards for members.

Chapter 7 – Working group suggested next steps and outline roadmap

Developing the evidence base – suggested analytical next steps

As well as seeking views on policy solutions to tackling the small, deferred pots challenge, the six expert panels supporting the Working Group were also used to facilitate discussion of current evidence gaps and areas where further research and analysis could support next steps in terms of policy development. A high-level summary of priorities identified by the panels is presented below, but there has not yet been any agreement on whether these are deliverable and over what timescales. The summary focusses upon the areas where there was most agreement over evidence need amongst members of the panels. The panels at which each point was raised are subsequently noted.

- For all consolidation options under consideration, evaluation of costs and benefits and proof of value for money was seen as an important next step. Modelling of impacts on individuals in different circumstances should be part of this. *(Member, Master Trust, Contract);*

- More comprehensive evidence on the average size of deferred pots and how many are being generated. This was seen as important for informing the specifics of policy design e.g. deciding pot size thresholds for pot transferral to a consolidator scheme *(Contract, Single Employer Trust, Employer);*

- As discussed in Chapter five, contributors from across a number of panels were supportive of a small-scale pilot of Member Exchange within Master Trust schemes. Research on member awareness and attitudes alongside such trialling activity was seen as helpful in addition to using data from the PPI Pensions Data Project to understand the scope of possible application. (Master Trust, Tech, Consumer);

- A specific need for further economic/market impact analysis in relation to the consolidator model was identified by several panels. This should look at the different options for determining who the consolidator scheme is and the impact on the market for a competitor that is not limited by commercial constraints. *(Member, Contract, Single Employer Trust);*

- In relation to Pot follows member, some providers suggested more research into the administrative costs of such an approach as well as GDPR implications. It was also considered important to better understand (through modelling) where the benefits of consolidation are potentially outweighed due to the higher charges in a new scheme. Interest in surveying saver and employer views on the processes and implications of Pot follows member was also expressed – e.g. employer attitudes to inheriting new staff's old pension *(Tech, Master Trust, Employer); and*

- Overseas research investigating the move from the current mature system to an automatic lifetime provider. There was particular interest in how Australia handles the various concerns that panel discussions have identified with the model. *(Master Trust, Contract).*

On the basis of the Working Group identifying these areas, it is suggested that the following five priority areas are explored to consider what evidence can be delivered in response:

1. How do individual members experience the small deferred pots challenge? How many small pots do individuals have? To what extent are these held across schemes or within the same scheme?

2. Which individuals tend to have small pots? How does this influence their retirement decision making and ultimately outcomes?

3. What is the estimated impact of policy options on scheme finances, pot numbers and individual outcomes?

4. What are the concerns and preferences amongst the general population of savers regarding small deferred pots and the design of the policy solutions being taken forward? How can their interests best be protected?

5. What is the most appropriate way to understand value for members? How can this best inform decisions around pot transfers and the design of consolidation solutions (e.g. pot size thresholds)?

Table 0.1 provides a summary of the research and analysis activities that the Working Group has suggested that will strengthen the evidence base in relation to the research questions identified. (although this is not an exhaustive list).

Table 0.1. Upcoming analysis and research activities on small, deferred pots

Analysis/research	Description
PPI Pensions Data Project	This research project will bring together DC pensions data from five Master Trust pension providers (NEST, NOW, SMART, B&CE and L&G) who have agreed to participate in the project to create the first individual administrative dataset of pensions. It will help to provide a more comprehensive view of the small pots challenge at the member level and may also show the extent to which individuals' pots are held within the same scheme or distributed across multiple providers.
Policy impact modelling	This would build upon PPI's published modelling to estimate the impact consolidation options (particularly those preferred by the

	Working Group) would have on pot numbers and provider finances.
Quantitative survey analysis	By developing further analysis of existing survey data sources (primarily the Wealth and Assets Survey) a more up-to-date understanding of aggregate trends in DC pot sizes and how these vary by key demographic (age, earnings, sector) can be obtained. There may also be scope to extend this analysis to explore the relationship between individuals' pot sizes/numbers and other variables e.g. retirement expectations and decisions, but this is more uncertain and requires full scoping.
PPI "How have other countries dealt with small, deferred member pots?" report	A rapid review of evidence from countries who have addressed, or are looking to address, the small deferred pension pot issue; how they did so; and the impact that their mitigation policies had, including a deeper analysis of three case-study countries (Australia, USA and Ireland) in addition to country profiles for a further eight. High level findings from this research have been included in this report and PPI intend to publish a report of the findings in early 2021.
Research with members and employers	Work to understand member and employer awareness of small, deferred pots; associated risks; and preferences/concerns related to the consolidation options being taken forward. This may involve building upon the insights taken from small scale surveys conducted by a number of schemes during the Working Group to build a nationally representative picture. This could be achieved through the development of new research studies (external or stakeholder-led) or through including relevant questions in existing nationally representative surveys. Findings would help inform the design/implementation of Pot Follows member/Consolidator solutions so that they best protect member and employer interests
Research with the pensions industry	Qualitative and/or quantitative research to help understand the costs and benefits of scheme-led consolidation solutions across different types of pension providers.
Evaluation of Member Exchange Proof of Concept (PoC)	Gathering of evidence to support evaluation of the PoC including possible research with participating providers and savers on their experiences of the Member Exchange process and their initial view of outcomes.

Below is an indicative roadmap that is intended to provide a high-level outline as a starting point. The activities and timescales suggested here will necessarily be informed and shaped by the process of discovery, learnings and outcomes from year 1 onwards.

	Immediate/short term Activity – 1 year	Medium term Activity – 2-3 years	Long term activity 3-4 years
Same scheme consolidation	Scoping / feasibility work - 2021/22	❖ Implement single consumer view/portal	❖ Move towards same scheme consolidation where pots are held in charge capped default funds
Core administrative reform- data standards, proxy for unique reference, and transfers	Scoping core minimum admin processes ❖ Initial update report summer 2021	Develop admin requirements ❖ Implementation of first pensions dashboards	❖ Core admin reform implementation
Member exchange proof of concept (PoC)	❖ Set-up operational group to take forward PoC trials early 2021 Scoping / feasibility work ❖ Feasibility report summer 2021	Depending on feasibility report - conduct PoC Evaluation of PoC	
Consolidation models – Default Small Pots Consolidator Scheme & pot follows member	Cost/benefit analysis ❖ Initial update report end of 2021	Customer journey modelling	❖ Potential implementation
Research/wider evidence base building	❖ PPI International evidence ❖ PPI Pensions data project ❖ DWP research with members and employers	❖ DWP quantitative survey ❖ DWP policy impact modelling with PPI input	❖ DWP monitoring and evaluation of consolidation system models
Governance	❖ Pensions industry-led operational groups ❖ Publicised update Summer 2021 Governance / update meetings every 3 months		

Annex A – Terms of Reference of DWP Small Pots Working Group

Context / challenge

- Automatic enrolment (AE) has successfully extended pension saving to millions of today's workers. It has been based on widespread consensus. Employers, pension scheme providers and private sector delivery partners throughout the supply chain have been central to its success.

- Making workplace pension saving the norm, including for lower earners and people who move jobs frequently, and without active engagement being necessary, created a higher risk that an individual's pension savings would become fragmented in a number of small pension pots. The growth of deferred small pension pots presents significant challenges, in particular for savers and pension providers. Enabling consolidation could help to support greater personal ownership and empower people to understand and maximise their workplace pension savings.

- Pensions Dashboards will help members to keep track of their various pensions, including small pension pots, and see what they have online and in one place to help support them in their retirement planning. Enabling widespread consolidation of multiple small pots will necessitate complementary solutions.

- The Department has formed a cross-sector Working Group to examine the issue, prioritise options and provide an interim roadmap, with a package of actions and key considerations to tackle the growth of small pension pots.

Role and purpose of the small pots Working Group

The purpose of the Working Group is to:

a) examine the scale and nature of deferred, small pension pots to scope the problem that needs to be addressed, looking at the whole automatic enrolment market, with a particular focus on master trust schemes at this point;

b) gather evidence, engaging with member, employer and other interested parties, with the aim of building consensus on the priority options to tackle the problem; and

c) provide reasoned recommendations to the Department's Ministers as an interim step, on the most appropriate option or combination of options, with an indicative roadmap of the issues and actions (including pilots and trials) for industry, delivery partners in the supply chain and government to help inform the Department's consideration of next steps.

Methodology / guiding principles

- To engage with interested parties and across sectors, with the aim of starting to develop consensus on emerging areas, as well as identifying potential issues and mitigating actions that would benefit from future work.

- To carry out a deeper analysis of available evidence, including consideration of behavioural insights and international perspectives concerning deferred small pots.

- In considering and prioritising options and associated issues and actions to balance costs and benefits for scheme members, pension providers and employers, mindful of the balance and trade-off between the following guiding principles:

  - Build on the success and behavioural insights of AE, and optimise retirement outcomes
  - Promote value and transparency for savers
  - Minimise administrative burdens for pension providers and employers (including SMEs)
  - Support competition and a vibrant pensions market for members
  - Fit with the direction of HMG’s existing pension policies and reforms
  - Maximise affordability and sustainability for members, employers, pension providers and tax-payers

Membership

The Department will act as chair to the group and provide secretariat support. The group membership will include representatives and officials from:

- The pensions and insurers trade bodies: Lizzy Holliday – PLSA and Rob Yuille – ABI
- Representative for Master Trusts: Adrian Boulding – Now: Pensions
- Consumer representative organisations: Stephen McDonald – Which?, Jack Jones TUC and Laurie Edmans – the Financial Inclusion Commission
- Employer representatives: Katie Miller – CBI and Emelia Quist – the FSB
- Payroll industry: Samantha Mann – the Chartered Institute of Payroll Professionals (CIPP)
- Research and Evidence: Chris Curry / Sarah Luheshi – Pensions Policy Institute
- Government: Greg Salt – HMT and DWP officials
- Regulatory body: Lisa Leveridge – TPR, John Reynolds – Financial Conduct Authority
- Software industry: Pauline Green – BASDA

These members will actively engage with other interested parties and be supported by the following expert panels:

- Member / Consumer panel
- Master trusts panel
- Provider / contract based panel
- Single employer pensions panel
- Employer panel
- Implementation / technical panel

Members of the Working Group will act as chair to the expert panels.

Confidentiality
A data sharing agreement will be established between the Department and members of the Working Group.

Outcomes and timing
The Department will prepare an interim report for DWP Ministers later in the Autumn, which reflects the Working Group’s input and recommendations.

Resources
The Department will provide all secretariat support for the Group, alongside support and input from the Pensions Policy Institute.

Annex B – Small Pots Expert Panels: Terms of Reference

The Department has established a cross-sector Working Group with the pensions industry involving payroll; employer and member representatives to assess and make recommendations, as an interim step, on ways to tackle deferred, small pension pots. The Working Group will be supported by Expert Panels, to provide expert input and advice from the perspective of their panel's area of interest.

The Panel's objectives are to:

1. Provide evidence, advice/ challenge and insight for the Working Group, on the scale and nature of the problem of deferred, small pension pots from the perspective of their Expert Panel's area of focus;
2. Help to build the evidence-base on the challenge and assess potential solutions, including through responding to survey questions; and
3. Help to build consensus around the findings; priority option(s) and provide advice on the overall roadmap to help inform the Working Group's recommendations in an interim report for the Department's Ministers later in the Autumn.

The expert panel will support the Working Group with the aim of developing consensus on emerging findings and next step options, as well as identifying potential research; issues and mitigating actions that would benefit from future work.

The Department will provide all secretariat support for the group, alongside support and input from the Pensions Policy Institute.

Annex C – Expert Panel Membership

Master Trust

- NOW: Pensions – Chair
- Aegon
- Aviva
- Smart Pension
- AON
- Creative
- Legal & General
- National Employment Savings Trust (Nest)
- B&CE (The People's Pension)
- Scottish Widows
- Phoenix Group
- Atlas
- Crystal
- Pensions and Lifetime Savings Association (PLSA)
- Pensions Policy Institute (PPI)
- Mercer

Contract Based

- Association of British Insurers (ABI) – Chair
- Hargreaves Lansdown
- Fidelity
- Prudential
- Aviva
- Scottish Widows
- Willis Towers Watson
- Phoenix Group
- Zurich
- The Investing and Saving Alliance (TISA)
- Royal London
- Financial Conduct Authority (FCA)

Single Employer Pensions

- Pensions and Lifetime Savings Association (PLSA)
- Legal & General
- Aviva
- Phoenix Group
- Mercer
- Lane Clark & Peacock (LCP)
- Industry Technology Systems Ltd (ITS Ltd)
- Urenco
- Siemens

Member / Consumer

- Which? – Chair
- Financial Inclusion Commission
- Money and Pensions Service (MaPS)
- Wealth at Work
- Trades Union Congress (TUC)
- Financial Service Consumer Panel (FSCP)
- Age UK
- Nest Members' Panel

Employer

- Department for Work and Pensions (DWP) – Chair
- Federation of Small Businesses (FSB)
- Tesco
- Royal Bank of Scotland
- Confederation of British Industry (CBI)
- Direct Line

Implementation

- Chartered Institute of Payroll Professionals (CIPP) – Chair
- Zivot
- Pension Bee
- The Pensions Regulator (TPR)
- Association of British Insurers (ABI)
- Pensions and Lifetime Savings Association (PLSA)
- The Society of Pension Professionals (SPP)
- Origo
- Association of Consulting Actuaries (ACA)
- Investment and Life Assurance Group (ILAG)
- Business Application Software Developers Association (BASDA)
- NOW: Pensions
- Reach PLC
- The Chartered Institute for IT (BCS)
- Pensions Policy Institute (PPI)
- Criterion
- Royal London
- Hargreaves Lansdown
- Aviva
- Association of Pension Lawyers (APL)

Annex D – Policy Options

Table Ex.1: policy option trade-offs[54]

The July 2020 Pensions Policy Institute (PPI) report – *Policy options for tackling the growing number of deferred members with small pots*.[55] Explored the potential outcomes of various policy options on the number of deferred pension pots. The report included a range of policy options which are outlined in the table below.

The Working Group has updated the trade-offs in light of the available evidence and its guiding principles, consistent with its terms of reference. While individual models are considered, they are not mutually exclusive. When examining the options, it became clear that some of them complement each other and could be combined which could increase effectiveness. Examples of this include dashboards; same scheme consolidation; member exchange and potentially the consolidator options.

Policy	**Trade-offs**	
	Potential positives	**Potential negatives**
Dashboards	• Encourages engagement	• Potential for lower levels of consolidation • Not expected to alter the small deferred Defined Contribution pension pot trend, if relying on member initiated action alone

[54] Policies not modelled are not included in the table
[55] https://www.pensionspolicyinstitute.org.uk/research/research-reports/2020/2020-07-23-policy-options-for-tackling-the-growing-number-of-deferred-members-with-small-pots/

Same provider consolidation	• Potential to reduce administrative burden on providers and employers	• Less comprehensive coverage • May not be possible in schemes where members have multiple pots with different charges and different funds
Same provider – single consumer view	• A single view could be consistent with the direction of dashboards	• Does not reduce the number of small pots
Member exchange	• A potentially simpler, quicker to implement version of pot follows member • 'Safe' proof of concept trials could provide potential for significant learning • Opportunity for proof of concept testing	• Less comprehensive coverage than pot follows member • Delay in transfers leading to pot erosion • Potential for "cherry picking"
Pot follows member	• More comprehensive coverage • Reduces administrative burden on employers • Opportunities to build out from Pensions Dashboards data standards • Harnesses inertia in a similar way to AE • Simplicity enables greater consumer understanding • If no active account, some deferred small pots would be unconsolidated	• Increased pot erosion resulting from transfers to schemes with higher fees • Increased administrative burden for providers • Increased transfers and associated costs could be passed on to members or risk scheme viability
Lifetime provider	• Policy simplicity • Ease of administration • Most comprehensive coverage • A voluntary lifetime provider could mean greater 'ownership' but only by the more engaged	• Unfair competitive advantage • Significant systemic change – presents risks to the continuing success of AE • Very complex for payroll systems and for employers to manage contributions to multiple schemes. Potential for "cherry picking": less engaged/low earning savers could be disadvantaged;

			• Delay, leading to small pot generation • Risk of employer disengagement, resulting in anchoring to minimum contributions
Long-term savings models	Default Small Pot Consolidation Scheme – first provider	• More comprehensive coverage • Provides for those who change jobs frequently or move in and out of work • Low administrative burden on employers • Harnesses inertia in a similar way to AE • Could be delivered within the existing pensions landscape	• Potential for unfair competitive advantage • Delay in transfers leading to pot erosion • Potential for “cherry picking” • Unlikely to drive engagement with retirement savings, due to automatic process • Costs of managing pots sent to the consolidator may need to be cross-subsidised at expense of other members • Need to consider the risks if assets are separated from collecting contributions – if this happens we may not be able to move away from dual charges to a single charge on funds under management
	Default Small Pot Consolidation Scheme – Carousel of providers	• Facilitates member engagement by introducing a degree of member choice to the consolidator model • Provides for those who change jobs frequently or move in and out of work	• Potential unfair competitive advantage for schemes on the carousel vs. those not included • Commercial viability uncertain – needs an assessment of the costs and benefits to establish this • Need to consider the risks if assets are separated from collecting contributions – if this happens we may not be able to move away from dual charges to a single charge on funds under management

	Default Small Pot Consolidation Scheme – Single scheme (Government funded)	• Provides for those who change jobs frequently or move in and out of work • Low administrative burden on employers • Being 'state approved' might help aid member trust	• Would have implications for the scheme cross-subsidy; competition and tax-payer funding • Need to consider the risks if assets are separated from collecting contributions – if this happens we may not be able to move away from dual charges to a single charge on funds under management
Short-term savings models	Default Small Pot Consolidation Scheme – Government Consolidator	• Possible lower cost financing options and so better outcomes for members • Possible lower cost financing options and so better outcomes for member	• Potential for unfair competitive advantage between government-backed consolidator and commercial schemes • Would operate outside of the current pensions system • Would present government funding implications • Would be inefficient for providers and consumers, and remove investment opportunity • A short-term deferred pot 'holding tank' would not benefit from member engagement opportunities

Source: PPI July 2020 - Policy options for tackling the growing number of deferred members with small pots

Annex E – Data tables and methodology

The following annex provides data tables and further methodological information relating to new research and analysis presented in Chapter two.

Analysis of early cessations using HMRC RTI data

This analysis was conducted using Real Time Information (RTI) data from HMRC. It uses the same RTI employee pension contributions data and a slightly adapted methodology from an established methodology previously published to monitor stopping saving rates from pension saving, analysis from which was most recently published in the Automatic Enrolment Evaluation Report 2019.[56] Detailed information about the assumptions and caveats associated with that analysis listed in Annex 7 of the Evaluation Report will mostly also apply to this ad-hoc analysis of early cessations.

This analysis counts the number of "active decision cessations" (as defined in the methodology of the existing monitoring analysis) with a short length of time between the first and last month of pension saving in the data. In the existing monitoring analysis, an "active decision cessation" is someone who:

- Has stopped saving;
- Did not leave their employment or become ineligible for automatic enrolment; and
- Whose last pension contribution was not within 6 weeks of their first pension contribution.

The analysis is restricted to employees eligible for automatic enrolment at staged employers.

RTI only includes information on when pension contributions were made, not when employees requested to stop saving. It is for this reason that the methodology previously established set an effective opt-out window of 6 weeks.

Our chosen primary definition of an "early cessation" (informed by the distribution of cessations made during the early months of saving as shown in – the Results section) is when the length of time saving is up to 3 months.

The main caveats of this analysis are:

- The definitions used from the existing analysis were chosen to create good proxies for the estimates of the number of opt-outs and total numbers stopping-saving. However, this new analysis is using these definitions for a different purpose, namely assessing active decision cessations soon after the opt-out window, but has not been tested for accuracy against this new

[56] https://www.gov.uk/government/publications/automatic-enrolment-evaluation-report-2019

purpose. In particular, a metric of active decision cessations the month after starting to save may be an undercount due to the 6-week window used for the purpose of assessing opt-out.
- As only employee pension contributions are reported through RTI, it cannot identify employees saving into a workplace pension with employer-only contributions or via salary sacrifice.
- The analysis is only based on whether employees pay any pension contributions in a given tax month, not how much, and therefore can only give an indirect indication of potential pot sizes.

The analysis defines the month in which an employee starts saving as the earliest month of saving over an 18-month period. This was sufficient for the purposes of the stopping-saving monitoring analysis. However, in the context of assessing the potential number of micro pots, it may lead to an over-estimate in cases where the employee had previously contributed into a pension at the same employer before then, such as employees who previously stopped saving who are later re-enrolled. Figure 0.6 of the report shows the distribution of cessations falling in the first six months of saving. Table 1 below shows the same figures, including the remaining proportion of cessations made after more than six months of saving.

Table 2: Distribution of cessations by number of months saving – average April 2014 to June 2020, eligible employees at staged employers

Length of time saving (months)	2	3	4	5	6	More than 6
Proportion of cessations	0.5%	8.9%	5.1%	4.0%	3.8%	77.7%

Notes:
1) Cessations in this table refer to active decisions to stop saving after the opt-out window. This is measured in RTI by when contributions are made, not when employees inform employers.
2) Length of time saving means the number of tax months between the first and last month of saving, inclusive of both first and last month. An individual may have not made a pension contribution in every month during that period.
3) The analysis only identifies cessations where the last pension payment was at least six weeks after the first pension contribution. Therefore, the proportion who cease saving after two months shown in this table is likely to be an under-estimate.

DWP DC Scheme Data Request

Data on the size distribution of deferred pension pots among DC pension schemes presented in Figure 0.3 and Figure 0.4 was requested by the Department and shared by scheme providers. In total, five schemes were contacted and shared their data. These were predominantly Master Trust schemes with one scheme including data for the Group Personal Pension (GPP) schemes they manage alongside their master trust business. The schemes were selected for the exercise based on their large size (estimated total number of accounts) and significant automatic enrolment customer base. The data gathered should not be interpreted as a comprehensive or representative view of the wider DC pensions market. It provides an indicative view of the size distribution of deferred pots at a single point in time for five of the largest DC scheme providers only. All individual level scheme data was shared with the Department on a confidential basis due to its commercial sensitivity and will remain anonymous. Tables 2 and 3 below present the proportion of deferred pots in each size band based on data aggregated from the five participating schemes. The data is unable to be quality assured by the Department, as the figures have come from an external source. Therefore, the data in the tables relies on the transparency of the self-reporting providers. The data refers to August - September 2020. In total, the data presented encompasses 11.2 million deferred pension pots. As one provider was unable to share distributional data below £1,000, the distribution shown in Table 3 is based upon a smaller sample of 8 million deferred pots.

Table 3 Distribution of deferred pension pots in sample of DC schemes by £1,000 size band.

Pot Size	**Aggregate percentage of pots by £1,000 size band**
£0-999	73.8%
£1000 - 1999	12.0%
£2000 - 2999	4.9%
£3000 - 3999	2.4%
£4000 - 4999	1.4%
£5000 - 5999	0.9%
£6000 - 6999	0.6%
£7000 - 7999	0.4%
£8000 - 8999	0.3%
£9000 - 9999	0.3%
£10,000+	2.9%

Table 4 Distribution of deferred pension pots in sample of DC schemes by £100 size band.

Pot Size	**Aggregate percentage of pots by £100 size band below £1,000**
£0-99	25.2%
£100 - 199	13.4%
£200 - 299	8.9%
£300 - 399	6.5%
£400 - 499	5.0%
£500 - 599	4.1%
£600 - 699	3.3%
£700 - 799	2.8%
£800 - 899	2.4%
£900 - 999	2.1%
£1,000+	26.2%

Pensions and Lifetime Savings Association (PLSA) Data Gather

The Pensions and Lifetime Savings Association (PLSA) carried out a data gather request in Summer 2020, which involved asking pension scheme providers for information on the number of pension pots (both active and deferred) below £10,000, as well as the average balance of deferred pension pots below £100. Overall, twenty-four different providers responded to the data gather request including defined contribution (DC), defined benefit and hybrid schemes. For the purpose of the analysis in this report, only the eight DC providers were included. The names of these providers will remain anonymous. The data was collected by the PLSA using the SurveyMonkey online survey tool in July 2020, and was analysed by the Department in September 2020. Due to the small sample size, the data should be treated as indicative and not necessarily representative of the entire DC market.

The aggregate data included in Chapter two Figure 0.5 is presented below in Table 4, which shows the distribution of pots £10,000 or below in the eight DC providers included in the data gather.

Table 5 Active and deferred pension pots below £10,000 by size band from PLSA data gather sample of eight DC providers – August 2020.

Pot/fund size	**Total number of active/deferred memberships across schemes for each pot/fund size below £10,000(2020)**	
	Active	Deferred
£1-£100	261,220	468,946
£101-£500	367,055	679,757
£501-£1,000	265,368	317,306
£1,001-£2,000	366,405	267,557
£2,001-£5,000	548,923	236,369
£5,001-£10,000	304,916	116,624

Wealth and Assets Survey analysis of occupational DC pot size

Data from the Wealth and Assets Survey (WAS) is included in Chapter two of the report. WAS is a large-scale national longitudinal survey of private households in Great Britain. The survey uses Postcode Address File (PAF) as the sampling frame, and to ensure that the sample is representative of the GB population, 'probability proportional to size' sampling technique is used. Interviews are conducted using Computer Assisted Personal Interviewing (CAPI), and collect detailed information on individual and household wealth in various forms. The analysis presented in Chapter two of this report uses data from Wave 5, which covers a period of July 2014 until June 2016 and Round 6 of the survey which was conducted over a period between April 2016 to March 2018. Overall, 18,400 households were interviewed in Wave 5 of the survey and 16,000 in Round 6. The data on occupational DC pot size is self-reported and is only based on an individual's two largest occupational DC pots. Therefore, some smaller pots could be missing from the analysis. In addition, as it is self-reported, where an individual has forgotten or "lost" a pension pot they necessarily will not report it and it will not appear in the data. Table 5 presents the size distribution of occupational DC pension pots reported in WAS in Wave 5 and Round 6. To produce the figures in Table 5, separate frequency distributions were first calculated for the relevant WAS variables containing the value of the largest and second largest occupational DC pension pots, by £2,000 size band. These were then summed to produce an overall size distribution encompassing individuals' two largest DC pots. The appropriate cross-sectional individual-level weight variables were used for the Wave 5 and Round 6 analysis.

Table 6 Distribution of occupational DC pension pots reported in WAS Wave 5 and round 6 by pot value.

	Wave 5		Round 6	
	Total	**Cumm. %**	**Total**	**Cumm. %**
Under £2000	2,609,567	35.3%	3,329,650	41.6%
£2000-£3999	888,436	47.3%	905,443	52.9%
£4000-£5999	541,508	54.7%	483,182	58.9%
£6000-£7999	288,050	58.6%	257,733	62.2%
£8000-£9999	207,083	61.4%	210,910	64.8%
£10000-£11999	255,946	64.8%	283,546	68.3%
£12000-£13999	145,167	66.8%	154,395	70.3%
£14000-£15999	208,496	69.6%	173,151	72.4%
£16000-£17999	127,979	71.3%	114,205	73.9%
£18000-£19999	79,513	72.4%	93,322	75.0%
£20000-£21999	140,247	74.3%	107,430	76.4%
£22000-£23999	54,054	75.1%	78,883	77.4%
£24000-£25999	106,256	76.5%	102,949	78.9%
£26000-£27999	65,121	77.4%	100,033	79.9%
£28000-£29999	46,199	78.0%	40,422	80.4%
£30000-£31999	178,834	80.4%	129,903	82.0%
£32000-£33999	53,508	81.1%	65,912	82.8%
£34000-£35999	102,396	82.5%	94,261	84.0%
£36000-£37999	49,647	83.2%	34,168	84.4%
£38000-£39999	19,061	83.5%	44,562	85.0%
£40000 and over	1,222,289	100.0%	1,200,830	100.0%

Annex G - Small-Scale Consumer Insight Surveys

A number of small-scale consumer insight surveys were conducted by members of the Master Trust and Contract-Based Expert Panels, to support the Working Group's evidence gathering on member perspectives. These took place between the 19th October and 6th November 2020. Due to the short timeframe within which insight needed to be gathered, sampling for the surveys generally relied upon use of organisations' existing member panels or representatives. A number of the participating organisations noted that the sample achieved was likely to be skewed towards individuals who were more engaged with pensions and selection bias should therefore be assumed across all samples. The nature of these surveys means that results should be treated with caution and only used to draw broad indicative conclusions. The surveys were carried out by the participating organisations through email or web-based electronic survey systems.

Five organisations participated in the surveys, these were Creative Pensions, Legal and General, Hargreaves Lansdown, Nest and Aegon. All of the survey samples are relatively small and their design means that findings should be treated as indicative and not generalised to the wider population of savers. Four of the participating organisations were able to provide quantitative responses from their surveys. Due to the particularly small sample achieved in the fifth survey, themes emerging from it are only discussed qualitatively in Chapter two of this report. No quoted percentages are based on this survey and it is not included in Table 6 (below) for this reason. The total base size for the remaining four surveys and reported percentages for each survey question drawn upon in Chapter two are included in the table below. Please note that only the total base size is included and sample sizes will vary for individual questions given that not every respondent answered all questions.

Table 6. Aggregate responses to member insight surveys by participating organisation, conducted between 19th Oct and 6th Nov 2020.

		Organisations			
		1 (Sample = 4205)	**2** (Sample = 2499)	**3** (Sample = 2406)	**4** (Sample = 948)
Are you aware of the number of pension pots you have?	Yes	65%	82%	83%	-[57]
	No	35%	18%	17%	-
Are any of the pension pots you currently have inactive?	Yes	58%	85%	85%	85%
	No	22%	11%	9%	13%
	Don't Know	20%	4%	6%	2%
Which of these best describes how accurately you know the balance in each of your inactive pension pots	I have no idea at all	47%	29%	34%	18%
	I have a rough idea of how much	41%	48%	42%	61%
	I know exactly or to within the	12%	23%	24%	21%

[57] Organisation 4 chose to modify the wording of question one so data has not been included due to comparability issues.

	nearest pound or two				
How much do you feel you understand about the possible risks of owning one or more small inactive pension pots?	nothing	60%	33%	40%	23%
	very little	20%	29%	25%	30%
	a basic understanding	11%	19%	14%	27%
	a fair amount	5%	13%	13%	14%
	a lot	4%	6%	8%	6%
Which of the following best describes your feelings, when thinking about owning one or more small, inactive pension pot?	it wouldn't worry me at all	18%	22%	21%	34%
	it would worry me a little	18%	27%	24%	26%
	I wouldn't really think about it	40%	27%	27%	32%
	it would worry me	16%	20%	21%	7%
	it would worry me greatly	8%	4%	7%	2%
When thinking about small, inactive pension pots, which of the following most concerns you?	Risk of pots being eroded in value by charges	20%	27%	33%	42%
	Pots being forgotten and lost	42%	34%	26%	26%
	Difficulty in accessing and managing them in retirement	22%	22%	23%	34%
	Other	-	-	-	5%[58]
	None of these things would concern me	16%	17%	18%	29%
Which of the following are important to you when	allowing my current employer to take responsibility for	27%	18%	23%	24%

[58] Organisation 4 added in an additional response to this question of 'other'.

thinking about your workplace pension pot?[59]	the pension provider I use				
	To make it easier to stay in control of my pension	-	73%[60]	-	-
	keeping the same pension provider throughout my working life	31%	20%	20%	14%
	having my pension pot follow me to a different providers as I move jobs	61%	57%	46%	35%
	having more personal control over movements of my pot between providers	42%	50%	42%	35%
	for my inactive pots to be consolidated together on my behalf	51%	53%	50%	27%
	Other	-	7%	-	-
Which of the following best describes how aware you were of the treatment of your pension contributions if you were to choose to stop saving into your pension	I was not aware at all	46%	37%	34%	35%
	I had some awareness	32%	35%	33%	37%
	I was completely aware	22%	28%	33%	28%

[59] Respondents were asked to select all options that applied to them, therefore the percentages for this question will equal greater than 100 percent.
[60] Organisation 2 added in some additional answer choices for this question.

after the 'opt-out' window?					
If you were to choose to stop saving into your pension in the 1-2 months following your opt-out window, how worried would you feel about the pension contributions you had made remaining in a small, inactive pot?	it wouldn't worry me at all	14%	15%	18%	18%
	it would worry me a little	25%	28%	23%	28%
	I wouldn't really think about it	21%	20%	21%	26%
	it would worry me	23%	27%	24%	20%
	it would worry me greatly	17%	10%	14%	8%

Contact Details

Press enquiries should be directed to the Department for Work and Pensions press office.

Media enquiries: 020 3267 5144

Out of hours: 07659 108883 (journalists only)

Website: www.gov.uk/government/organisations/department-for-work-pensions

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