DWP Department for Work and Pensions

Meeting future workplace pension challenges:

improving transfers and dealing with small pension pots

Presented to Parliament by the Secretary of State
for Work and Pensions by Command of Her Majesty
December 2011

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Foreword by the Minister of State for Pensions

Automatic enrolment will make pension savings the norm. This is vital for the health of our society and our economy. But to successfully achieve this cultural shift, we need to make sure that money put into pension saving stays there.

This paper sets outs key areas where the Coalition Government is taking action to ensure the future pensions system works in the interests of individuals, helping them achieve a decent standard of living in retirement.

First, we will abolish the use of short-service refunds for defined contribution (DC) occupational schemes. We estimate that this will retain £70 million–£130 million per year in pension saving. These rules jeopardise persistent pension saving for younger and low-to-moderate earners, and will not be part of an automatic enrolment world. We aim to abolish these rules at the earliest legislative opportunity and expect the rule change to happen as soon as 2014, provided we are able to implement an accompanying solution for small pot transfers at the same time.

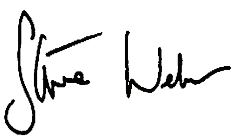
With regard to small pots, the case for reform in this area is clear: as a result of automatic enrolment and high job churn, there could be up to 4.7 million additional small pension pots in the system by 2050. The problem is compounded by systemic barriers that make transfers of pensions costly, complex and time consuming.

We do not want the achievement of automatic enrolment undermined by a future where people collect lots of small pension pots, which they may lose or never consolidate to achieve a decent annuity.

This paper sets outs possible ideas for how we might address this, ranging from small changes to the current system to encourage transfers, to an automatic transfer system where pension pots could either be consolidated in one ‘aggregator’ scheme or move with people from job to job.

These ideas are ambitious and there are a lot of questions for us to answer before finalising what shape any reform should take. For instance, what do we do with the existing stock of small pension pots, and how do we effectively design a system that balances efficiencies for industry with the need to protect individuals’ savings? This paper asks these questions and challenges the pension community to suggest other models and ideas to deal with small pots and transfers.

I would like to thank the pensions community for their input to this work so far. This collaboration needs to continue if we are to make automatic enrolment a success and achieve an efficient, robust pension system for the 21st century.



Steve Webb MP
Minister of State for Pensions

Executive summary

Introduction

1. The UK pension landscape is undergoing a transformation. Automatic enrolment will result in millions of people saving for their retirement for the first time. We will see employers taking on new duties to enrol their workers into a pension and contribute to this scheme. Membership of defined contribution (DC) pension schemes will also increase. But the onset of automatic enrolment and the changing pension landscape also brings challenges.

2. To successfully achieve a cultural shift so that pension saving becomes the norm, we need to make sure that money put into pension saving stays there. The short-service refund rules for DC occupational pension schemes work against this principle. By allowing a refund of the individual contribution if the member does not make an active choice, these rules jeopardise persistent pension saving for younger and low-to-moderate earners. We will, therefore, abolish these rules at the earliest legislative opportunity. This will retain £70–£130 million per year in pension saving[1]. We expect the rule change to happen as soon as 2014, provided we are able to implement an accompanying solution for small pension pot transfers at the same time.

3. We anticipate a significant increase in the number of small, dormant pension pots after automatic enrolment. This is because the workplace pension reforms will take place against the backdrop of an increasingly mobile labour market, where, on average, an individual will work for 11 employers during their working life. This combination of job churn and five to eight million new pension savers could lead to up to 4.7 million small pension pots added to the system by 2050. This, coupled with the barriers that prevent people from transferring their pension pots, will lead to poor outcomes for individuals and the pensions industry. The case for change is clear.

4. This paper presents three broad approaches to initiate debate about how best to address the problem of small pension pots: relatively minor changes to the current voluntary transfer system; automatic consolidation of small pensions in an aggregator scheme; and pensions automatically moving with people from job to job.

[1] A full Impact Assessment is published alongside this report.

The case for change – dealing with small pots and improving transfers

5. Chapter 2 presents the case for change. It shows that the expected increase in the number of small pension pots and the associated poor outcomes for individuals are compounded by a system where individuals and schemes are not incentivised to pursue transfers.

6. We estimate that there are in excess of one million small pots in the current system, with around 50,000 small pension pots created each year. Our modelling predicts a more than seven-fold increase in 2017, with around 370,000 new small pension pots under £2,000 being created each year. By 2050, we expect this figure to have risen to 420,000 each year, resulting in a total of around 4.7 million small pots in the system. This represents a huge burden for pension schemes to manage. At an aggregate level, it is inefficient for multiple providers to manage several small pension pots for any given individual.

7. An increase in small pension pots also creates significant difficulties for individuals. Some may pay higher annual management charges for any deferred pension pot they are no longer saving into. And pension schemes may pass on the cost of managing more small pots to members. Having multiple small pension pots makes it more difficult for people to take and act on decisions about their pension saving. Additionally, a small pension pot does not buy a decent annuity through the open market. These small pots may not translate into a pension at all – for instance, some individuals may not bother to keep track of any small pots and, also, they may not find a scheme willing to accept a transfer of such a small amount or annutise it. This is somewhat mitigated by trivial commutation rules, which allow individuals to take a cash sum of their small pot in certain circumstances, but it does not fully ensure that individuals benefit from the full retirement income that they have been saving for.

8. Individuals should be confident that the money they and their employer contribute to their pension will go towards their retirement, and will not end up stranded or lost in the pension system.

9. However, there are a range of barriers that prevent individuals from dealing with their small pension pots. Firstly, there is individual inertia, which means individuals are unlikely to act on decisions about their retirement. Secondly, there are a range of systemic barriers that mean initiating transfers of pension pots between schemes is costly, complex and time consuming.

10. Without action to address these barriers, we will face a future where the UK pension landscape will be overwhelmed with small, inactive pension pots. Other countries that operate a compulsory pension system are facing a similar dilemma. For example, the Australian Government is introducing an automatic consolidation process to deal with the millions of lost accounts in its superannuation system.

11. The UK pensions landscape, however, is unique and we need solutions that suit our circumstances. Chapter 2 suggests a number of principles for reform. These principles reflect the need to balance the costs and benefits for individuals, the pensions industry and employers.

12. For individuals, our guiding principles for reform are:

- Promote good retirement incomes.
- Promote engagement with saving.
- Fairness.
- Simplicity.

13. For schemes and employers, our guiding principles are:

- Ease administrative burdens.
- Tackle inefficiencies.
- Sustainability.

14. And finally, for Government, our guiding principles are:

- Affordability.
- Compatibility with wider pension reform.

How should reform be approached in this area?

15. We put forward three approaches to generate debate on how we might improve the transfer system and reduce the number of small pension pots. After considering changes that could improve the current voluntary system, the paper presents two approaches to automatically transferring small pension pots when an individual leaves or joins an employer.

16. The first approach (Chapter 3) looks at changes to the current voluntary system to improve member outcomes. Potential changes might include:

- providing additional information to encourage members to transfer;
- making transfers easier for members through standardised, simple forms;
- improving access by requiring schemes to accept all transfers in;
- reducing the fixed costs of administering small pots; and
- promoting existing services such as the Pensions Tracing Service to help people find all their pension pots.

17. These measures may go some way to reduce costs for schemes. However, the key problem is that this would not overcome individual inertia. Research consistently suggests that giving individuals more information or encouragement is unlikely to result in them making an active decision about their retirement[2]. However, we are keen to hear whether stakeholders agree with this and whether there is anything more we could do within the current system to help schemes and individuals.

[2] Clery, E., Humphrey, A. and Bourne, T, 2010, *Attitudes to Pensions: The 2009 Survey.* DWP Research Report No. 701. Available at http://research.dwp.gov.uk/asd/asd5/rports2009-2010/rrep701.pdf

Possible automatic transfer processes

18. Chapters 4 – 6 discuss two automatic transfer approaches for DC schemes. The first would bring together an individual's small pension pots into an aggregator scheme. The second would transfer small pension pots when an individual joins a new employer into that employer's automatic enrolment scheme.

19. These approaches would facilitate the consolidation of an individual's small pension pots in one scheme. The key advantage of an automated process is that it overcomes individual inertia. We are keen to hear from stakeholders about other mechanisms that could facilitate the transfer of pension pots, with minimal action from individuals, employers and providers.

20. Although the models we discuss are different, both encompass common challenges and we are interested in feedback on how to deal with these. The key challenge is around how to design a system that balances the need for efficiency and simplicity while also protecting the interests of members.

21. Chapter 4 looks in detail at how we might mitigate any risks to individuals in an automatic transfer system and poses questions about:

- the degree of individual choice in an automatic transfer model, in particular the right to opt out;
- the role of advice; and
- how to deal with the existing stock of small pension pots.

Automatic transfers into an aggregator scheme

22. Chapter 5 explores a proposal where all small pension pots are moved automatically into an aggregator scheme when an individual leaves their employer. If they have a pension pot under a certain size, then that pot would be default transferred to the aggregator scheme.

23. To offset any risks to individuals, we suggest that an aggregator scheme should have certain characteristics, including accepting even the smallest pot, having a simple process, ensuring it is a low-charging scheme and that it interacts effectively with members.

24. The chapter also considers possible design features for this model. We are seeking feedback on the following issues:

- Who should cover transfer costs?
- Possible approaches to defining a small pot for this model.
- Whether older small pots could be automatically transferred to the aggregator scheme.
- Whether there should be a single or multiple aggregator schemes.
- Whether there is appetite in the pension industry to act as an aggregator(s) and what are the advantages to the National Employment Savings Trust (NEST) having an aggregator role.

Pension pots following people from job to job

25. Chapter 6 sets out the most ambitious reform approach – where pension pots follow individuals from job to job. This process could dovetail with automatic enrolment. As such, it is forward looking and relies on a person joining a new employer and being automatically enrolled into a new pension scheme. Each time this happens, the default action will be for a person's pension to move automatically to their new employer's automatic enrolment scheme.

26. For such a system to work in practice, the cost of establishing and running an automatic transfer process would need to be less than the cost of maintaining small, dormant pots. We assume, for efficiency, that the system will therefore need to be electronic and include a database, whereby schemes can cross check the details of members and their pension pots.

27. There are a number of outstanding questions about this approach that we want to raise with stakeholders:

- How to mitigate risks to individuals, particularly considering different charge levels and investment returns between schemes.
- Whether there should be a maximum value for pots that are eligible for transfer and if so what it should be.
- What should happen to small pots if the individual is out of work for an extended period of time?
- What should happen to existing small pots and should they be brought into this transfer system?

Next steps

28. Chapter 7 sets out the consultation process and summarises the consultation questions. The consultation closes on **23 March 2012**. We will follow this initial consultation with a government response by summer 2012 and firmer proposals for reform.

Introduction 1

1. We are living longer and life expectancy is projected to continue to increase. In 2007, the number of pensioners exceeded the number of children in the UK for the first time[3]. This is good news and has led to a programme of pension reform to help people to achieve the retirement income they would like. In April 2011, we published *A state pension for the 21st century* (Cm 8053), setting out options for delivering a simpler and fairer State Pension which rewards those who do the right thing and save for retirement, and is sustainable for future generations.

2. Despite the fact that we are living longer, private pension saving has declined dramatically. Between 1997 and 2010 the proportion of jobs in the private sector with any employer-sponsored pension provision declined from 46 per cent to 36 per cent[4]. The number of employee jobs with pensions has fallen from 12.7 million in 1997 to 10.5 million in 2010. This decline is seen most sharply in occupational pension schemes, where the number of active members fell from 12 million in 1997 to 8.3 million by 2010, the lowest level since the 1950s[5]. We estimate that around seven million people are not saving enough to meet their retirement aspirations.

3. From 2012, our workplace pension reforms will address that under-saving gap and help people afford a decent standard of living during retirement. Ten million people will be automatically enrolled by their employers. We expect five to eight million people to stay in and save into a workplace pension for the first time or to save more than before[6]. Their employers will also contribute to their pension saving.

[3] Office for National Statistics, 2009, 2008-based national population projections, ONS.
[4] Office for National Statistics, 2010, The Annual Survey for Hours and Earnings, ONS.
[5] Office for National Statistics, 2011, The Occupational Pension Schemes Survey 2010, ONS.
[6] Pensions Bill 2011 Impact Assessment, summary of impacts, Annex B – workplace pension reform, DWP.

1.1 The pensions landscape after automatic enrolment

4. Workplace pension reforms will change the pension landscape. We expect automatic enrolment to make private pension saving the norm. For the reforms to succeed we need to make sure that the whole UK pensions landscape can evolve to meet new challenges and deliver the best outcomes for everyone.

5. For individuals, this means a pensions system which promotes good retirement income and engagement with saving while being simple and fair. For industry, this means recognising and reducing burdens on business, tackling inefficiency and ensuring that any reforms have long-term sustainability.

6. We are working in partnership with HM Treasury (HMT), the Financial Services Authority (FSA) and The Pensions Regulator (TPR) to ensure that, under automatic enrolment, members' interests are protected and that the regulatory regime for defined contribution (DC) schemes is robust.

7. However, there are still some areas which may cause members not to get the retirement income they might otherwise expect. These include:

- **Inappropriately high charges:** we do not want to see individuals exposed to excessive charges that eat into their pension savings. That is why, in the Pensions Act 2011, we extended an existing reserve power to set a maximum charge for pension schemes used for automatic enrolment. It means that a maximum charge level can be applied to pension scheme members who become deferred members as well as active scheme members. We will use this power if we feel it is needed.
- **Poor take-up of the open market option:** we do not want individuals to lose out on valuable income in retirement by unknowingly signing up to an uncompetitive annuity arrangement at the point of retirement. That is why we want to encourage people to shop around for the best annuity rate available on the open market. Representatives from industry, consumer groups and government bodies are jointly considering how to make the open market option (OMO) the default position, and how to provide further support to individuals in making that important one-off decision about retirement income. We support the Association of British Insurers's (ABI) proposal to remove the annuity application form from the information provided to individuals and to promote the benefits of the OMO as part of this approach. We will be making a further announcement on the broader underlying package of measures to promote the OMO and increase consumer engagement in spring 2011.
- **Short-service refund rules in DC schemes:** these rules mean an individual can receive a refund of pension contributions if they leave an occupational pension scheme within two years[7]. Unless they make an active choice to initiate a transfer, this refund of contributions is often the default action. We intend to abolish the use of short-service refunds for DC occupational pension schemes at the earliest legislative opportunity. Though timing will be subject to the Parliamentary timetable, we expect this rule change to be introduced as soon as 2014. Section 1.3 and Annex A provide more details.
- **Small pension pots and transfers:** we are concerned that having multiple small, dormant pension pots, and no easy way to amalgamate them, is detrimental to individuals' long-term saving. Concern about small pension pots and the difficulties inherent in the current transfers system have been raised by other interested parties.

[7] The rules apply to early leavers leaving the scheme between three and 24 months of becoming active members.

Box 1 – stakeholder comments

'Government and regulators should review as a matter of some urgency how to ensure that it is more straightforward for people to move their pension pot with them as they move employer...'

***Making automatic enrolment work: A review for the Department for Work and Pensions*, Paul Johnson, David Yeandle and Adrian Boulding, October 2010.**

'The issue of transfers and small pots is a big risk for the longer-term success of auto-enrolment. If the number of small pots proliferates, with most workers having multiple unconsolidated pots relating to different employments, then the costs of pensions will inexorably rise. This will hurt scheme members, employers and the industry, and ultimately reduce savings level and erode the benefits of auto-enrolment.'

National Association of Pensions Funds, response to DWP Call for Evidence: regulatory differences between occupational and workplace personal pensions.

'...the issue of small pots needs to be addressed...This will become a bigger problem with the arrival of automatic enrolment.'

The Association of British Insurers, response to DWP Call for Evidence: Regulatory differences between occupational and workplace personal pensions.

1.2 This paper – small pots and transfers

8. This paper focuses on the issue of small pots and pensions transfers. We want to work with others, particularly in the pensions industry, to fix what we see as a pressing issue for the pensions industry, employers and individuals. Currently, around 50,000 small, dormant pension pots are created each year[8]. With millions of people starting saving from 2012, as well as an increasingly mobile workforce, we estimate that around 370,000 small pension pots will be created each year, more than a seven-fold increase. In the absence of change, by 2050 we expect small, dormant pension pots to number around 4.7 million[9].

9. This anticipated volume of small pension pots, coupled with the barriers to transfers, will lead to poor outcomes for individuals and inefficiency for the pensions industry. This paper considers changes to address the problem of small, dormant pension pots, whether pre-existing or created by automatic enrolment.

10. The scale of change that automatic enrolment will bring means that any policy solution needs to be forward-looking and work alongside automatic enrolment. However, we must also seize the opportunity to consider whether our policy solutions can address the problem of 'legacy' small, dormant pension pots. We discuss issues specific to legacy pots throughout the paper.

11. We set out three key options to reduce the number of small pension pots to generate discussion and debate.

[8] Modelling based on 2010 ASHE data. For our analysis we are assuming that a small pot is a pension fund that is worth less than £2,000. This figure is based on structured discussion DWP had with providers throughout 2011.

[9] Based on DWP modelling using Pensim2.

12. The options cover:

- relatively minor changes to the current system to help make member-initiated transfers easier and less expensive;
- a transfer system where small, dormant pension pots can be easily consolidated into an aggregator scheme or schemes with minimal involvement of individuals or employers; and
- a system where small pension pots follow individuals from job to job.

13. Through this paper we are seeking input and evidence from stakeholders about the scale of the problem and the extent that the solutions we have suggested can meet the challenges ahead. We will work with industry to refine these reform options and identify what solutions can work in practice. We particularly welcome suggestions from all our stakeholders about how the pensions industry might lead in this area, without the need for government-led interventions, so that any new legislation facilitates rather than forces change.

14. We need to find solutions that balance the needs of all interested parties and that will work in the long-term. Together, we have a real opportunity to address these issues and make automatic enrolment a success. We aim to publish a government response by summer 2012.

1.3 Short-service refunds

15. A key trigger for dealing with small pension pots and transfers now, rather than later, are changes that we will make to the short-service refund rules for DC occupational pension schemes. These rules conflict with the primary objective of automatic enrolment – helping people save more for their retirement. By allowing a refund, these rules jeopardise persistent saving by excluding certain individuals from building up a decent pension pot.

16. In early 2011 we released a *Call for Evidence*[10] to help find solutions to this problem. It asked whether the current regulatory framework supported automatic enrolment and the key policy objective of getting more people to save more for their retirement. We are grateful to everyone who replied to the *Call for Evidence*.

17. In our response to the *Call for Evidence*, we said that the short-service refund rules were unlikely to continue in their current form, but that we wanted to take more time to consider our policy options and how, more broadly, the pension industry can deal with more small pension pots after automatic enrolment. Following this analysis of the policy options available to us, we have decided to remove short-service refunds for occupational DC schemes at the earliest legislative opportunity.

18. Though timing will be subject to the Parliamentary timetable, we expect this rule change to be introduced as soon as 2014, provided we are able to implement an accompanying solution for small pot transfers at the same time.

19. Our analysis suggests that removing the option of short-service refunds from 2014 will retain £70–£130 million a year in pension savings. This represents pension contributions that would otherwise have been refunded to individuals and employers. We are publishing an Impact Assessment of this change to short-service refund rules alongside this document.

[10] *Preparing for Automatic enrolment: Regulatory differences between occupational and workplace personal pensions*, A Call for Evidence. January 2011. DWP. Available at http://www.dwp.gov.uk/docs/personal-pensions-consultation.pdf

20. To give effect to this change, we propose to amend the preservation requirements in the Pensions Act 1993. This would mean that an individual's right to a pension in a DC scheme begins from the time that contributions are paid in. This would not override the right to a refund arising from a worker's right to opt out of an automatic enrolment scheme.

21. However, we know that the elimination of short-service refunds removes an important mechanism that DC occupational pension schemes use to manage small pension pots. Without the ability to offer a refund to early leavers, employers with occupational DC schemes will need to cover the cost of administering pension pots for deferred members.

22. Therefore, we want the abolition of short-service refunds to come into force alongside a solution to deal with small pension pot and improve transfers.

23. This makes it a priority to work together to design solutions to deal with the increase in small pension pots, and overcome inefficiencies in the transfers system.

1.4 Small personal pension pot commutation rules

24. The Government recognises that even with a much improved transfer system for small pots, there remain existing issues for individuals left with very small pots at retirement. These can become effectively stranded if such a pot is too small to annuitise, cannot be combined with other pensions savings, and an individual does not have the lifetime trivial commutation option open to them.

25. Examples include where an individual has already taken lifetime trivial commutation, but later discovers a remaining small pot (or receives a late payment into a pension), or where an individual has a defined benefit (DB) pension in payment which puts their wealth above the trivial commutation threshold, but also has a remaining small DC pension pot.

26. Since 2009, tax rules permitted individuals with small occupational pension pots of £2,000 or less to be commuted as a lump sum payment from age 60, regardless of other pensions wealth held and outside the lifetime trivial commutation limit. Recognising that there are cases where small personal pension pots can become similarly stranded, the Government has recently announced, alongside the draft Finance Bill 2012 that it will extend these rules to allow individuals to commute up to two small personal pension pots of £2,000 or less as a lump sum in their lifetime. Draft legislation has been published and is open to comments on the HMT website, and the reform will take effect from April 2012.

1.5 The rest of the paper

27. Chapter 2 presents the case for change to reduce the number of small pension pots and sets out our reform principles. Chapters 3 to 6 set out a range of options to address the problem of small pots across DC schemes and assess options against our reform principles. Chapter 7 summarises our questions and the process for responding.

Small pension pots: the case for change 2

28. This chapter sets out the scale of the small pots problem, current barriers to transferring small pots and why change is needed. It then looks at current policies to help deal with small pots, in particular trivial commutation rules, the current industry response to the problem and our guiding principles for future reforms.

2.1 The scale of the current problem

29. We estimate that currently around 50,000 small pension pots are created each year[11]. The Pension Advisory Service (TPAS) have suggested that they deal with an average of 30 to 40 enquiries a week, or around 3 per cent of all calls, about stranded pots – small pots that members cannot access[12]. And statistics from the Association of British Insurers (ABI) show that between July 2009 and June 2010 there were nearly 110,000 pension funds of less than £5,000 annuitised. This was around 22 per cent of all funds being annuitised[13].

30. With limited evidence, the Department for Work and Pensions (DWP) currently has no robust estimate of the current scale of the problem, but believes there to be well in excess of a million dormant pots in DC schemes with a value below £5,000. We would welcome evidence to help us estimate how many small, dormant pension pots already exist[14].

31. For the analysis carried out for this paper, we define a small pot as a fund with a value below £2,000. This is based on structured discussions with providers and aligns with the limit for small pot trivial commutation.

[11] Modelling based on 2010 ASHE data. For our analysis we are assuming that a small pot is a pension fund that is worth less than £2,000.
[12] This is based on informal discussions with TPAS on the volume of calls they receive on small pension pots.
[13] Association of British Insurers, Q2 2010 data. Pension annuities sold by size of fund.
[14] DWP estimates, based on ABI data of the value of defined contribution (DC) pots annuitised and estimates of the total number of current DC pension arrangements.

32. However, we appreciate that this £2,000 figure is somewhat relative and, from a provider's point of view, the measure of a small pot may depend on the scheme's particular business model. Equally, a small pot from an individual's perspective may be one with so small a value that they may not bother to track it down or it may be too small to purchase a decent annuity. In Chapters 5 and 6 we ask how to define a 'small pot' for different reform options.

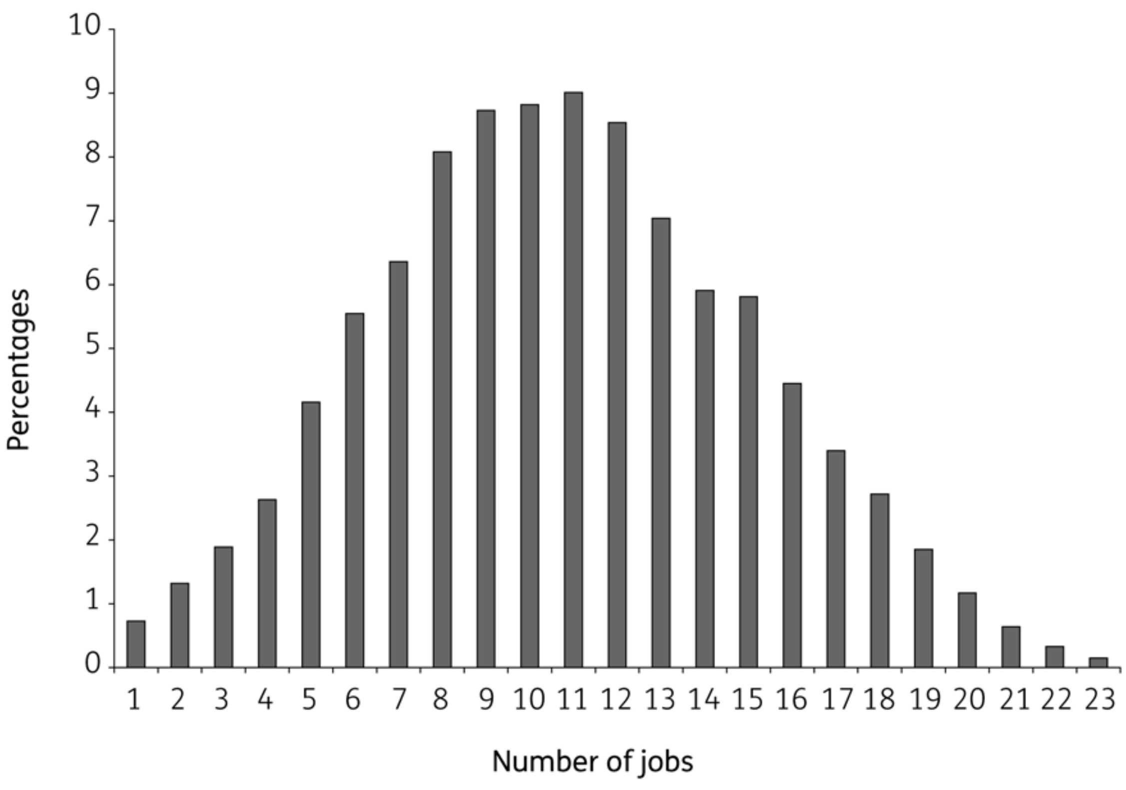
Question:

1. Do you have evidence on the scale of the current problem of small pension pots?

2.2 The possible scale of the future problem

33. Automatic enrolment will achieve a major behavioural change and will see millions of people saving in workplace pensions. From 2012, 10 million people will be automatically enrolled, resulting in five to eight million people newly saving or saving more[15]. These new savers will not stay with one employer for life. On average, an individual will work for 11 employers during their working life. And 25 per cent of individuals will work for 14 or more employers[16].

Figure 2.1: Distribution of total number of jobs an individual will have over their lifetime, full working history

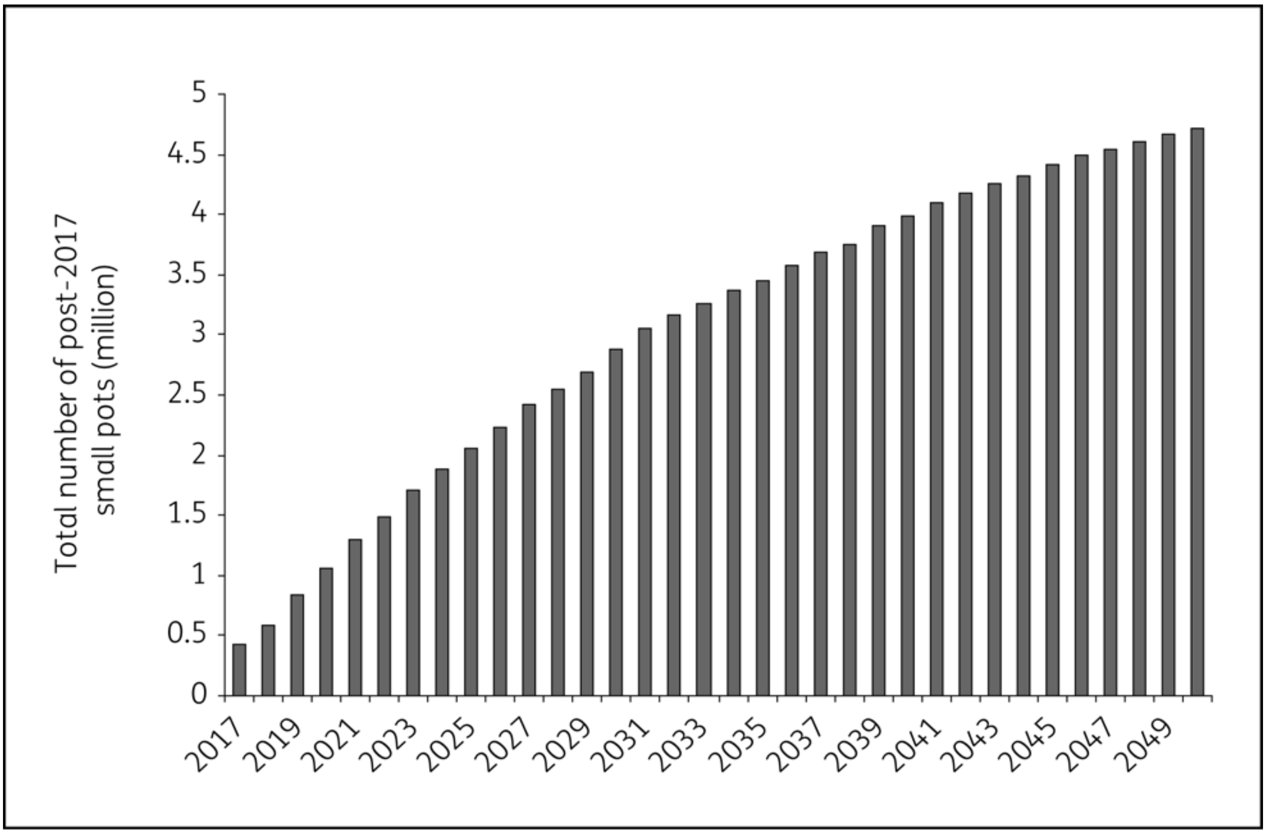


Source: DWP modelling using GB Pensim2 model.

[15] Pensions Bill 2011 Impact Assessment, summary of impacts, Annex B – workplace pension reform, DWP.
[16] Johnson, P., Yeandle, D. and Boulding, A., October 2010, *Making Automatic Enrolment Work, A review for the Department for Work and Pensions* – Chart 5.1. Available at http://www.dwp.gov.uk/docs/cp-oct10-full-document.pdf

34. This combination of the expected high volume of new savers and labour market churn will lead to a significant increase to the number of small pension pots that are generated. By 2017, our modelling predicts a more than seven-fold increase, with around 370,000 new small pension pots under £2,000 being created each year[17]. By 2050, we expect this figure to have risen to 420,000, and there to be a total of around 4.7 million small pots in the system – see Figure 2.2. This creates a huge challenge for all pension schemes.

Figure 2.2: Total number of newly generated small pots, from 2017[18]



35. It also creates problems for individuals. An individual retiring in 2050, who had 11 jobs over his or her lifetime will have saved in around four or five separate DC-type schemes[19].

2.3 What are the barriers to transferring small pots?

36. The current transfer process is governed by the Pension Schemes Act 1993, which gives individuals the right to a transfer. Additional regulatory requirements on transfers in workplace personal pension (WPP) schemes fall from Financial Service Authority (FSA) rules.

[17] This estimate is based on DWP modelling, which combines forecasts of expected participation in pension schemes following automatic enrolment, with data on job churn from the Labour Force Survey.
[18] Based on DWP modelling using Pensim2. These figures do not account for the combination of pots through transfers or master trusts, but do include the removal of pots through annuitisation, death, or fund growth. Pots created before 2017 are not included on this figure.
[19] Based on DWP modelling using Pensim2.

37. Transfers of DC pensions in the current pensions system are based on two principles – that the onus for pursuing a transfer rests on individuals, and that trustees and providers have ultimate discretion over whether to accept the movement of the pension pot. Current pension products are designed for this world where the member initiates transfers. For WPPs, contracts between schemes and members will not usually allow schemes to make transfers without member consent.

38. DWP has held informal meetings with stakeholders to get a better understanding of the burdens associated with administering small pension pots and what barriers exist at the moment to transferring, and consolidating pension pots. There are both demand- and supply-side barriers as well as transactional costs.

- **Supply-side barriers:** many schemes currently do not accept transfers or impose a minimum transfer amount, meaning individuals with small pension pots have difficulties finding a scheme to transfer into (though stakeholder pension schemes must accept transfers in). Some advisers are unwilling to take on small pension transfers.
- **Transactional costs:** where advisers do take on small pension transfers, the cost can take a significant proportion out of the pension pot. For low earners this can act as a financial barrier to transfers. Administrative problems, such as the complexity of transfer forms and the time taken to complete a transfer, may also discourage members from acting. Upcoming DWP research suggests that the reasons some of these transactions are delayed may include the need for trustees to approve transfers and the need for providers to check that a scheme is valid[20].
- **Demand-side barriers:** research shows a lack of engagement in pensions (at least partly because of complexity), especially among low to moderate earners[21]. Because the transfer process in workplace DC schemes is generally initiated by members, many do not transfer their pension when they leave an employer even when it may be in their best interest to do so. Where members do choose to make a transfer, the supply-side issues and transactional costs discussed above may prevent the transfer happening.

Question:

2. Do you agree that these are the current barriers to transfers?

2.4 Why change is needed

39. The anticipated seven-fold increase in the number of small pension pots generated each year after automatic enrolment, together with the barriers to transfers will lead to poor outcomes for individuals and inefficiency for the pensions industry.

20 Wood, A., Young, P., Crowther, N. and Toberman, A., 2011, *Transferring a Pension Scheme: Summary of Research Findings*. Available at http://research.dwp.gov.uk/asd/asd5/summ_index_2011_2012.asp

21 Clery, E., Humphrey, A. and Bourne, T., 2010, *Attitudes to Pensions: The 2009 Survey.* DWP Research Report No. 701. Available at http://research.dwp.gov.uk/asd/asd5/rports2009-2010/rrep701.pdf

40. For individuals, the accumulation of small pension pots means that they may not be able to access the retirement income that they have been saving for. Our specific concerns are:

- **Higher charges:** individuals who are deferred members of a pension scheme (i.e. those who are no longer paying contributions because they have moved employers) may find themselves subjected to higher charges than when they were an active member (if they received an active member discount). Also, the cost of administering all small pension pots may end up being shared by all members if passed on through charges.
- **Barrier to engagement:** once automatic enrolment has achieved a cultural change to make pension saving the norm, people may start to engage more actively in considering, for example, whether they are saving enough. It may be more difficult for people to engage actively in decisions about pension saving if they have multiple pension pots. Furthermore, if people lose track of pots they may have an inaccurate picture of what they can expect their retirement income to be.
- **Lost retirement income:** if an individual has a small pot, they may not be able to get a pension at all from this pot. For example, some individuals may not bother to keep track of any small pots and their provider may be unable to trace these pots without further information. Research conducted by DWP in 2010 suggests that moving jobs is a big factor in losing track of a pension. This research surveyed 2,000 customers who had used the Pensions Tracing Service – of these, the majority (68 per cent) said they had lost their pension because they had switched jobs and had not bothered to keep records of their previous pension scheme.[22]
- **Problems accessing all retirement income:** Even if someone has not lost track of their pension pot, they may still be unable to turn their small pot into a pension, for example, if they are unable to transfer the pension to another fund because the scheme will not accept such a small amount. The small pot could remain stranded if they are unable to take it as a cash lump sum – for example, because they are over their £18,000 trivial commutation limit from several pots and still have a small personal pension of, say £2,000. Such a small pot would provide a trivially small income stream in retirement and the individual may not bother to purchase or may not be sold an annuity through the open market option (OMO).
- **May not be able to transfer their pot:** where an individual chooses to make a transfer, they may not be able to do so in practice, due to the supply-side barriers discussed above. For instance, the transfer may be too costly or the receiving scheme may refuse to accept such a small amount. If this happens, and the individual is unable to take the pot as a cash sum under the trivial commutation rules or chooses not to annuities it, the small pot will remain stranded – representing lost retirement income.

[22] Shury, J. and Koerbitz, C., 2010, *The Pension Tracing Service: A quantitative research study to establish who is using the service, and their outcomes*. DWP Research Report No 697. Available at http://research.dwp.gov.uk/asd/asd5/rports2009-2010/rrep697.pdf

Box 2 – stakeholder comments

'The costs of managing small pots impact on all pension savers, as they are covered through charges...Small pots create significant problems for consumers. Many people end up with several small pension pots because they lose track of their pension when they move employer. They also find it complicated, confusing and expensive to combine multiple pots, and may find providers and indeed trustees unwilling to accept transfers in.'

Association of British Insurers, response to DWP Call for Evidence.

'...even if the member is willing to arrange a transfer, it may be difficult to find an arrangement that will accept small amounts. And individuals may find it difficult to choose an appropriate vehicle – or to find a financial adviser willing to help with the choice in respect of such a sum... if the amount is retained in the original occupational scheme, the charges could be very high relative to the size of the fund, resulting in the individual receiving little benefit from the arrangement.'

The Actuarial Profession, response to DWP Call for Evidence.

'We welcome your strong commitment to.. deal[ing] with the stranded small pot issue. We would stress that this is an urgent issue.'

The Peoples Pension Coalition (Which, Age UK, the Trade Union Congress), letter to the Minister for Pensions.

41. For the pensions industry, the increase in small pension pots will lead to ongoing cost increases. At an aggregate level, it is inefficient for multiple providers to administer multiple pots for a given individual. For some providers, administering a small pension pot is not profitable business and providers will need to find ways of covering the expected increase in small pension pots, possibly by passing the cost on to members.

42. There may also be additional costs for employers with occupational schemes. Some fund administrators charge a fixed rate to employers with occupational pension schemes to cover the maintenance of pension pots, no matter their size (fees range from £25–£50 each year)[23]. If the pot is very small, the value of the administrative charges over an individual's working life may outweigh the value of the pot itself. This type of scenario is both inefficient and individuals and employers do not benefit from it.

43. These issues were recognised by respondents to the DWP's January 2011 *Call for Evidence*[24], who agreed that automatic enrolment will compound the problems associated with small pension pots. Nearly all respondents agreed that government needs to start tackling these issues before the onset of automatic enrolment.

[23] *Preparing for Automatic enrolment: Response to the Call for Evidence, Regulatory differences between occupational and workplace personal pensions*. DWP, June 2011. Available at http://www.dwp.gov.uk/docs/personal-pensions-consultation-response.pdf

[24] *Preparing for Automatic enrolment: Regulatory differences between occupational and workplace personal pensions, A Call for Evidence.* DWP, January 2011. Available at http://www.dwp.gov.uk/docs/personal-pensions-consultation.pdf

> 'Small pots are a problem for schemes because the cost of administering them diverts resources away from effective management of long term, more stable, saving pots. Small pots do not often become part of a bigger consolidated pot but are trivially commuted later at the point of retirement.'
>
> **Confederation of British Industry, response to DWP Call for Evidence**

2.5 Current measures to help deal with small pots

44. Recognising the issue of long timescales and complexity involved in completing pension transfers, UK pension providers have taken steps to facilitate easier transfers. For example, a number of providers of WPPs have joined the Origo Options system.

45. The Options system was set up by Origo (an industry owned not-for-profit initiative) to standardise the transfer process between pension schemes by providing a single inter-company IT platform for participating schemes. This system has simplified processes and removed a lot of paperwork for both customers and schemes, therefore saving time and money. Initially, Options only handled pension to annuity transfers, however, the system has since started transferring pots from pension to pension. Currently, 29 providers are signed up to the Options system.

46. In Quarter 3 of 2011, 32,000 pension to pension transfers took place between pension schemes through the Options system. During 2010, around 20 per cent of pension to pension transfers within Options were below £10,000, of which almost half were under £5,000. So, unsurprisingly, around 90 per cent of transfers were above £5,000 suggesting that larger pension pots are more numerous, more viable or desirable to move[25].

47. The use of Options has cut down the time usually taken to process a transfer of a pension between providers. The average time for transfers using Options is 8.7 calendar days, compared with up to 36 calendar days, prior to the introduction of Options in 2008[26]. Occupational pension schemes can typically take four–seven weeks to complete transfers[27].

48. In addition to industry led solutions, HM Treasury (HMT) has also taken steps to help those with very small personal pension pots remaining at retirement. New regulations will allow individuals aged 60 or over to access up to two small personal pension pots of £2,000 or less as a lump sum, regardless of other pensions wealth held. This mirrors the existing easement for small occupational pots, which can already be paid out as a lump sum.

49. While this easement will help those who have already reached retirement with very small, fragmented pension pots, the more important reform going forward is to ensure that it is much easier for individuals to consolidate pension pots during the accumulation of their savings. In future, this will mean fewer individuals reach retirement with many separate small pots, or pension savings they have lost track of entirely.

[25] Information used with permission from Origo.
[26] *ibid*.
[27] Wood, A., Young, P., Crowther, N. and Toberman, A. (2011). *Transferring a Pension Scheme: Summary of Research Findings*. Available at http://research.dwp.gov.uk/asd/asd5/summ_index_2011_2012.asp

2.6 Reforming the system – guiding principles

50. The expected increase in the number of small pension pots and the associated poor outcomes for individuals are compounded by a system where individuals and schemes are not incentivised to pursue transfers.

51. Without action to address these barriers and make the process of moving small pots easier, we will face a future where the UK pensions landscape will be overwhelmed with small, inactive pension pots. If individuals are unable to access these pots, because of the cost or because they have simply lost track of them, it may undermine the impact automatic enrolment has on improving retirement incomes.

52. Australia operates compulsory pension saving and is facing a similar dilemma and is looking at ways to help individuals consolidate their pension in the one place. The Australian Government is currently exploring ways to reduce the number of lost superannuation accounts by introducing an auto-consolidation process that draws together individuals' pension accounts into their last active scheme.

Box 3 – International evidence – Reforms in Australia to reduce the number of small pension pots

Australia has been practising compulsory superannuation arrangements for 25 years (compulsory 3 per cent award-based system commenced in 1986). This has led to over $1.4 trillion (AUS) being saved in the pensions system.

However, compulsory pension savings, and high job churn, mean that the Australian system has amassed millions of 'lost accounts'. A lost account is one where no contributions have been paid for two years and schemes no longer have the current address for individuals.

The Australian Government estimates that, out of its 11.5 million strong workforce, there are 33 million pension accounts, five million of which are 'lost' containing $20.2 billion (AUS). Unless individuals proactively look for these accounts, they will remain stranded and eventually claimed by the tax office. The Government wants to make sure individuals can access these savings, to maximise their retirement income.

Previous attempts to encourage members to consolidate their pensions have failed, and the number of lost accounts has been growing. These measures include:

- The Tax Office contacting people to encourage consolidation.
- Improved tracing services for members to access pots.
- A standardised transfer protocol.
- Funds continually reminding members of the need to do so.

The Australian Government is now looking to introduce an auto-consolidation system, where 'lost' pots will be transferred to a member's last active account. This relies on the Tax Office cross checking an individual's lost pots with their Tax File Number (universal identifier), and then instructing scheme A (with the lost pot) to transfer funds to scheme B (member's active account).

To mitigate the risk that individuals will be worse off through this process and exposed to higher fees or poor returns, the Australian Government has the power to set standards for all pensions schemes through a licensing system. It has also recently introduced 'My super' arrangements, which set a standard for default funds across the system.

53. However, the UK pensions system is unique and we need solutions that suit our particular situation and complement the workplace pension reforms. It is important that any changes in this area are guided by appropriate principles so that we are fully aware of the costs and benefits for individuals, the pensions industry and employers.

54. We have set out these principles below. Throughout the paper we have assessed reform options against these principles.

55. For individuals, our guiding principles for reform are:

- **Promote good retirement incomes:** we want to enable low cost and low charge pension provision, as well as promoting persistency in saving, so that people can draw the optimum retirement income from their pension savings. Individuals should be confident that the money they and their employer contribute to their pension will go towards their retirement, and will not end up stranded or lost in the pension system.
- **Promote engagement with saving:** we want people to keep track of their pension savings so they know how much they have saved and can make informed decisions about current and future pension saving. We do not want people to reach retirement having forgotten about, or lost track of, small pension pots or have them stranded so they can neither buy an annuity to draw a retirement income nor, for those with very small pension savings, get a cash lump-sum through trivial commutation.
- **Fairness:** for example, members who leave an employer should not be subjected to excessively high charges compared to those members making active contributions.
- **Simplicity:** building on automatic enrolment, we want to make sure that pension processes are as easy as possible – especially for those individuals who are not engaged with saving decisions. Processes need to be simple and require individuals to take little or no action.

56. For schemes and employers, our guiding principles are:

- **Ease administrative burdens:** we recognise the burdens for schemes of managing small pension pots and want to help minimise these costs.
- **Tackle inefficiencies:** we want to reduce inefficiencies in the market. At an aggregate level it is inefficient for multiple providers to administer small pension pots for any given individual.
- **Sustainability:** ensure that any reform will work for the long term and is not just a quick fix.

57. And finally, for government, our guiding principles for reform are:

- **Affordability:** any government support for change must be affordable and sustainable.
- **Compatibility with wider pension reform:** for example, automatic enrolment and improving access to the open market option.

Improvements to the current regulatory framework 3

58. This chapter looks at a least-change reform option by considering possible ways to improve the current transfers system without wholesale changes to legislation or the regulatory framework. The system would, as a whole, remain voluntary and member initiated.

3.1 How it might work

59. These proposals could be pursued separately or as a package alongside the more ambitious reform options discussed in Chapters 5 and 6. The proposals under this option have two aims:

- Making it more attractive and easier to voluntarily transfer pension pots.
- Where members do not transfer their pot, consider ways to reduce scheme running costs associated with small pension pots.

3.2 Possible measures

60. We have already identified a number of barriers that prevent individuals and schemes undertaking transfers of pensions between defined contribution (DC) schemes while their savings are building up. These are around costs faced by schemes and individuals, as well as individual inertia and disengagement with pensions.

61. There are a number of things we could do in the current system that could overcome these barriers, including:

- **Encourage individuals to initiate transfers:** require schemes to provide information to members on the benefits of transfers, including highlighting issues such as increases in charges where the member stops paying into the scheme. This could be achieved through enhanced disclosure requirements or through guidance.

- **Make the transfer process simpler for members:** requiring schemes to provide standardised, simple forms, so that individuals find it easier to transfer their pension.
- **Improve individuals' access to schemes:** require pension schemes to accept transfers in, no matter the size of the pot.
- **Reduce the fixed costs of administering small pots:** schemes have the option to stop issuing benefit illustrations, but it is unclear how many schemes take advantage of this exemption[28]. This does not apply to benefit statements and terms and conditions information and so we could consider extending this exemption.
- **Promote existing services:** for example, the Pensions Tracing Service, as mechanisms to help people find all their pension pots when they reach retirement.

62. We would welcome views from stakeholders on whether these measures would work.

Questions:

3. Would any or all of the proposals under this option be an effective way to facilitate more transfers and reduce the number of small pension pots?
4. Are there other ways to reduce costs further and make it easier for people to find any small, dormant pension pots – during the accumulation phase and at the point of retirement?

3.3 Assessment against principles for reform

63. When compared to our principles set out in Chapter 2, the measures explored in this chapter have the potential to overcome the costs associated with administering small pots. However, the key disadvantage is that these measures do not address individual inertia. They still rely on individuals taking actions to transfer their pensions.

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

Assessment against reform principles

Promote good retirement incomes

- May make it easier and encourage consolidation of pots, but does not guarantee it.
- If reductions in administrative costs were passed on to members this could lead to larger pension pots in decumulation.

Promote engagement with saving

- Encouraging transfers and pension tracing could promote some engagement, but does not address individual inertia.

Fairness

- Reducing administrative costs could reduce inequalities in charge levels.
- However, this is not guaranteed – inertia may mean differential charges reduce the value of small pension pots.

Simplicity

- While these measures may simplify the process somewhat, complexities are likely to still remain in the system.

Ease administrative burdens

- Some of the measures could potentially reduce burdens on business.
- Requiring schemes to accept all transfers could, however, increase burdens.

Tackle inefficiencies

- Requiring schemes to accept all transfers in could create inefficiencies, as it would force schemes to accept unprofitable funds.

Sustainability

- This is likely to be a short-term solution to small pot concerns as it does not address the issue of member inertia.

Affordability

- No costs for government.

Compatibility with wider pension reform

- Fits with the Government's wider simplification plans.

Automatic transfers 4

64. The following two chapters examine more ambitious reform paths and look at ways to make the transfer process automatic for pension pots within defined contribution (DC) schemes. The attraction of an automatic process is that it overcomes the individual's inertia that defines many people's attitudes to pensions and their retirement. An automatic process will help ensure that a person's pension savings do not end up stranded or lost within the system.

65. We propose two variations of an automatic transfer system in this paper. An automatic process reflects the same principle behind the automatic enrolment reforms. However, we are keen to hear from stakeholders about any other mechanism that could facilitate the transfer of pension pots with minimal action from individuals, employers and providers.

66. Our assumption is that an automatic transfer system should apply to both DC occupational pensions and Workplace Personal Pensions (WPPs) to ensure a level playing field and not to create instances of regulatory arbitrage.

67. Given the scale of change that automatic enrolment brings, it is important that any reform processes work alongside automatic enrolment while also addressing the problem of legacy pots that are small and inactive. We discuss some of the issues specific to legacy small pots later in this chapter.

68. The key options outlined in Chapters 5 and 6 are:

- A process where small pension pots are automatically transferred to an 'aggregator' scheme. This would essentially give pension schemes the right to initiate transfers. This scheme would be a holding place for small pension pots until a member reaches retirement age and can claim an annuity or draw down.
- A system where pension pots follow people from job to job, so that they build up one pension throughout their working life.

69. These models address slightly different issues. The aggregator model, for example, overcomes the problem of small, dormant pots remaining in the pension system by drawing them together in one place. The second model overcomes the problem of accessibility and promotes engagement with savings by ensuring an individual will have one pension pot throughout their working life. The possible design features of these models, such as what might trigger a transfer and how automatic the process is, could vary greatly and these are discussed in more detail in the following chapters.

Questions:

5. Taking account of our principles for reform, which of the two models in Chapters 5 and 6 do you think has the most merit?
6. Do you have any other suggestions for a process to overcome problems associated with small pots and improve transfers?
7. Although the solutions in this paper deal with small pots in DC schemes, we would be grateful for views on how defined benefit (DB) schemes should be treated and whether we should also consider applying any transfer solution to DB rights?

4.1 Benefits and costs for individuals, schemes and trustees

70. The success of any automatic transfer system will rely on designing a cost-effective and simple process that balances efficiencies for schemes against appropriate safeguards for individuals.

71. There are common challenges and trade-offs that cut across these propositions and government is keen to consider these carefully. These trade-offs are about ensuring that the benefit for individuals, employers and industry outweighs any risks faced by individuals in having their DC pension moved from one scheme to another.

72. This degree of risk faced by individuals is hard to quantify and relates to differences in charges and investment options from one DC scheme to the next. For example, a person may have accumulated a small, dormant pot in scheme A where charges are fairly low and investment options are appropriate. If this pot is then moved to scheme B, where charges are higher and investment returns are not as good as the previous scheme, the individual may find themselves materially worse off in terms of eventual retirement income. Equally, however, an individual's investment fund may do better in the scheme they are transferred to.

73. Against this potential risk, however, we must also consider the benefits for individuals. This includes the benefit of having access to a pension in the one place – whether in an aggregator scheme or in an employer's automatic enrolment scheme. This amounts to a reduced risk of losing pension pots and therefore missing out on valuable retirement savings.

74. An automatic transfer system could deliver benefits for pension schemes and trustees – provided the model is simple and straightforward. Firstly, it could cut administrative costs for providers, especially where very small pensions are unprofitable to administer. For trustees, an automatic transfer system could mean they can easily move small, dormant pots of deferred members to another scheme. This would reduce administration costs for these trustees over the long term (as described in para 42, the cost to employers of administering these pots can actually outweigh the value of the fund over a person's working life).

75. In the context of this trade-off between benefits and costs, there are questions in three areas that we want to consider ahead of looking at the reform options.

4.2 Individual choice

76. We need to consider the degree of choice that an individual should have in a transfer process. We have already highlighted that the current system relies on individuals initiating the transfer process. However, we have argued that this is a weakness in the current system. Research into individuals' attitudes to pensions suggests that encouragement alone does not ensure that individuals take action even when it may be the right thing for them to do[29].

77. We could investigate giving schemes the right to initiate transfers of small pots, with no involvement from the individual. This would introduce a compulsory system of transfers. The advantage of this option is that it fully overcomes the barrier of inertia and it could be more straightforward for schemes to operate (i.e. fewer steps in the process). The disadvantage of this approach is that the individual has no choice on where their pension pot goes. Some members may wish to be more engaged with their pension, deciding to keep their small pension pot with the existing scheme due to low charges or certain features of the scheme. Full compulsion would not allow them the option to do so.

78. The automatic enrolment process aims to overcome inertia by 'nudging' individuals into pension saving. It places a duty on employers to enrol their eligible workers into a qualifying scheme, while providing individuals with the opportunity to opt out of pension saving if they wish. We think that it is right to give members a similar choice about pension transfers.

79. The advantage of an opt-out process for transfers is that it enables individuals who are engaged with their savings to take greater control of their pension – they may wish to retain their pension in the existing scheme or an alternative scheme. The disadvantage of this choice is that it introduces more complexity into the process and means that schemes retain some small pots to manage. We would need to ensure any opt-out process complements the automatic enrolment process.

Question:

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

[29] Clery, E., Humphrey, A. and Bourne, T., 2011, *Attitudes to Pensions: The 2009 Survey*. DWP Research Report No. 701. Available at http://research.dwp.gov.uk/asd/asd5/rports2009-2010/rrep701.pdf

4.3 Role of advice

80. Another key question we are considering is the role that advice should play in any automatic transfer process. Many providers and their representative bodies have told us that the cost and complexity of advice is a key barrier to enabling effective transfers and moving small pots into WPPs. Some providers only accept transfers of pension pots where individuals have taken financial advice on whether the transfer is in their interests.

81. This is because the decision to move a pension from one scheme to another can involve a degree of risk, particularly when someone has built up a larger pension pot, say greater than £10,000, and they may want to compare one provider against another to fully understand the impact of different charges and investment strategies.

82. Although there is no requirement that advice is taken when a person moves their pension, we recognise that decisions relating to pension transfers are important and can have a significant impact on retirement income.

83. Providers take a commercial decision to stipulate that advice must be taken before they accept a transfer in – this is about managing risk and also making sure individuals understand the implications of their decision to move their pension. Where advice is given, transferring deferred benefits from occupational pensions to personal pensions (including WPPs), and between different personal pension schemes are subject to the Financial Service Authority's (FSA's) Conduct of Business Rules. There are additional rules and permissions where the transfer is from an occupational pension scheme to a personal pension scheme.

84. The question of where advice fits in an automatic transfer process is important. On the one hand, it is good that an individual takes advice and is more aware of implications for their retirement income. However, like automatic enrolment, an automated transfer system is based on inertia and intended to benefit those individuals who are disengaged from decisions about their pension. Introducing a requirement to take advice would be very costly for individuals, as well as impractical in a system designed to be as simple as possible.

85. Our assumption in the two models that follow is that an automatic transfer process should be unadvised business – this is to ensure simplicity and reduce costs for individuals and schemes. But this makes it vital to design any transfer model in a way that minimises risks to individuals' pension savings. Such safeguards could include setting key standards for an aggregator scheme – such as low charges and sensible investment strategies (discussed in Chapter 5) – and designing safeguards for a system where pots follow members from job to job – such as setting a maximum limit on the size of pots that are automatically moved (discussed in Chapter 6).

Question:

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

4.4 Legacy small pots

86. In Chapter 2 we highlighted the evidence gap on the current number of small, dormant pension pots. However, we estimate that these number in excess of a million. It may not always be in members' interests to transfer these small pension pots. For example, some individuals may have legacy small pots with more favourable terms, such as Guaranteed Annuity Rates (GARs). GARs were common in schemes from the 1960s to the mid-1980s.

87. However, many individuals may benefit from bringing their older small pots into one larger pension pot. Where members want to, we should do all we can to help them transfer legacy small pots. In the following chapters we consider how our suggested approaches might address the problems of legacy small pots.

Question:

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

An aggregator scheme for small pots

5

88. This chapter explores what a system where schemes default transfer small pots into an aggregator scheme might look like. An aggregator scheme would, over time, consolidate the small pots accumulated by an individual into one place.

5.1 The process

89. Where an individual leaves the employer and their pot is under a certain size, that pot would default transfer to an aggregator scheme. The small pot could be transferred from a defined contribution (DC) occupational pension scheme or a Workplace Personal Pension (WPP).

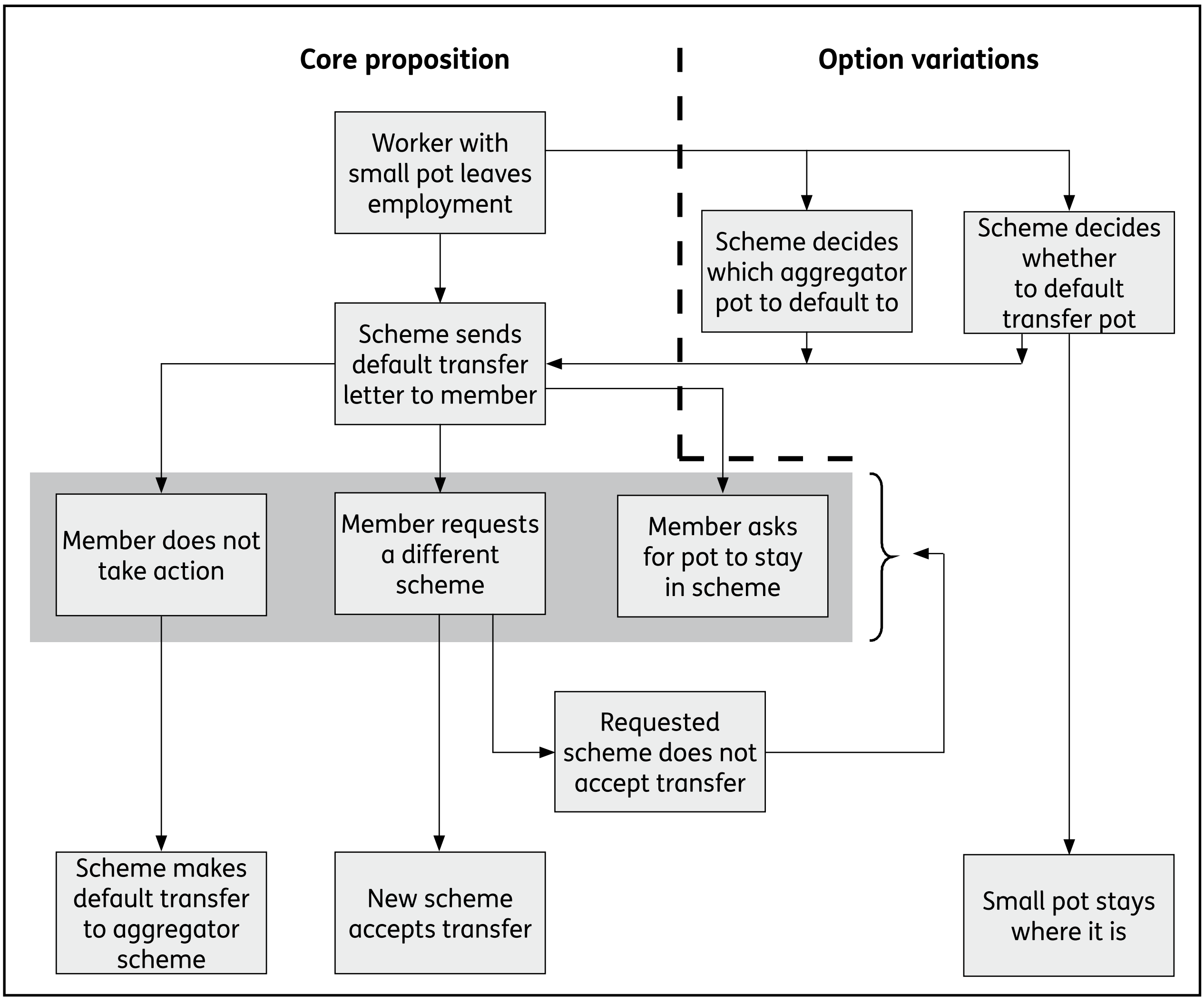
90. We are proposing a default process to overcome individual inertia and make the process as straightforward as possible. This would essentially introduce a right for schemes to initiate transfers. For this proposed new process, we suggest that the trigger for the transfer could be the member leaving their employer.

91. Where the person remains with the employer, but has stopped saving, perhaps because their earnings have dipped below qualifying earnings for a period of time, they may return to saving so should not be default transferred.

92. When the member leaves employment the employer would tell the member's scheme. The scheme would then contact the member to say that they will be transferring the funds to an aggregator scheme within a certain period of time unless the member objects. The scheme would need to do this within a window of time after the member has left. If the member did not want the transfer to occur, they could request a transfer to another scheme or could ask for the funds to stay where they are.

93. Figure 5.1 illustrates this process. The option variations shown are discussed later in the chapter.

Figure 5.1: Aggregator scheme automatic transfer process



5.2 Aggregator scheme characteristics and arrangements

94. To ensure that the aggregator scheme supports savings persistency and the ability of individuals to access their savings, such a scheme would need to have certain characteristics:

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

95. Low charges and an appropriate investment approach will be important. We believe those affected will either be lower earners or will have been saving for a short period of time. We would not generally expect this group to be particularly engaged with the terms of their pension savings and so they are unlikely to be aware of the impact of charges and the possibility that the provider may increase charges once they are no longer an active member.

96. One option is for there to be one single aggregator scheme, with pensions industry operators potentially bidding for the role for a fixed period, with the arrangements reviewed and renewed after that period. If the role went to another scheme, then all small pots that had been default transferred in would need to be moved over and administered by that scheme. This would not stop individuals from choosing to transfer their funds to another scheme prepared to accept them, but default transfers would need to be made to the aggregator scheme.

97. Another option is for there to be multiple aggregator schemes, with a range of industry players involved. To avoid complexity for the transferring scheme it would be preferable for there to be one destination for default transfers. This is likely to require a front-end process that accepts pots and then allocates small pots to a scheme and sends any further small pot transfers for that member to the same place. We would be interested in views on how this process might operate.

Implications of a single aggregator scheme versus several aggregator schemes

	Single aggregator scheme	**Several aggregator schemes**
Transferring scheme	One destination Contract transfer disruptive/costly, but without aggregator scheme not competitive	Front-end process needed to ensure one destination for members Reduces competition assuming members are disengaged
Member	Simple to locate pot through aggregator	More difficult to locate – though could go through front-end process?

Questions:

11. What are the particular challenges and benefits created by introducing one or several aggregator schemes?
12. Do you agree with the aggregator scheme characteristics set out?
13. Could the pensions industry offer an aggregator scheme with these characteristics?
14. Have we correctly understood the implications of there being one or several aggregator scheme(s)?
15. Should there be several aggregator schemes or one?

5.3 Possible advantages of the National Employment Savings Trust acting as the aggregator scheme?

98. The National Employment Savings Trust (NEST) is being designed to have many of the characteristics that would be needed for an aggregator scheme and could potentially take on the role of aggregating small pots. However, this would not be without its challenges.

99. NEST was established to support the introduction of automatic enrolment by filling a supply-side gap, as evidence showed that low to moderate earners were not well served by the pensions industry. Giving NEST an aggregator scheme role would substantially extend the function of NEST.

100. This approach would need to ensure that there is not a detrimental impact on the ability of NEST to deliver its core remit. Based on our estimates of the expected volumes of members in NEST after the introduction of automatic enrolment, default transferring small pots into NEST would increase the volume of non-contributing members by up to 35 per cent by 2026[30]. Since non-contributing members are less attractive for schemes than contributing members it would be important to consider how an aggregator role might affect NEST's other members and how to ensure fairness for these members.

101. We also recognise that should this approach be pursued it would change the picture with respect to the current restrictions on transfers into NEST. The transfers restrictions (both in and out) were designed to reduce market turbulence during implementation and keep the scheme focused on its target market. There is already a government commitment to review NEST constraints in 2017.

Questions:

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

5.4 Advice

102. With the aggregator scheme characteristics set out above, we currently believe that those whose pots are default transferred are unlikely to need to take advice. Our aim would be to ensure that any system of default transfers into an aggregator scheme would be low risk and in the member's interest. The consolidation of several small pots into one place would ensure that individuals would be able to access and use their savings upon retirement.

5.5 Defining what constitutes a small pot for automatic transfers

103. A key challenge for this option is what would constitute a small pot and on what this would be based. A pot of up to £2,000 might be considered small, as this is equivalent to the trivial commutation maximum and is also the level that has been suggested in discussions with providers.

[30] Based on existing volumes estimates (for details of the methodology, see http://www.dwp.gov.uk/docs/pensions-bill-2011-ia-annexb.pdf), and job churn and pot size estimates from the Labour Force Survey and Department for Work and Pensions modelling.

104. From a scheme perspective, a small pot could be a pot that is unprofitable because of its size. That is, the cost of administration is greater than the management charge, since administration is generally a fixed cost, but the management charge is generally a percentage. Given the available evidence, it is very difficult to estimate the maximum size of pot that schemes would wish to transfer. It is also likely that this pot size will vary substantially between schemes.

105. There are three potential approaches for setting the small pot default mechanism. These are:

Approach to setting small pot	**Impact**
a) Default transfers are compulsory for schemes if pot is under a certain size. The Government sets a figure, balancing individual and scheme interests, and either reviews it periodically or indexes it.	All members in all schemes have equal treatment. Compulsory for schemes, may be forced to make loss-making transfers.
b) Voluntary for schemes, they decide which pots they want to transfer. Still a default process for members if the scheme decides to transfer. Short-service refunds would not be available as alternative.	Voluntary for schemes, therefore not forced to make loss-making transfers. Less transparency for members and may lead to a lack of fairness.
c) The Government sets a band and schemes have flexibility within that band.	Balances clarity for individuals and flexibility for schemes.

106. The administrative cost of transferring the very smallest pots may exceed the value of the pot, which raises the question of whether there should be a minimum transfer level for the very smallest pots. A transfer limit on pots below a certain size would enable the aggregator scheme to be more cost effective, as it would not need to administer the tiniest and least cost effective pots.

107. However, there are some strong reasons to avoid such a limit on transferring the smallest pots. The original scheme would still need to deal with the tiny pot somehow, by continuing to administer it or by refunding it, both of which come with costs. A refund of the pension would not support persistency of saving and is the reason why short-service refunds are being abolished, whereas multiple default transfers over time could lead to individuals building a bigger pot.

Questions:

17. What is the best approach to defining a small pot for this option? Would it be preferable for:
    - Default transfers to be compulsory if the pot is under a certain size.
    - Default transfers to be voluntary for schemes.
    - Default transfers to be compulsory under a certain size, but voluntary within a band.
18. Should there be a transfer limit on pots below a certain size and if so, what should happen to the pot?

5.6 Transfer costs

108. Requiring or enabling schemes to default transfer small pots would have a cost for the transferring scheme ('push costs') and the aggregator scheme ('pull costs'). We feel that since the transfer would be a default the member should ideally not be charged for the cost of the transfer as it would be difficult to justify. However, the impact on other members in the receiving scheme and the cost to the scheme must also be considered – ultimately the decision on who should bear the costs will be finely balanced.

Impact on the transferring scheme and the member of paying the transfer out ('push') costs.

Who pays?	Advantages	Disadvantages
Transferring scheme	• Incentive on scheme to reduce cost of transfer as much as possible. • Significant benefit to scheme, as able to default transfer small pots that are not economical to maintain.	• Costs potentially passed to all scheme members. • Incentivises the scheme to keep the pot.
Member	• Prevents costs from being passed on to all members. • Members who benefit from the transfer pay for the transfer.	• Hard to justify as transfer is a default. • Potentially large impact on member's pot. • Saving for scheme, but may not be passed on to members. • No incentive to reduce transfer costs.

Impact on the transferring scheme, aggregator scheme and the member of paying the transfer in ('pull') costs.

Who pays?	Advantages	Disadvantages
Transferring scheme	• Scheme is able to transfer unprofitable small pots to aggregator scheme.	• Cost not controlled by aggregator scheme so no incentive to reduce. • Cost likely to be passed to all scheme members.
Aggregator scheme	• Incentive on aggregator to reduce processing costs.	• Costs may be passed on to other scheme members (if there are active members in scheme).
Member	• Prevents costs from being passed on to all members (if there are other members in the scheme). • Members who benefit from the transfer pay for the transfer.	• Hard to justify as transfer is a default. • Potentially large impact on member's pot. • No incentive to reduce transfer costs.

Question:

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

5.7 Older small pots

109. Initially, this option would only address small pots newly created by the departure of an employee. In the longer term it would be possible to consider ways to address small pots that had been created since the introduction of automatic enrolment as well as legacy small pots.

110. A key challenge would be for schemes with legacy small pots to locate members to notify them of a default transfer and for those schemes to provide accurate member data to the aggregator scheme. Default transfers of older small pots might therefore need to be voluntary for affected schemes. This could be supplemented by encouraging members to initiate transfers of their small pots to their aggregator pot or another pot.

5.8 Assessment against principles for reform

111. Overall, this option would go a significant way towards addressing the issue of people accumulating small pots and not being able to find or access them. It would be simple for the members affected and relatively low risk. It would also be relatively straightforward for the pensions industry and reduce administrative burden.

Assessment against reform principles

Promote good retirement income

- Would promote good retirement income by automatically consolidating individuals' smallest pots, which they will then be able to track down and annuitise upon retirement.

Promote engagement with saving

- Pots would be in fewer places and therefore it would be simpler for individuals to see how their savings are progressing.

Fairness

- Cost of transfers borne by all, but not all members will be frequent job movers.
- If default transfers are on a voluntary rather than compulsory basis then individuals will be treated differently depending on the scheme they are in.

Simplicity

- Option would be simple from an individual perspective.
- The default process for schemes relies on the aggregator scheme putting in place a straightforward 'pull' system for transfers and transferring schemes adhering to this.

Ease administrative burdens

- Schemes would no longer need to manage small pots that cost more to administer than they make in management fees.

Tackle inefficiencies

- Fewer small pots to administer across industry will be more efficient overall.

Sustainability

- No particular issues here. In the longer term the aggregator scheme would receive repeated transfers in for the same individuals, so there would be fewer small pots overall rather than an ever growing number of small pots across the industry.

Affordable

- If NEST were to play a role, this option could impact on NEST financial arrangements.

Compatibility with wider pension reforms

- This option is consistent with the goals of automatic enrolment as it would provide a suitable solution to the removal of the ability of occupational schemes to refund small pots and support the broader goal of helping more people to save more for their retirement.

Pensions move with people from job to job

6

112. This chapter considers the most ambitious change to the way the pension system works. It considers creating a system where an individual's pension pot would follow them from job to job by default as they move employment.

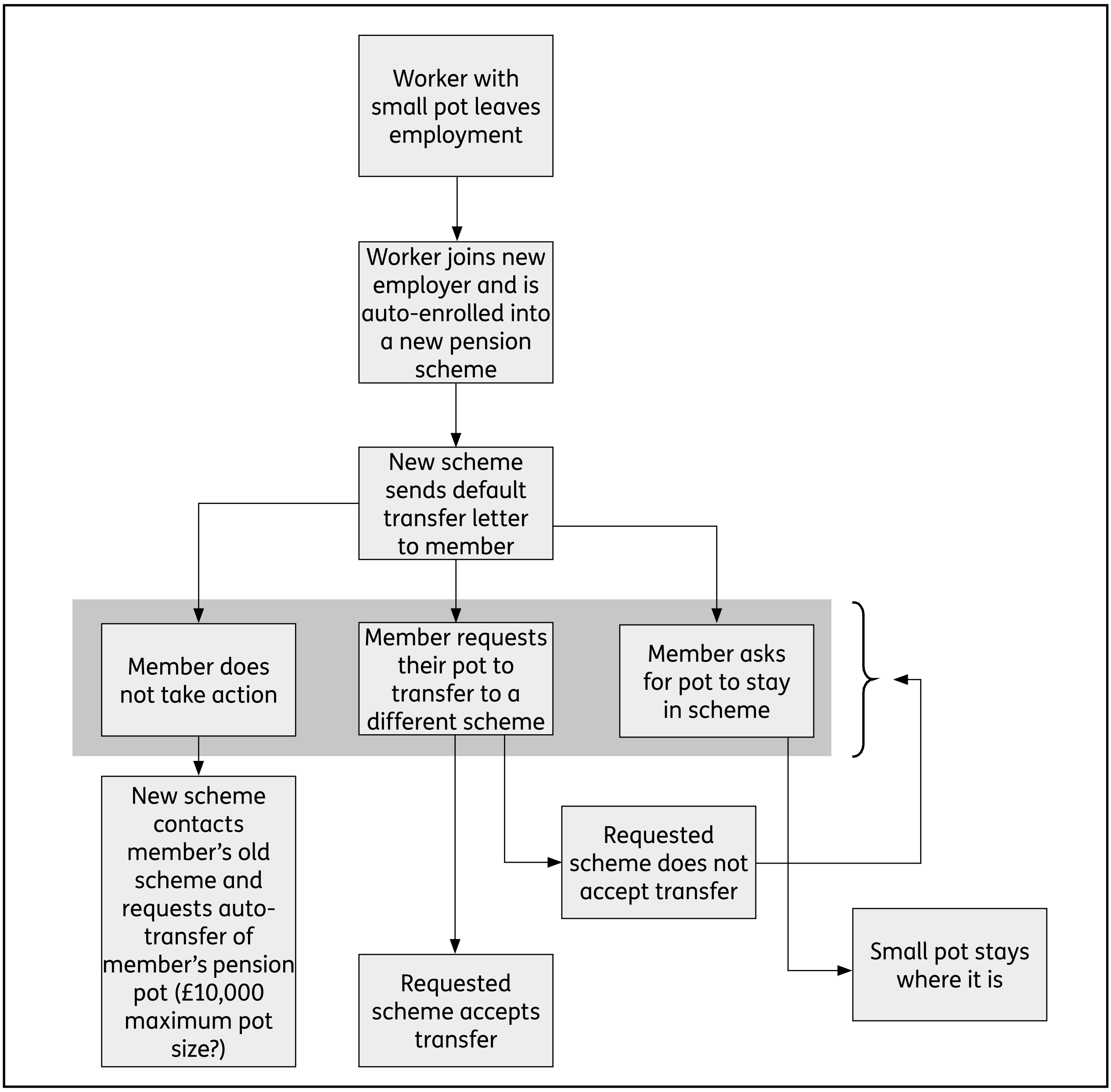
6.1 How it might work

113. Where an individual leaves an employer their pot would be default transferred to the new scheme they are automatically enrolled into with their new employer. We envisage that this would be a scheme to scheme process supported by an electronic interface and with a minimal role for employers and individuals.

114. The process would be designed to dovetail with the automatic enrolment process and timings. The default action would be initiated by the individual's new scheme after they have taken up work with their new employer and been automatically enrolled. To ensure that the member is going to remain in saving, the default action would need to occur after active membership has been achieved and the automatic enrolment opt-out deadline has passed.

115. The new scheme could write to the member to say that they will transfer the pension pot from their most recent employment unless the individual opts out of the transfer. If the member takes no action the pot would be transferred. If the member makes an active choice, the pension pot may remain where it was or move to another scheme of their choice.

Figure 6.1: Pensions follows individuals from job to job automatic transfer process



6.2 Impact on members

116. Overall we do not think that this proposal will have a detrimental impact on members saving into pensions. While the default transfer does introduce the possibility of the pot going into a scheme with higher charges and a lower performing investment fund, it also introduces the possibility that the terms will be better. Over time and after several moves the impact is likely to be limited, as demonstrated in the case studies below.

117. At the moment, some inactive members pay a higher annual management charge relative to active members. This option would prevent this from happening for all those whose pots are default transferred, therefore reducing the charge rate during a lifetime of savings.

118. As well as the system of regulation already in place for occupational pensions and Workplace Personal Pensions (WPPs), additional protections have been built into the automatic enrolment system. Schemes and employers are expected to follow the Government's guidance for default investment funds, which sets out standards for governance and charges in relation to default funds[31]. Government intends to closely monitor the charges for schemes used for automatic enrolment and has the power to regulate to cap these if required.

119. The case studies below illustrate the effects that this option could have on an individual's pension fund. Case study A shows that moving a median earning individual on £26,000 from a low charging to a high charging scheme after three years could lead to a 1.5 per cent smaller pension pot. This ultimately would result in £1 less income a week in retirement compared to leaving the pot in the old scheme. Conversely, case study B shows that if that same individual was moved from a high charging to a low charging scheme, this results in a 1.3 per cent larger pot, leading to £1 more a week when an annuity is purchased.

Case study: possible levels of benefit or detriment[32]

Case study A – Moving from a low charging to high charging scheme

Helen is a median earner on £26,800. The minimum amount under automatic enrolment is being contributed to her defined contribution (DC) pension – 8 per cent of gross banded earnings[33] (4 per cent individual, 1 per cent tax relief and 3 per cent employer contribution). She starts at her employer at age 25.

After three years she moves jobs and is automatically enrolled into their new employer pension scheme. She stays with that employer for the rest of her working life until age 68.

Currently she would have two funds, one with the old employer (Fund A) and one with the new employer (Fund B).

The new employer's pension scheme has a 1 per cent Annual Management Charge (AMC) compared to 0.5 per cent in the old employer's pension scheme. The impact on her final pension size if automatically transferred compared to leaving the pot in the old employer's scheme is shown in the table below:

	Years of contribution	Fund value at retirement	Annuity income per week
A1: Small pot – from low to high charging	3	£4,430	£3
A2: Small pot – low charging throughout	3	£5,420	£4
B: Pot built up in new employers scheme	40	£62,070	£48
Total: Funds auto-transferred (A1 + B)	-	£66,500	£51
Total: Funds combined at annuitisation (A2 + B)	-	£67,490	£52

Therefore, if she were automatically transferred the small pot would lose 1.5 per cent of their fund value (nearly £1,000), meaning she would have £1 less a week retirement income.

31 *Guidance for offering a default option for defined contribution automatic enrolment pension schemes*, DWP, May 2011. Available at http://www.dwp.gov.uk/docs/def-opt-guid.pdf

32 These illustrations assume the same investment return of 5.39 per cent. We would expect schemes to provide better service or return where charge levels are higher.

33 Earnings between £5,800 and £38,700 (lower and upper thresholds in 2011 earnings terms).

Case study B – Moving from a high charging to low charging scheme

Jeff is also a median earner on £26,800. Like Helen, his employer contributes the minimum amount under automatic enrolment on his behalf into his pension. Also similar to Helen he starts working at age 25.

After three years he moves jobs and is automatically enrolled into his new employer's DC pension scheme. He then remains with that employer for the rest of his working life and retires at age 68.

As with Helen, he would have two funds, one with the old employer (Fund A) and one with the new employer (Fund B).

The new employer's pension scheme has a 0.5 per cent AMC, where as the old employer's pension scheme has a 1 per cent AMC. The impact on his final pension size if automatic transferred compared to leaving the pot in the old employer's scheme is show in the table below:

	Years of contribution	Fund value at retirement	Annuity income per week
A1: Small pot – from high to low charging	3	£5,370	£4
A2: Small pot – high charging throughout	3	£4,390	£3
B: Pot built up in new employers scheme	40	£68,765	£43
Total: Funds auto-transferred (A1 + B)	-	£74,135	£47
Total: Funds combined at annuitisation (A2 + B)	-	£73,155	£46

Therefore, if Jeff's small pot was automatically transferred; it would gain 1.3 per cent value, meaning he would have £1 more weekly income in retirement.

Question:

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

6.3 Should there be a pot size maximum?

120. Setting a pot size maximum for automatic transfers would be a means to further protect individuals from any detriment that could be caused by automatically moving their pension pot from one scheme to another. This is because variables such as investment choice and percentage-based charges (applied by the majority of current schemes) could have a more significant impact on a larger pension pot.

121. A possible pot limit could be £10,000. This is a level where members have better access to the open market when purchasing an annuity. Once a pension pot reaches any set maximum limit, the transfer would revert back to being member initiated.

Question:

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

6.4 An electronic solution

122. The process as proposed is unlikely to work if it is paper based. Any benefits of such a system would be outweighed by the additional administrative complexity of manually processing forms. There would also be difficulties matching members to old pension pots if there is not some form of central database to hold members' details.

123. Therefore, we believe that an automatic transfer system of this kind must be an electronic process. Moving to a new electronic system would create initial costs for the pensions industry, particularly those occupational pension schemes that primarily use paper-based systems, making this a long-term option. For the process to work effectively the cost of transfers has to be less than the cost of maintaining the pot.

124. One option to enable schemes to recognise individuals within an electronic system could be using the information required under automatic enrolment to match members through a central database. The automatic enrolment regulations require employers, as a minimum, to give schemes the information on a jobholder:

- Name.
- Date of birth.
- Postal residential address.
- Gender.
- Automatic enrolment date.
- National Insurance number.

125. We would need to explore whether this information is sufficient to ensure that members are reconnected with previous pension pots and consider whether any further support would be needed, such as assigning members a unique number identifier within the central database.

126. The pension industry is already developing its own systems to reduce the cost of transfers, including the Options system developed by Origo. We would be interested to hear from the industry about what capacity there is to develop an electronic platform to deliver automatic transfers.

Questions:

22. How could a central database successfully match members with their pension pots?
23. To what extent could the pensions industry deliver a suitable electronic platform/ database?

6.5 Large gaps in employment

127. One of the key trigger points in the current process model is the member achieving active membership of a new scheme after automatic enrolment, as this would trigger the new scheme requesting a transfer from the old scheme. We are proposing that where there is a large gap between employments, pots should remain dormant in the old scheme until the individual joins a new employer and is automatically enrolled.

Question:

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

6.6 Legacy pots

128. The proposed automatic transfer process dovetails with the automatic enrolment. As such, it is forward looking and relies on a person joining a new employer and being automatically enrolled into a new pension scheme. Each time this happens, the default action will be for a person's pension to move automatically to their new employer's automatic enrolment scheme.

129. There is a question of what should happen to an individual's 'backlog' of small pension pots, and whether this proposed model should also provide a means to draw together an individual's pension pots from previous employments.

130. There are various options for helping members bring their legacy pension pots into this system, ranging from individuals taking action to enabling schemes to track down these pots and draw them into the member's active pension pot. Briefly, two possible options are:

- **Member-initiated:** members could be encouraged, through scheme information, to take their own action to transfer their old pots into their latest active pension scheme. This could involve promoting existing services, such as the Pensions Tracing Service.
- **Scheme-initiated:** when a member's new automatic enrolment scheme transfers across their old pension pot, the scheme could also check on the central database to see if the member has any other smaller pots in other schemes. This would rely on the central database holding details of all members' pensions. For this second option to work, schemes would need to 'log' details of each dormant pension pot that they hold on the central database.

131. We recognise that there are many complex issues to overcome in order to deal with legacy small pots – for instance, existing WPPs represent contracts between individuals and providers and cannot be interfered with unless members' consent or there is some form of contractual override. We would need to consider these legal issues carefully. Also, the second option described above, where schemes would have access to a central database of dormant pots, represents a burden on schemes to enter details on, track down and transfer dormant pots. We would need to ensure this cost is balanced by benefits to individuals and to schemes in relieving them of the cost of maintaining these legacy pots.

Question:

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

6.7 Assessment against principles for reform

132. This option compares favourably against the principles set out in Chapter 2, with significant benefits for members, providing effective safeguards can be put in place. This could potentially increase engagement with savings and help individuals get the most out of their pension.

133. However, the different charge levels in schemes may mean that some people could lose out in the long term. This would need to be considered in more detail.

134. The industry benefits could be substantial, but only if the costs of transfers can be reduced to such a level that they are less expensive than administering small pension pots. If transfer costs remain the same, burdens on industry would likely increase substantially.

Assessment against reform principles

Promote good retirement incomes

- Removes risks of individuals losing pension pots or leaving them stranded and therefore helps them consolidate their retirement savings and achieve their optimum retirement income.

Promotes engagement with saving

- Increase engagement, as there is only one pot to keep track of and makes retirement planning easier.
- Also less chance of stranded pots – some will remain however.
- Some risk of less engagement as fewer decision points.

Fairness

- Addresses concerns around differential charges.
- As instigated by the new scheme there could still be a large gap between moves and some impact from differential charge levels.

Simplicity

- Simple for individuals, as minimal involvement.

Ease administrative burdens

- If the process reduces the costs of transfers this would lead to administration savings.

Tackle inefficiencies

- Overcomes the key barriers to transfers created by individual inertia, administrative costs and transactional costs.
- Addresses difficulties finding a scheme willing to accept a small pension pot.
- Removes the financial and access difficulties with getting advice on small value transfers.

Sustainability

- Provides a lasting solution to reduce the number of small pension pots.

Affordability

- Questions around who bears the build costs for the system.

Compatibility with wider pension reform

- Consistent with the principles of automatic enrolment of increasing savings and work on promoting the open market option.

Summary of questions and processes 7

7.1 Questions

Chapter 2 – Small pension pots: the case for change

1. Do you have evidence on the scale of the current problem of small pension pots?
2. Do you agree that the barriers listed on page 17 are the current barriers to transfers?

Chapter 3 – Improvements to the current regulatory framework

3. Would any or all of the proposals listed on pages 24 and 25 under this option be an effective way to facilitate more transfers and reduce the number of small pension pots?
4. Are there other ways to reduce costs further and make it easier for people to find any small, dormant pension pots – during the accumulation phase and at the point of retirement?

Chapter 4 – Automatic transfers

5. Taking account of our principles for reform, which of the two models in Chapters 5 and 6 do you think has the most merit?
6. Do you have any other suggestions for a process to overcome problems associated with small pots and improve transfers?
7. Although the solutions in this paper deal with small pots in defined contribution (DC) schemes, we would be grateful for views on how defined benefit (DB) schemes should be treated and whether we should also consider applying any transfer solution to DB rights?
8. Do you agree that under an automatic transfer system, members should have the right to opt out?

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

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

Chapter 5 – An aggregator scheme for small pots

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

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

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

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

15. Should there be several aggregator schemes or one?

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

17. What is the best approach to defining a small pot for this option? Would it be preferable for:

    - Default transfers to be compulsory if the pot is under a certain size.
    - Default transfers to be voluntary for schemes.
    - Default transfers to be compulsory under a certain size, but voluntary within a band.

18. Should there be a transfer limit on pots below a certain size and if so, what should happen to the pot?

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

Chapter 6 – Pensions move with people from job to job

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

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

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

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

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

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

7.2 How to respond

135. This document is available on the Department for Work and Pensions (DWP) website at http://www.dwp.gov.uk/consultations/2011/. Please send your response, preferably by e-mail to: regulatory.differences@dwp.gsi.gov.uk

Or by post to:

Natalie Weddell
Private Pensions Policy and Analysis
Department for Work and Pensions
7th Floor
Caxton House
Tothill Street
London
SW1H 9NA

Please ensure your response reaches us by **23 March 2012**.

136. When responding, please state whether you are doing so as an individual or representing the views of an organisation. If you are responding on behalf of a larger organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled. We will acknowledge your response.

7.3 Freedom of Information

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

138. All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purpose of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information which is provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this. We cannot guarantee confidentiality of electronic responses even if your IT system claims it automatically.

139. If you want to find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact:

Central Freedom of Information Team
Department for Work and Pensions
The Adelphi
1-11 John Adam Street
London
WC2N 6HT
Email: freedom-of-information-request@dwp.gsi.gov.uk

140. More information about the Freedom of Information Act can be found on the Directgov website. http://www.direct.gov.uk/en/governmentcitizensandrights/yourrightsandresponsibilities/dg_4003239

7.4 The consultation criteria

141. This consultation follows the Code of Practice on Consultation – www.berr.gov.uk/files/file47158.pdf and its seven consultation criteria which are as follows:

- **When to consult** – Formal consultation should take place at a stage when there is scope to influence the outcome.
- **Duration of consultation exercises** – Consultations should normally last for at least 12 weeks, with consideration given to longer timescales where feasible and sensible.
- **Clarity of scope and impact** – Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence, and the expected costs and benefits of the proposals.
- **Accessibility of consultation exercises** – Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is designed to reach.
- **The burden of consultation** – Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
- **Responsiveness of consultation exercises** – Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
- **Capacity to consult** – Officials running consultation exercises should seek guidance in how to run an effective consultation exercise, and share what they have learned from the experience.

7.5 Feedback on this consultation

142. We value your feedback on how well we consult. If you have any comments on the process of this consultation (as opposed to the issues raised) please contact our Consultation Coordinator:

Roger Pugh
Department for Work and Pensions' Consultation Coordinator
1st Floor, Crown House
2, Ferensway
Hull
HU2 8NF
Email: roger.pugh@dwp.gsi.gov.uk

143. In particular, please tell us if you feel that the consultation does not satisfy these criteria. Please also make any suggestions as to how the process of consultation could be improved further.

144. If you have any requirements that we need to meet to enable you to comment, please let us know.

145. The responses to the consultation will be published in 2012 in a report on the DWP website that will summarise the responses and the action that we will take as a result of them.

Annex A Short-service refunds

The case for change

1. Short-service refund rules allow occupational pension schemes to offer a refund of contributions or a cash transfer if a member leaves the scheme with more than three months, but less than two years, of service and has not accrued a right to future benefits under the scheme[34]. This refund is of the member's contributions only, with the employer contributions remaining within the scheme to be used in accordance with scheme rules. This remaining employer contribution can be used to cover future employer contributions for other members, scheme administration costs or one-off scheme costs. If the member does not choose between a refund of contributions or a cash transfer to another pension, the scheme can opt to make the refund anyway[35].

2. At present, defined contribution (DC) occupational pension schemes issue around 30,000 short-service refunds each year[36].

3. A key concern for government is that short-service refund rules could act as an incentive for employers to choose DC occupational pension schemes, such as master trusts, with the primary aim of reducing their costs. A master trust may be particularly beneficial for large employers (1,000+ employees) and employers with higher than average staff turnover, for example in the retail sector[37]. While this is unlikely to be the sole driver influencing decisions, this could lead to some individuals never building up pension savings and others building smaller pots.

[34] See section 101 of the Pensions Schemes Act 1993.
[35] See section 101AH of the Pension Schemes Act 1993.
[36] Occupational Pensions Schemes Survey 2010 (ONS).
[37] Wood, A., Young, P. and Wintersgill, D., 2011, *The Use of Vesting Rules and Default Options in Occupational Pension Schemes*. DWP Research Report No. 725. Available at http://research.dwp.gov.uk/asd/asd5/rports2011-2012/rrep725.pdf

4. Based on research, structured discussions we have had with intermediaries[38] and observed market behaviour, we believe the short-service refund rules could have an impact on employer choice of scheme and significantly increasing the number of refunds. Taking account of this incentive, our analysis suggests there could be around **50,000–80,000** short-service refunds each year in steady state, reducing overall pension savings by **£70 million–£130 million** each year.

5. Individuals leaving an employer within 24 months are more likely to be young[39] and low to medium earners[40] than individuals who leave their employer after 24 months. This suggests that those most likely to receive a short-service refund will be disproportionately represented by our key target group for automatic enrolment.

Options we considered and ruled out

6. On balance, we have concluded that the potential annual loss of pension savings of £70 million–£130 million means the short-service refund rules are inconsistent with our aims to achieve persistent pension savings. We sought views on options to address these concerns through the Call for Evidence and the options suggested included:

- Reducing the short-service refund period to one year.
- Limiting the rules to certain circumstances.
- Extending short-service refunds to Workplace Personal Pensions (WPPs).
- Modifying the rules so the member's refund includes the employer and employee contributions minus tax relief.

7. It is our view that none of these options would address the key concerns around the loss of persistent savings. Some of the options proposed would even increase the effect the rules could have on an individual's ability to build pension savings. Therefore, we do not intend to modify the rules in these ways. Box A briefly sets out our reasons for ruling out the options.

[38] Structured discussions conducted in 2011 with a range of intermediaries, covering factors which will drive employers' scheme choice between workplace personal pensions and occupational pension schemes.
[39] Aged between 22 and 30.
[40] Earning between £7,500 and £25,000.

Box A: Options we ruled out

Reducing the period

The first option open to us is to reduce the applicable refund period from two years to one year. While this would result in fewer refunds, it would still lead to a reduction in overall pension savings and would not remove the incentive created by the rules. Further, this change would mean the rules would continue to affect the target market for automatic enrolment disproportionately, as the people receiving refunds are more likely to be short-term workers.

Refund under limited circumstances

Respondents also suggested we could consider restricting when occupational DC schemes are allowed to offer a short-service refund. These restrictions included:

a) refunding pension funds under a certain value (such as less than £1,000);

b) allowing schemes that meet additional requirements, such as the employer is paying in 6 per cent of contributions to offer refunds; or

c) only allowing refunds for certain types of members, such as those who leave the UK.

While many of these options could limit the impact short-service refund rules could have on savings levels each would add a level of complexity to the regulations. Applying a restriction to pot size or for certain types of members would make it difficult for schemes to administer and would erode any easement occupational DC schemes receive from the refund option, thereby devaluing it. Allowing schemes with double the statutory minimum contribution level to maintain short-service refunds would mean remaining employees are better off in the scheme. It would, however, still mean departing workers lose out on savings. Further, this could increase the incentive for employers to set up occupational DC schemes to take advantage of the rules, especially for large employers with high staff turnover, where the savings would be substantial.

Extend to WPPs

To reduce the number of differences between occupational pension and WPPs, we also considered extending short-service refunds to WPP schemes. This would remove the incentive short-service refunds create to use one type of scheme over another, but also increase the number of individuals who could fail to build up savings. Given the nature of the types of individuals that automatic enrolment is intended to target (low earners who often move jobs), this would have a significant impact on the success of the workplace pension reforms and could mean workers do not build any savings during their career.

Member receives refund of whole pot

A couple of respondents suggested we could modify the rules so that the individual receives both the employer and employee contributions as part of the refund. While this would lessen the incentive for employers to set up these types of scheme, it would not remove the risk to savings levels that the rules represent. Further, it would make the refund more appealing to members of the scheme and could cause workers to leave the pension scheme even though they still work for that employer to be able to access the refund.

Options for change

8. Fuller analysis of two commonly suggested options from the Call for Evidence:

- Abolish short-service refunds.
- Refunds an active choice.

Abolish short-service refunds

9. One of the key options open to us is removing the right to a refund. This could be achieved by bring forward preservation requirements so that a member's money is locked into the scheme once the employer passes over the contributions. This would mean that the individual would start to accrue a right to future pension benefit under the scheme as soon as they join. They would still have the right to transfer when they leave under existing transfer legislation and a right to opt out of automatic enrolment under the Pension Act 2008.

10. This approach would be fully consistent with the aims of automatic enrolment and would ensure persistent pension savings. This could lead to £70 million–£130 million savings being retained in the pension system each year.

11. However, removal of the refund would mean employers lose out on £20 million–£40 million each year of contributions they would otherwise have been able to use. Removal would also create additional small pension pots which would need to be retained in the scheme. Our estimates are that around 50,000–80,000 pension pots, many of them small pots, would remain in DC occupational pension schemes.

12. In addition to the loss of the refund pot, some employers pay a per-member charge for scheme administration. This would mean increased explicit employer costs of below £5 million each year[41].

Make the refund an active choice

13. Alternatively, we could modify existing rules so that the refund becomes an active choice. This would mean that when an individual does not choose between a refund and a transfer to another scheme, the individual's pot remains in the occupational scheme. This is different from the current approach where schemes have the ability to refund a member's contributions if they do not make a choice.

14. This option would allow employers and schemes to retain some benefit from short-service refunds. We believe that inertia will play a significant influence on individual behaviour, and so expect that the results of making the refund an active choice to only be marginally less than removing the rules completely.

[41] In around three-quarters of trust-based DC schemes the employer covers administration charges and pays a per head member fee to a third party administrator. These figures are based on a per head charge of up to £50 per head charge. Again this would have a commensurate employee benefit as the employee would not have to cover the administration charges in the scheme.

15. We predict this could lead to up to 20,000–30,000 refunds annually in steady state. This would generate up to £20 million for employers in contribution refunds. Overall, employer refunds retained in the scheme would be up to £20 million lower compared to if we did nothing. However, our analysis suggests that £10 million–£50 million per year may still be lost from pension savings.

16. This option would also lead to an increase in the number of small pension pots. There will be about 40,000–50,000 fewer refunds per year than compared to doing nothing, leading to 10,000–30,000 more pots that would otherwise have been refunded, many of which will be small. Where employers pay a per-member charge for scheme administration these additional small pots would equate to an explicit employer cost increase of below £5 million each year[42].

Our decision: removing short-service refunds for defined contribution schemes

17. As set out in Chapter 1, our primary goal is to promote good retirement incomes. Making the refund an active choice would reduce the risk short-service refunds create that some may not save, but does not remove the risk. Therefore, we have decided to make changes to the preservation requirements so that DC occupational pension schemes can no longer operate short-service refund rules. We intend to do this at the earliest legislative opportunity. This will ensure savings remain in the pension system.

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

Impacts

19. The key impacts of this decision are:

- Increased costs for employers due to forgone refunds of £20 million–£40 million.
- Retention of and an additional 50,000–80,000 pension pots, many of which will be small.
- Where employers pay administration charges to third party administrators, this equates to under £5 million extra administration costs.

[42] As before, this is based on £50 for each member. This would have a commensurate employee benefit as the employee would not have to cover the administration charges in the scheme.

Annex B
Glossary of terms

Aggregator Scheme	A scheme that could be used to consolidate an individual's small pension pots.
Annual Management Charge (AMC)	A charge levied annually by a pension provider on a member's pension fund to cover the costs associated with providing that pension scheme. The charge is usually levied as a percentage of the total fund value.
Automatic enrolment	Employers will be required to make arrangements by which eligible jobholders become active members of an automatic enrolment scheme with effect from the automatic enrolment date. Automatic enrolment is not applicable if the jobholder is an active member of a qualifying scheme on that date.
Automatic transfer	Making pension transfers the default action unless the individual indicates they would like to keep their pension pot in the scheme or transfer it to another pension scheme.
Cash equivalent transfer value	A transfer from an occupational pension scheme which is taken during the short-service refund period. This is the cash equivalent of the benefits when the worker's membership ends.
Charges (member charging)	A form of charge structure where the member of the pension scheme pays management fees. Also see Annual Management Charges.
Conduct of Business Rules	The Financial Service Authority (FSA) handbook which the requirements applying to firms with investment business customers.

Contract-based pension scheme	In this call for evidence contract-based pensions are synonymous with workplace personal pensions.
Defined benefit (DB) scheme	An occupational pension scheme that provides benefits based on a formula involving how much a person is paid at retirement (or how much a person has been paid on average during their membership of the scheme) and the length of time they have been in the pension scheme.
Defined contribution (DC) scheme	A pension scheme that provides pension scheme benefits based on the contributions invested, the returns received on that investment (minus any charges incurred) and the rate at which the final pension fund is annuitised. These can be an occupational pension or workplace personal pension schemes. They are some times referred to as a money purchase scheme.
Disclosure of information	Information which is disclosed by occupational or personal pension schemes to members, prospective members and others (for example, Trades Unions) in accordance with legislation.
Eligible Jobholder	A jobholder aged between 22 and State Pension Age, eligible for automatic enrolment if they are not already a member of a qualifying scheme.
Financial Service Authority (FSA)	The regulator for financial service firms with responsibility for personal pensions.
Guaranteed Annuity Rates (GAR)	A feature commonly offered in DC pension schemes in the 1960's to the 1980's. GARs set a minimum income that the pension scheme holder must offer the individual as an annuity when they retire, as a minimum income which is guaranteed.
Group personal pension (GPP)	An arrangement made for the employees of a particular employer, or for a group of self-employed individuals, to participate in a personal pension scheme on a grouped basis.
Group Self-Invested Personal Pension (GSIPP)	A group personal pension where the contracts are SIPPs rather than personal pensions. (see SIPP definition).
Group stakeholder pension (GSHP)	A personal pension that must meet certain legislative conditions including annual management charges of no more than 1.5 per cent for the first 10 years, then 1.5 per cent subsequently. Employers with five or more employees who do not already offer a pension scheme must currently offer a group stakeholder pension scheme. These employers do not have to contribute to a group stakeholder pension but they must allow employees access to the scheme. SHPs will cease to be mandatory after the workplace pension reforms are introduced.

Immediate vesting	Denotes that the worker has a right to a pension under the scheme as soon as they become a member.
Inactive member	An individual who no longer pays into the workplace pension because they have left the employer.
Legacy pot	An existing pension pot where the individual no longer pays into the pot and has become a deferred member.
Master Trust	A multi-employer trust-based pension scheme for non-associated employers, which enables investors to combine their assets for greater leverage.
NEST	The National Employment Savings Trust. A new multi-employer DC occupation pension scheme set up for automatic enrolment.
Occupational Pension Scheme	A pension scheme taking the form of a trust arrangement, which means that a board of trustees is set up to govern the scheme. Benefits can be either defined contribution or defined benefit.
Open market option	A process that allows an individual to transfer their pension pot at retirement from one life assurance company to another to achieve a higher annuity rate.
Options	An electronic platform developed by Origo on behalf of the insurance industry to improve pension transfers.
Opt out (automatic enrolment)	In automatic enrolment – Once active membership has been achieved and the jobholder is in receipt of the enrolment information, the jobholder has a right to 'opt out' of active membership and will be treated as having never been a member of the scheme.
Opt out (automatic transfers)	In an automatic transfer process – an individual's right to ask for their small pension pot to be kept in the existing pension scheme or transferred to another pension scheme of their choice.
Pensions Regulator (TPR)	UK regulator of workplace pension schemes.
Pension Tracing Service (PTS)	A service offered by the Pension Service in DWP to help individuals (or their representatives) trace their lost pensions. The PTS has access to a database that is a subset of the Pension Regulator scheme administration data to trace pension schemes. This contains information on over 200,000 occupational and personal pension schemes.
Pull costs	The costs that the receiving scheme incurs when an individual's pension pot is transferred into their scheme.

Push costs	The costs that the transferring scheme incurs when they transfer an individuals pension pot.
Self-Invested Personal Pension (SIPP)	An arrangement that forms all or part of a personal pension scheme, which gives the member the power to direct specifically how some or all of the member's contributions are invested (as opposed to simply choosing a fund or funds).
Short-service refund	In an occupational pension scheme, the member's right, after three months and up to two years of service, to a refund of their contributions or a cash equivalent transfer when they leave the pension scheme.
Stranded pension pot	A small pension pot that an individual is unable to access.
Superannuation	The system of compulsory pension saving in Australia.
Trust-based pension scheme	In this Call for Evidence, trust-based pensions are synonymous with occupational pension scheme.
Trivial commutation	Tax rules that allow individuals with pension savings of less than £18,000 to withdraw their pension savings as a lump sum from age 60.
Workplace pension	A pension scheme which is: • an occupational pension scheme; • a personal pension scheme where direct payment arrangements exist in respect of the members of the scheme who are employees; and • a stakeholder pension scheme.
Workplace personal pension	A defined contribution pension scheme purchased by an individual, either through their employer or individually, from a pension provider. It is owned entirely by the individual with the contract existing between the individual and the pension provider. Includes Group Personal Pensions, Group Stakeholder Pensions and Group Self-Invested Personal Pensions.

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