Response by TISA to:

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

Renny Biggins, Head of Retirement
renny.biggins@tisa.uk.com – 07802 324962

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About TISA

The Investing and Saving Alliance (TISA) is a unique, rapidly growing membership organisation for UK financial services.

Our ambition is to improve the financial wellbeing of all UK consumers. We do this by convening the power of our broad industry membership base around the key issues to deliver practical solutions and devise innovative, evidence-based strategic proposals for government, policy makers and regulators that address major consumer issues.

TISA membership is representative of **all sectors of the financial services industry.** We have **over 240-member firms involved in the supply and distribution of savings, investment products and associated services**, including the UK's major investment managers, retail banks, online platforms, insurance companies, pension providers, distributors, building societies, wealth managers, third party administrators, Fintech businesses, financial consultants, financial advisers, industry infrastructure providers and stockbrokers.

As consumers, the financial services industry and the economy react to and recover from the effects of the pandemic, the importance of the three key pillars of work that TISA prioritises has never been more apparent:

- **Strategic policy initiatives that influence policymakers** regarding the financial wellbeing of UK consumers & thereby enhancing the environment within which the industry operates in the key areas of **consumer guidance, retirement planning, later lifetime lending, vulnerable customers, financial education, savings and investments**.
- TISA is recognised for the **expert technical support provided to members** on a range of operational and regulatory issues targeted at improving infrastructure and processes, establishing standards of good practice and the interpretation and implementation of new rules and regulations covering **MiFID II, CASS, ESG/RSI, operational resilience, Cyber Risk, SM&CR** and a range of other areas.
- **Digital transformation initiatives** that are driving ground-breaking innovation and the development of industry infrastructure for greater operational effectiveness and revenue promoting opportunity for firms. TISA has become a major industry delivery organisation for consumer focused, digital industry infrastructure initiatives – **TISAtech** (a digital marketplace that brings together financial institutions and FinTechs for greater collaboration and innovation) and **TURN** (TISA Universal Reporting Network – a digital platform providing a secure data exchange for financial services using blockchain technology) – alongside projects **Digital ID** and **Open Savings, Investments & Pensions**. This reflects TISA's commitment to open standards and independent governance.

Executive Summary

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TISA welcomes the opportunity to respond to the DWP call for evidence - Addressing the challenge of deferred small pots.

The issue was discussed several years ago and it is worth recognising that the original barriers and challenges still exist, however we now have the added complication of increased regulation which impacts the transfer process. That is not to say that consensus and a solution cannot be achieved, however there will need to be carve-outs and compromises made to overcome some of these.

When considering solutions to reduce the problems caused by the proliferation of small-deferred pots, we need to address the wider context of pension saving, the challenges that exist for consumers in achieving good outcomes and initiatives that are currently in progress.

The over-arching challenge to address in pension saving is consumer engagement. A general lack of engagement is resulting in consumers not taking an active involvement in the accumulation phase, losing track of older pension entitlements and not being equipped with the knowledge to make informed decisions when finally being faced with them at retirement – all ultimately leading to poorer retirement outcomes.

We have various initiatives in progress, all of which have an objective of improving understanding and engagement in DC pensions – Value for Money framework, the New Consumer Duty, the impending review of the advice/guidance boundary and Pension Dashboards. The collective outcomes from these could be a game changer and significantly change the way in which pension saving is approached by consumers. It would be prudent to explore the increased opportunities for member-led solutions.

Simplicity is a fundamental principle to adhere to and consumers need to understand any changes that are made to the transfer process for small pots. The introduction of multiple automated approaches is likely to lead to complexity and confusion. The cost of the transfer will also play an important part in the wider process. We strongly believe that the adoption of open transfer standards is promoted as without this requirement, third party software costs of processing any transfer could be prohibitive and risk undermining the objectives.

TISA has an active role in the Small Pots industry group and all other aspects of regulatory change which is aiming to improve consumer retirement outcomes. As such we would be pleased to discuss any aspects of our response or any other associated aspects of change with you.

Question responses

1. Do you agree that these are the appropriate key criteria to inform development of a market-wide small pots consolidation solution? Are there additional/different criteria to apply?

We agree with the key criteria identified and would also add that the solution must be straightforward to implement from a scheme provider perspective.

Automated solutions were considered several years ago and the same challenges still exist. However, we now have the added complexity of additional regulation to overcome which potentially impacts on consumer outcomes – such as the anti-scam transfer regulations and the new protection regime linked to the increase in NMPA to 57 from 2028.

There is no silver bullet and industry is divided on what the most appropriate automated solution or solutions are. We also need to be aware of the scale of regulatory change currently being dealt with and recognise that the implementation of any automated solution is going to take time to agree and ultimately implement.

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If engagement levels were higher, then arguably the number of small-deferred pots would be lower and the consumer detriment associated with them would be largely removed. Whilst pension schemes should be considering member outcomes and look to provide a consolidated view of entitlements where possible, pension dashboards will provide this functionality when eventually launched to the public and largely remove the issue of lost or forgotten pension pots.

If launched in the appropriate way, Pension Dashboards have great potential to engage individuals. A consumer accessing the Dashboard and viewing (often unexpectedly) several separate pension pots is potentially an important trigger point for engagement, which could occur at a much earlier point in the consumer journey than would have otherwise. If the pots have already been consolidated through an automated solution, that could be considered a missed engagement opportunity.

The FCA have committed to undertaking a review of the advice/guidance boundary this year, in recognition of the huge support gap that currently exists. A support framework which can help engage and equip consumers with knowledge through meaningful personalised guidance compliments the aims of Pension Dashboards, the Consumer Duty and more generally what we are collectively trying to achieve for long-term savings culture and financial resilience.

The joint DWP/TPR/FCA Value for Money framework currently in consultation and the FCA Consumer Duty also have objectives of improving consumer engagement and understanding across DC schemes.

These changes and consultations which are either in progress or in the pipeline have the potential to move the dial on consumer engagement and understanding. It may be prudent to work on ensuring these are successful and assess the impact this has on small pots before implementing an automated solution.

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

As mentioned in Q1, member-initiated consolidation is limited at present due to low levels of engagement, however that is being addressed in various ways including Pension Dashboards, the Value for Money framework, the new Consumer Duty and the forthcoming review of the advice/guidance boundary.

The risks associated with automated consolidation solutions also apply to member-initiated consolidation, however the requirement of member engagement does provide some safeguards. There are also some changes which should be considered which may increase the effectiveness of a member-led approach.

- Currently, there is no obligation to provide a SMPI on an annual basis if the pension pot is under £5,000. We should be trying to increase engagement with smaller pension pots and remove or reduce this fund threshold. This also links in with the non-requirement for Pension Dashboards to show a SMPI and annualised value for these pots, so the change should be reflective across the board.
- The Privacy and Electronic Regulations (PECR) currently restrict any electronic communications covering the potential benefits of consolidation, so this has to be done at cost to the provider through the traditional and rapidly dated approach of paper. A change in PECR rules to allow this supports a member-led consolidation approach.

Although for launch, Pension Dashboards will not be able to trigger transactions, it has the potential to trigger engagement which may then prompt off-dashboard consolidation to take place. However, this could be taken one stage further given an automated solution has been accepted as a viable approach.

A subsequent iteration of Dashboards could arrange for a member-led consolidation exercise if the option is selected and the pots are below the pre-determined small pot value. This introduces no additional risks to an automated approach but placing the member in control is an important engagement lever. And given that nearly all pension entitlements should be displayed, it would also be possible to incorporate exceptional scenarios, such as a restriction or prompt to consider consolidating DC pots of less than £10,000 if the member is close to or has breached the LTA. In this circumstance it may be possible to take these through small pot commutation and avoid a further LTA check and potential charge.

Those who actively engage in the consolidation process will be more engaged than those dependent on an automated solution and given engagement is a fundamental principle which would improve retirement outcomes at all stages of the consumer journey, we should be considering how we can turn the small pot issue into an engagement opportunity.

Of course, there will always be a cohort who will never engage irrespective of the opportunities that are presented. We will need to consider whether an automated solution is required for this group but the scale of this given the potential opportunities for engagement in the coming years is as yet unknown.

3. We would be keen to understand from respondents, how far do you believe market innovations can go in reducing the growth of deferred small pots?

Technology has a significant role to play in market innovation but the challenges which existed during previous small pot discussions several years ago still exist today but have been complicated further by the layering of additional regulation such as the important anti-scam transfer regulations and the new protected pension age linked to the increase in NMPA to 57 from 2028.

Whilst there is scope for innovation, we need to consider the wider challenges associated with pension saving and not address small pots in isolation. A fully automated solution which largely removes the stock and ongoing flow of small pots but does nothing to promote engagement and understanding, fails criteria point number 3.

Pension Dashboards have the potential to be a game-changer and further innovation in this area to enable the triggering of a member-initiated consolidation for pots below a pre-determined value could play a pivotal role in addressing small pots in conjunction with wider engagement issues.

Innovation also has a part to play in reducing the costs involved for providers in administering these small pots, which is the other key aspect to address. If administration costs can reduce to a level which means that the variable part is covered and there is a small surplus to allocate towards fixed costs, this would remove much of the financial burden for providers. Some costs could be reduced through innovating regulation such as PECR mentioned in our response to Q2 – if more communications could be undertaken electronically without breaching existing PECR rules, this provides both a more economic method of communicating and also increases the likelihood of it being read for a large cohort who prefer electronic communications.

We also need to be aware that there are exceptionally high levels of regulatory change being placed on pension providers at present. Recent examples include the Consumer Duty, new non-workplace pension requirements and phase 1 and phase 2 of the Value for Money framework which is currently undergoing consultation. It takes considerable time to implement robust propositions in response to new legislation and as such, restricts the opportunities that firms have to consider ongoing innovation.

4. Do you consider one of the values below to be the most appropriate starting limit for eligibility for automatic consolidation, and why – or is there an alternative value?

a) £1,000
b) £2,500
c) £5,000
d) £10,000

The answer to this largely depends on the solution and the role that the provider plays in the market. A consolidator will want the small pot threshold to be as high as possible from a commercial perspective, whereas providers will not want to lose pots above their break-even threshold.

Research evidence from a member firm shows the break-even point for a pension pot is typically around £3,000. A single consolidator should have a much lower break-even point which should continue to reduce over time as AUM increases.

5. How many deferred pots does your scheme have within each of the above breakdowns, how many of these are within AE charge capped default funds, and what is the total AUM of deferred pots for each of these breakdowns?

N/A

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

N/A

7. Would the increase in pot transfers associated with an automated small pots solution affect your investment strategy? If so, how, and why?

N/A

8. What is the average cost of administering a pot for your scheme, does this differ by active/deferred, or by size? If so, what is the difference in costs and why?

N/A

9. What is the breakeven point for administering pots for your scheme, does this differ for active/deferred pots?

N/A

10. Do you think there should be a minimum pot size limit for pots to be eligible for automatic consolidation? If so, what do you think this limit should be, and what should happen to pots below that limit?

The bottom fund value limit for a small pot, or upper limit for a micro pot is not easy to establish and more work needs to be undertaken to agree what should happen to these. The answer to this largely depends on the final solution(s). Some additional key aspects for consideration include:

- The fund value break even point will be different amongst providers
- The cost of transfer vs the cost of refund
- The recipient of the refund – employer, employee, HMRC or a combination?
- How traceable is the deferred member and who is responsible for tracing?
- Would refunding pension contributions no matter how small be sending the right message for retirement saving?
- A fundamental principle to promote engagement and understanding is to keep it simple. Does the inclusion of micro pots and another set of associated rules create unnecessary confusion and complexity?

The cost of the transfer will also play an important part in determining pot thresholds. We strongly believe that the adoption of open transfer standards is promoted as without this requirement, third party software costs of processing any transfer could be prohibitive and risk undermining the objectives.

11. Do you agree that setting a prescribed period for a pot to be classified as deferred is the most appropriate solution – and what period of time would be appropriate, and why? If not, what would be a more suitable approach?

The pandemic and current cost of living crisis has placed unprecedented strains on the finances of many households and traditional savings trends have and will continue to change as a result. This makes placing a time frame on what constitutes deferred challenging – although opt-outs have not significantly increased, anecdotal evidence points to many considering this as a temporary measure. Rejoining only to find your pot has moved creates confusion and poor consumer outcomes. The only concrete way to identify a deferred pot for the purposes of consolidation is when the member leaves employment of the related scheme. However, an extended period of inactivity maybe considered appropriate for the final solution(s) adopted.

12. Do you agree with the above summary of potential benefits and implications of the default consolidator/s approach, and if not why?

It would be useful for these to be split between those that benefit members and those that benefit providers. This would then provide a clearer picture of those which are cost saving related and those that improve member engagement.

13. What are the key benefits / risks of a multiple default consolidator and single default consolidator approach, including impacts on the wider pension market, and employers?

The main impacts have been included in paragraph 52 – although the scale of these impacts will be determined to an extent by the final agreed definition of what constitutes a small-deferred pot.

14. Who should be able to be a consolidator; should there be a limited number, and, if so, how many, and why?

The robustness of the authorisation regime is crucial and this has already been identified as a key factor for inclusion. It would be logical for a consolidator to be a qualifying workplace scheme and therefore already operating within the Auto Enrolment framework.

Limiting the number may stray into aspects of anti-competition and unfairness – what would happen if more eligible schemes subscribed than the agreed limit? This needs to be tempered against simplicity as the more consolidator schemes available, the greater the complexity in decision making for consumers.

15. What would be the appropriate approach to giving members choice in terms of choosing their consolidator, and what approach should be taken if the member did not make an active choice?

Give we are in the small pot position we are as a result of disengagement and the powerful inertia/default approach, there seems little evidence to suggest a proactive consolidation decision would be made by consumers. There would have to be a backstop in place to cater for the large group who would not engage – this could be done using the carousel approach assuming there are multiple providers who want to operate in this space. Having a single default consolidator would create market distortions unless it was operating on a non-commercial basis.

16. Do you agree with the above summary of potential benefits and implications of the pot follows member approach, and if not why?

Yes, we agree the identified benefits and implications. We would also add that there are two approaches to this – a pull approach where the receiving scheme initiates the transfer and a push approach where the ceding scheme initiates the process. Each has its own set of challenges and it would be worthwhile separating this out within the section.

17. What are the key benefits / risks of a pot follows member, including impacts on the wider pension market, and employers?

The main impacts have been included in paragraph 55. Notably those who experience frequent job changes will have pots moving constantly within the framework for little benefit and the solution not supporting those who are multi job-holders.

18. Of the two solutions set out above what is your preferred approach, and why?

Our membership is divided on a preferred approach, which also includes 'a pot for life.'

It would be prudent to explore the increased opportunities for member-led solutions and the impact that pipeline regulatory change will have on small pots and wider pension saving more generally. If a decision is taken to progress prior to this, any solution(s) need to consider the wider challenges associated with pension saving and not address small pots in isolation.

19. Are there any further / fresh or hybrid solutions that are worthy of consideration?

A 'pot for life' has previously been discussed and is favoured by some providers in conjunction with a default consolidator. As with other solutions, there are various challenges associated with this approach, however it would be appropriate to include this as a potential option for consultation.

Hybrid solutions may diversify the risk as opposed to a single approach but do add complexity to an area which we know consumers do not understand. Member communications for any solution(s) need to be carefully considered.

20. Should there be an initial focus on managing the flow of new pots or removal of the existing stock, and where does the balance of impact lie for each of the solutions presented?

We agree that the stock and flow need to be considered separately, although the same solution(s) may be adopted to address both issues.

It would seem logical to focus on the flow first and once a solution is in place, this then allows the stock issue to be addressed with the comfort and knowledge that the issue is not escalating at the rapid rate it currently is.

21. What could be done to incentivise, build momentum, and help build market and member confidence in member exchanges, either now or in future? Would this be best taken forward by industry or government?

Although Master Trusts are trialling this, it is increasingly common for members to hold entitlements across both regulatory regimes and a dual approach creates confusion, adds complexity to the framework and will do little to promote consumer engagement and understanding.

22. Could a member exchange form part of a hybrid model alongside one of the large-scale consolidation solutions discussed in Section 5, or with a large-scale consolidation solution acting as a backstop?

We refer to our response to Q21 which relates to the addition of more complexity if member exchange is included as an additional solution alongside others.

23. Do you agree that same scheme consolidation has a key role to play in the wider consolidation of deferred small pots, and can act as a foundational measure to larger market-wide solutions? If not, why?

Some of the challenges linked to wider scheme consolidation also exist for single scheme consolidation. The respective arrangements under the main scheme are likely to have different characteristics including charging structure, fund composition, de-risking strategy and retirement age.

It has been suggested that an alternative approach could be to provide a consolidated view, without the need to physically combine the individual pots. This may have been a potential approach to consider were it not for the pending introduction of pension dashboards, where all entitlements held by a provider will be displayed in a single view.

24. If your scheme currently does not undertake same scheme consolidation, what are the reasons behind this and what would be required to overcome this?

N/A

25. As part of this call for evidence we would therefore welcome views on how protected groups are currently impacted by the deferred small pots issue;

(a) whether the impact differs between groups and in comparison, with non-protected groups
(b) what mitigations providers are putting in place and the impact of each of the options on protected groups, and
(c) and how any negative effects arising from them may be mitigated

N/A