Response by TISA to DWP consultation: Ending the proliferation of deferred small pots

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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.

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Executive Summary

TISA welcomes the opportunity to respond to the DWP consultation - Ending the proliferation of deferred small pots.

As a member of the Small Pots Cross-Industry Co-ordination Group, we fully support addressing the deferred small pot challenge through a collaborative approach, which delivers on agreed principles and objectives.

The challenges of resolving the small pot issue cannot be underestimated. Several years of Government and industry discussions, meetings and consultations have shown that whilst there is a strong support for addressing the issue, similar consensus cannot be achieved on a single practical solution.

We agree that in order to progress the initiative, a decision has to be made on an approach which can be adopted by industry and delivers on the main objectives whilst cognisant that all options come with their own set of challenges.

There has been previous discussions regarding the potential member detriment of moving a deferred small pot to a consolidator which offers less Value for Money (VfM) than the current scheme. The introduction of the Value for Money framework and linked consolidator requirements in relation to this should provide appropriate consumer protection to mitigate the risks. We do acknowledge that schemes will not be identical in all aspects and VfM is subjective to a degree. However, the risks should be minimised with the implementation and strong governance of the framework and as such, we do not believe there is any additional safeguards required in this respect.

The clearing house model proposed in the consultation introduces a layer of complexity which was not envisaged when the consolidator principle was previously discussed and consulted on. Given the reliance on technology and the overlapping requirements and objectives of Small Pots, Value for Money and Pension Dashboards, it would make sense for these to be approached in a more joined up way. Synergies, dependencies and timeframes can be identified more easily, which will assist in the development more generally of a consistent consumer journey.

There are two primary concerns:

1. The level and scale of technology required for a clearing house adds significant complexity and cost, which realistically means this could not be delivered for several years. The costs could have a material impact on the fees charged for small pot transfers – which is a crucial factor considering the average size of a pot below £1,000 is £350.

2. The presented options of allocating a consolidator in the absence of an active choice being made are complicated and either risks creating a monopoly or relies on the member having a small-deferred pot with a consolidator.

As such, we believe the key criteria around cost and complexity are not met with the proposed approach. We have included suggestions in our response for an alternative approach to determine the default consolidator. Ultimately this comes down to an approach which needs to consider timescales/cost/complexity vs the member outcome. Whilst a balance needs to be struck, we should be placing member outcomes at the centre of considerations.

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It is important that a deferred small pot regime operates across both Trust Based and Contract-Based schemes. We are all strong advocates of simplicity in the pensions framework to promote engagement and understanding. The operation of two separate regimes would undermine the objectives of the initiative itself as well as what we are trying to achieve more generally with the pension framework and consumer journey.

We also 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.

We are pleased to discuss any aspect of our response with you and look forward to ongoing involvement with the progression of this initiative and the wider schedule of pension change.

Question responses

Question 1. Do you agree with this proposal, or do you believe a central registry would be more effective approach to support the consolidation of deferred small pots, if so how would you design a central registry?

Given the reliance on technology and the overlapping requirements and objectives of Small Pots, Value for Money and Pension Dashboards, it would make sense for these to be approached in a more joined up way. Synergies, dependencies and timeframes can be identified more easily, which will assist in the development more generally of a consistent consumer journey.

Whilst we can see the benefits that a clearing house could deliver, given the requirements associated with the approach and the experiences learnt to date from the Pension Dashboard project, we believe this solution would take several years to design and implement. It also introduces a layer of complexity which was not originally envisaged when considering the consolidator approach

We believe the clearing house approach would essentially overlay automation to the central registry which would automatically perform the administration services that would be manually undertaken otherwise. The introduction of a third party from which communications are sent would provide an opportunity for scammers to operate impersonation scams, whereby consumers are knowingly providing financial details or authorising transactions in favour of the scammer because they believe the request source is genuine.

A central registry needs to exist in order to identify pension entitlements and determine where small-deferred pots should be transferred, in the event an active consolidator selection has not been made. Given that Pension Dashboards will provide a view of pension entitlements, it makes sense to benefit from the significant input already invested into this initiative and reuse this technology as the foundation for a central registry.

For Pension Dashboards, consumers provide their consent and will always be in control of who can access their data. Considerations will need to be include how this can be embedded within the agreed deferred small pot model.

An important question which has not been clarified in the consultation is where the funding for either approach would come from. The costs could have a material impact on the fees charged for Small Pot transfers – which is a crucial factor considering the average size of a pot below £1,000 is £350.

Question 2. Which, of the options we have set out, do you think is the best approach to allocate a member a default consolidator in cases where a member does not make an active decision? Are there alternatives?

Option A – we believe allocating pots by market share would create an oligopoly and subsequent monopoly. This would not promote fair competition.

Option B- the intention as stated in the consultation is to create ‘a small number of schemes’ to be consolidators. As such, it seems likely that some members would have small-deferred pots with schemes which are not consolidators. It is not clear what would happen in that scenario.

Ultimately this comes down to an approach which needs to consider timescales/cost/complexity vs the member outcome. Whilst a balance needs to be struck, we should be placing member outcomes at the centre of considerations.

A simple approach would be for pension schemes to partner with a consolidator, with all small pots meeting the defined criteria transferred to this scheme. It should be easy to understand and member communications would be straightforward. However, where members have multiple small-deferred pots with different schemes, there is a high likelihood these would be transferred to different consolidators. This would fail the primary objective of consolidating all small-deferred pots into a single scheme.

If we are to meet the primary member objective through a multiple consolidator approach, a more involved model is required which requires the use of a central registry. We believe the following would be more appropriate in the event of a member not actively selecting a consolidator:

- If a member has an active plan, deferred small pots should be consolidated into this arrangement
- If there is no active plan and pots are held with consolidator(s), deferred small pots should be consolidated into the arrangement which has the highest fund value

The above two steps should account for majority of individuals and small-deferred pots

- Where there is no active plan or pots held with a consolidator, the partnering approach could be used, or they could be transferred on a carousel basis.

It is important that the framework operates as a single regime i.e. it allows deferred small pot transfers which span across trust based and contract based schemes. Members are likely to hold pots across both regulatory regimes and need consistency in their treatment, otherwise it will only serve to confuse and produce some odd outcomes e.g. a consumer holds an active DC occupational pot with a consolidator. They also hold a small-deferred pot with a non-consolidator GPP in respect of a former employment. If we have separate regimes for trust and contract-based schemes, the GPP cannot automatically be consolidated with the active DC occupational pot and could end up being transferred to a new provider which the consumer has no connection with. Explaining this process to a scheme member would be a considerable challenge.

Government, regulators and industry all agree on the need for consistency and simplicity in the pension framework and as such, we need to ensure a single regime can be put in place to achieve this. Otherwise, much of the key criteria requirements will not be achieved.

We also 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.

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Question 3. Do you agree that there is a need for an authorisation regime for a scheme to act as a consolidator? If so, what essential conditions do you think should form part of the authorisation criteria?

Yes, consumer protection is paramount and there should be an authorisation regime put in place which demonstrates that consolidators have a strong business plan and can act as a standalone consolidator. Existing regulation should be used where possible, with changes made to specifically reflect the additional challenges and complexities that being a small-pot consolidator creates.

In order to assess the viability of becoming a consolidator and construct such a plan, more details are needed about the small pot market. We know how many pots there are but we do not know how many individuals these belong to – this data may influence commercial decisions.

As stated in the consultation, consolidator schemes will need to evidence they are providing the 'highest levels of value for money for their members.' The authorisation regime will need to ensure this is achieved and as such, we suggest this is completed as a separate piece of work in collaboration with industry and the ongoing Value for Money framework development.

Question 4. Do you agree with setting the initial maximum limit for consolidation at £1,000, with a regular statutory review?

The data shows the average value of a deferred pot of under £1,000 is £350. It would seem prudent to set the initial deferred small pot limit at £500 to ensure the regime, once implemented, is functioning as intended without consumer detriment.

Once the framework has been proven in an operational environment over a period of time, we believe it would then be appropriate to increase the limit to £1,000 without the need for a full statutory review.

However, we propose that it is written into legislation that any future increase above the £1,000 limit is subject to a statutory review and industry consultation process.

Question 5. Do you agree with this proposal not to mandate schemes to undertake same scheme consolidation at this current time?

Yes, we agree with this proposal.

Many of the challenges which exist for inter-scheme transfers are also applicable to intra-scheme transfers. As such, we should wait for the small pot regime rules and regulations to be finalised before considering this aspect further.

Question 6. As a whole, do you agree with the framework set out above for a default consolidator approach? Are there any areas that you think have not been considered, that need to form part of this framework?

As stated, the proposed framework is a very different consolidator model to the one considered by industry in previous discussions and consultations. The potential costs and complexity (for industry and consumers) do not align fully to the key criteria and the design and implementation of this approach is likely to take several, if not many years to complete. From a financial perspective, the estimated uplift these proposals would make to a median earners pension pot at retirement (£103,800) is £700 or 0.67%, whereas the removal of the lower earnings limit and reduction of minimum entry age to 18 for Auto Enrolment adds an additional £34,700 or 33.4%. It would seem prudent to consider change which is more proportionate to the consumer benefits that this creates.

We, of course, acknowledge that the benefits of small pot consolidation cannot be considered in monetary terms alone. Other benefits include potentially connecting with lost or forgotten pots and/or simplifying the retirement process, however 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 Advice/Guidance boundary review 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.

We are, however, fully supportive of addressing the small pot issue and have outlined throughout our response where we believe additional consideration and alternative approaches need to be considered to those that are proposed.

A final point is that the intention as stated in the consultation is to create 'a small number of schemes' to be consolidators. What happens if more schemes apply to become a consolidator than intended? Would DWP effectively haver the power to approve or reject an application based on criteria that falls outside of the authorisation regime? If so, how would such determinations be made on an equitable basis?

Question 7. Do you have any comments on the positive or negative impacts of a default consolidator approach on any protected groups, and how any negative effects could be mitigated?

We believe further consideration needs to be given to the definition of what constitutes a deferred pot. A period of no contributions for 12 months has been proposed, however this could disproportionately impact those (typically women) who take extended periods of leave due to reasons such as raising families and caring for family members.

There is no link to re-enrolment timeframes so those who have left the pension scheme with an accrued small pot and automatically re-enrolled perhaps 2-3 years later will have no existing pot to restart and will be creating a new pot, which may be confusing. The only concrete way to identify a deferred pot for the purposes of consolidation is when the member leaves employment of the related scheme. This would address the scenarios highlighted above.

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The implementation of the increase in Normal Minimum Pension Age to 57 from 2028 has created a new protection regime. It has been confirmed by HMRC that those who are in a scheme which benefits from a protected pension age of 55 can transfer in non-protected benefits and they will inherit the protected retirement age. We would expect to see protected pension pots being left open with minimal amounts invested for the purpose of consolidating accrued pension wealth into it at a later date - therefore benefitting from a protected retirement age on the total accrued pension wealth transferred in. It is important that a Small Pot regime does not remove this benefit by automatically transferring these protected pensions pots into consolidator schemes where this benefit is lost.

Finally, it is permitted for members to take up to three small lump sums of up to £10,000 per arrangement without these being subject to a Lifetime Allowance. From draft legislation, it appears these pots will continue being exempt from being tested against the permitted maximum from 06/04.24. For those who are close to or have reached this total fund value threshold, it is financially beneficial to leave these small pots as standalone arrangements, rather than have them consolidated and face a potential tax charge. There is a higher likelihood that anyone falling into this scenario is receiving regulated advice or is a more engaged individual and opt out of the small pot regime if appropriate. However, it is still an aspect which requires consideration and included in member communications.