TISA

tax incentivised savings association

Response by TISA to

DWP Consultation Meeting future workplace pension changes: improving transfers and dealing with small pots.

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TISA response to DWP Consultation: Meeting future workplace pension challenges: improving transfers and dealing with small pots.

The Tax Incentivised Savings Association – TISA has a growing membership of over 120 organisations interested in the UK market for retail financial services products, from Child Trust Funds, through Individual Savings Accounts to Pensions. We have Advisory Councils in Retirement Saving, Wraps and Distribution, whose observations and thinking have contributed to this response. We are distinguished by the very wide scope of our membership, from Banks, though Investment Houses and Life and Pension providers, to Distribution organisations and IFAs. We are not, therefore, restricted to representing a sector approach, but rather the views of a very broad church indeed. We also, as an organisation, start from the principle that what is good for the consumer must, in the long term, be good for the business of our membership.

CONSULTATION RESPONSE

TISA is pleased to have the opportunity to respond to this Consultation. Whilst we would not propose to respond in detail to all the consultation questions, we would wish to make the following observations.

Summary

TISA is strongly supportive of the guiding principles for reform, namely, increasing member engagement and promoting good retirement incomes. We also agree that the solution to be implemented should ensure fairness and simplicity.

With the support of both DWP and a wide group of pension industry stakeholders, TISA has established a project to explore practical solutions to the challenges of small pots and the improvement in the ability to execute pension transfers under whichever model is ultimately selected.

TISA does not take a specific position as to which of the proposed policy options would be preferable. There are benefits and drawbacks to each of the proposed approaches and challenges that arise under both models. TISA also recommends that policy makers are open to exploring alternative approaches which could include elements of both the aggregator and pot follows member options.

It is clear that stakeholders fall into two groups, with the majority of company scheme representatives favouring an aggregator approach whilst others prefer the pot follows member model or an alternative virtual pension pot solution. Overall there are considerable challenges to be addressed in any model which delivers automatic transfers.

TISA believes that it is helpful to understand the underlying drivers of opinion with regard to the current barriers to transfers and how these inform the solution preferences of each stakeholder group. We also note that there are many areas where there are challenges for whichever model is ultimately adopted. Our response therefore aims to set out the potential benefits and drawbacks of the various options.

Chapter 2 – Small pension pots: the case for change

TISA members agree that there are around two million Stakeholder Pensions, of which perhaps 500,000 could be classified as small pots. Trust based schemes have less of a problem with small pots because of the popularity of short service refunds. Many company trust based schemes currently do not accept transfers in from other schemes.

Another seven million people are expected to be auto-enrolled as a result of the new legislation. If these people move jobs on average every four years and a quarter of the leavers create what are deemed to be small pots, then we may make another 500,000 small pots a year going forward. This suggests that the number of small pots accumulated over time will be much larger than the analysis within the consultation document would suggest. TISA believes that the problem will compound if not addressed.

In considering the case for change there are a set of challenges that arise from the current pension market and its regulatory and legal framework.

The challenges may be grouped as follows:

Employee engagement

The main barrier is the lack of engagement of employees who have built up only a small pension pot before leaving their employer. The physical, emotional and financial strains of changing jobs leave issues like pensions low down on the priority list. Even if Government were able to solve all the supply side and transactional barriers, volumes of transfers would remain very low and auto-enrolment would still cause a severe small pot problem. In addition, small pots could hinder the achievement of the overall policy objective of auto-enrolment through people not seeing the benefit of their saving.

Potential member detriment

There are many potential areas for detriment which arise from the complexity and diversity of pension products. TISA broadly takes the view that criteria for an approved auto-enrolment scheme should be sufficient to make that scheme suitable for small pots to be automatically transferred in. However, qualifying schemes can range from equity trackers to cash deposit schemes – the potential investment swings between two very differing asset classes could make a huge difference in value within weeks of transfer. Also glide paths vary dramatically from 15 years to 5 years, with NEST choosing a different glide path for each annual target date cohort, you could have people switching out of 75% gilt and cash into 100% equity and vice versa with automatic transfers taking place during the glide path) . There are other potential risks to be considered, such as level of fund charges, asset allocation differences between schemes and benefits arising from previous schemes that might be lost on transfer. It could be possible to mitigate the risk of detriment by setting requirements for opt out communications which clearly highlight any significant scheme benefits, such as guaranteed annuity rates, which a scheme member would be wise to consider prior to a transfer taking place. However, an opt out alone is unlikely to remove the risk of liability issues for schemes and providers. We will leave others to comment on the specific detailed issues. TISA believes that this is an area for careful evaluation and would welcome an analysis of the risks and possible mitigation approaches within the policy framework.

<u>Legal issues</u>

Amalgamating member pots either in an aggregator scheme or in the member's new scheme, without their consent potentially presents a number of current legal issues which would need be resolved by legislative or regulatory change.

a) Contract law

   In current contract based schemes the contract between the scheme and the member cannot be terminated without the member's consent. This poses problems for automatic transfers and would need to be addressed for transfers out. A legal solution would have to be found which would allow the provider to terminate the contract in the event that the scheme member becomes a member of another automatic enrolment scheme.

b) Trust law

   Trustees have a fiduciary duty towards their members, which could not apply where automatic transfers take place. A solution would need to be found which removed the requirement for trustees to agree that transfers were in their members' best interests and the requirement for trustees to take actuarial advice. Trust schemes that are qualifying schemes for automatic enrolment would need to be obliged to accept transfers in if a pot follows member approach were to be taken.

c) European law – exemption from certain directives

   Automatic transfers would need to be considered in the light of the European Union directives designed to protect consumers who enter into financial contracts, for example, the Distance Marketing Directive.

d) European law – state aid rules

   If NEST were made the sole aggregator, it would have to be demonstrated to the EU that the provision of grant-in-aid and preferential loans to NEST Corporation were justified. In the case of automatic enrolment, the justification used for establishing NEST with state aid, was that employers would not be able to fulfil their legal duty because there was a market failure In the case of transfers, it is not clear that there is a market failure. The market already accepts small transfers in the case of stakeholder pensions.

<u>Commercial issues</u>

The major cost driver in the current transfer process is the requirement for engagement with members. The introduction of an automatic transfer process with an opt out should reduce the costs of transfer significantly. In addition, TISA believes that a standardised process, data set and electronic messaging format agreed by all market participants could deliver a low cost transfer model. However, there is likely to be a large cost involved with creating the infrastructure.

In order to achieve transfers between multiple market participants, it will be necessary to create some form of central database and/or transfer hub. The initial cost of building and the ongoing maintenance of the required infrastructure will need to be funded.

An increase in efficiency and reduction in cost of provision of pension schemes requires an administration infrastructure which operates at scale in an automated way.

Regulatory issues

The FSA's current approach that all transfers should be proved beneficial to the individual concerned will need to be reviewed if transferring small pots is to become automatic on leaving service.

TISA recognises that the government has reserved powers to address issues of charge capping and has issued guidance on scheme governance and the nature of default funds. It may be desirable to establish clear regulatory criteria for auto-enrolment or aggregator schemes to mitigate potential consumer detriment on auto-transfer.

Employer engagement

Employers with unbundled DC company schemes would prefer to see the small pots of people who have left their employment transfer away immediately employment ceases.

In addition, most company schemes do not currently accept transfers in and there are concerns about the potential administrative burden to employers of having to seek previous small pots and transfer them into the company scheme.

Some employers use pensions as a recruitment tool. One of the ways that they attract good staff is to offer a good pension scheme, not just with generous contributions but also with a wide fund range and low charges. It would be potentially unfair if an employer could remove the benefits of the fund range and low charges to those members who have left service.

Conversely, it could be an unfair burden on the employer to expect them to have to pay for the administrative upkeep of very small pots for ex-employees. This is a burden that is currently alleviated by short service refunds and there is concern amongst employer schemes that the abolition of short service refunds will add to their scheme costs and impose burdens of continuing communication with people with whom they no longer have a relationship.

Chapter 3 – Improvements to the current regulatory framework

TISA believes that none of the suggested changes within the consultation document would overcome the inertia that currently causes job changers to leave their small pots behind with their previous employer's scheme.

It has been suggested that an alternative solution might be to create a virtual pension pot. This solution might comprise a central database which provides a central view of all an individual's pension pots, whilst leaving the pots themselves with the original scheme. In addition to virtually amalgamating private pension savings, it could also be possible to include state pensions into the same single view. Such a system might also replace the pension tracing service, once the general public were aware of a central source for all pension pots.

The benefits of such a solution would be to address some of the consumer detriment and legal issues of automatic transfers. However, it would perpetuate the current complexity of people's pension arrangements without achieving the simplification of bringing all the pensions together in “one big fat pension pot”.) It is also not clear that this approach would drive increased consumer engagement. It is also that case that physically amalgamating pension pots may not increase consumer engagement. It would be interesting to see evidence that having a larger pot does actually drive engagement.

Chapter 4 – Automatic transfers

The right to opt out

TISA takes the view that automatic transfers would need to include the right for members to opt out. The right to opt out of the automatic transfer needs to balance the personal wishes of the member against what is a reasonable burden to place on an employer.

An opt-out right could work with members with a pot above a certain size having the right to opt out of an automatic transfer and to stay in their former employer’s pension scheme. However, as noted above there may be legal and liability issues around using opt out alone as a safeguard for potential consumer detriment.

Members with a pot below that size should have a right to a reasonable period of time to arrange a transfer to some other pension vehicle of their own choosing and their own facilitating. But beyond that, their former employer’s scheme would transfer their benefit onwards using the automatic process.

The need for advice

TISA believes that the costs of advice are disproportionate to the size of most transfers and therefore advice should not be included in an automatic transfer model. The regulatory framework introduced with automatic transfers should be designed to ensure that either automatic enrolment or aggregator schemes offer a suitable destination for the pension pot, thus considerably reducing the need for advice. Provided there is a right to opt out, there is no reason why people cannot choose to take advice should they so wish.

Existing stock of small pots

TISA takes the view that there is a great deal to be done to achieve a more efficient transfer system. There will need to be legislative and regulatory change, operational process re-design, an infrastructure to be built and new scheme member communications to be developed. There are considerable and complex challenges in addressing the stock of existing small pots, which are far from homogeneous. There is a risk that in attempting to include the stock, the delivery of a solution for the small pots arising from the auto-enrolment market could not be delivered in a timely manner.

In the short term there are strong merits in starting with new auto-enrolment small pots. These are much more likely to be simple, without the complicated features of older pensions like guaranteed annuity options, with profits market value adjustment factors, capital units and so on.

Once the pensions industry has become accustomed to automatically transferring new small pots, it should be possible to address the legacy business using a member driven transfer framework.

Costs of transfers

TISA takes the view that if transfers are to be automatic then it would be inappropriate for scheme members to bear the cost of the transfer. If scheme providers bear the cost of transfer, there is an incentive to make the process as efficient as possible in order to drive down cost.

Criteria for automatic transfers

TISA agrees with the principle that all pension contributions are important and will be well cared for, even if an individual left service after only a very small sum had been contributed.

TISA takes the view that an automatic transfer regime should be compulsory, in that the default position should be to transferThis approach removes the burden on employers. A voluntary approach would require the employer to make decisions, which could give rise to future complaints or concerns over the quality of the decision.

There are challenges in setting an upper limit for a small pot. Once that upper limit has been reached, the scheme member will have to start again with another small pot and will end up with a series of pots, rather than one big pot. This approach is unlikely to achieve the consumer engagement objective that is central to the reform.

Chapter 5 – An aggregator scheme for small pots

TISA believes an aggregator scheme offers some benefits. Such a scheme could be regulated in a way which ensures that consumers are protected against the risk of transferring to a scheme with high charges or poor administration.

An aggregator should be able to take small pots regardless of size. Otherwise the solution does not enable the short service refund option currently available to trust based schemes to be withdrawn.
An aggregator model would also allow company schemes to transfer out their leavers immediately, without having to wait for their ex-employee to be auto-enrolled into a new scheme.

Single aggregation scheme

A single aggregation scheme would have significant disadvantages on account if its size. If people move jobs eleven times on average, then we would trend to a position where the single aggregator controlled 90% of the pension market. That would destroy the marketplace, which today uses competition to drive innovation and cost benefits for consumers. The Competition Commission are likely to have concerns about such a large market participant.

Multiple aggregation schemes

TISA believes that a solution with multiple aggregators would not solve the central consumer engagement problem of small pots. People would still accrue several small pots in one of a number of aggregator schemes.

NEST acting as the aggregator scheme

TISA takes the view that using NEST as the aggregator scheme is unlikely to achieve the greater goal of encouraging member engagement and better decision making. Through its design and volumes NEST focussed on the needs of low to median earners and small companies. The NEST model is based on default decisions and low levels of active member participation. This would continue if NEST were the single aggregator.

NEST was created using over £120million of State Aid that was approved by the European Commission. Extending NEST's role to become an aggregator would require a fresh approach to the European Commission, or risk a challenge at the European Court. It is not clear that the European Commission would grant an extension of its permission for NEST to become an aggregator, as there appear to be existing private sector solutions that could fulfil this role without State Aid.

An alternative approach

Rather than using the concept of an aggregator scheme, it would be possible to envisage the aggregator as an administrative platform industry utility, jointly owned by all market participants. Consumers would effectively have a single account where their small pots would be aggregated. Schemes would place their funds on the platform and transfers onto the platform could be made on the basis that the default investment would be the investment the member already holds.

With platform technology one could see the possibility of such a central utility having a wide range of pension funds where transfers could come "in specie" as it were. This would mitigate some of the risks of transferring via cash. All the market participants could have their schemes or products available via the platform.

If the platform were jointly owned by market participants we could achieve the required scale and mitigate the risks of one aggregator having a 90% market share. The central utility could also act as clearing house for transfers between funds to achieve the merits of the pot follows member solution.

Consumers could make a choice of which scheme or provider they want for their pension saving and their relationship. It could even be possible to envisage a future where schemes use the central platform for their ongoing administration where new contributions could be pointed at the provider the consumer selects.

Chapter 6 – Pensions move with people from job to job

From a consumer engagement perspective, TISA views the pot follows member approach as one with potential merit. A single long term savings pot which grows over time provides simplicity for the scheme member and supports ongoing communication opportunities. However, there is a case that retaining multiple pots could mitigate the concentration risk of having the entirety of a person's workplace retirement savings in one scheme.. There would be one account to be maintained, rather than several and across the entire market it is logical to believe that this would reduce administrative costs.
Transfers can either be made at the point when a scheme member leaves employment or at the point when a person is auto-enrolled into their new employer's scheme. It would seem necessary for an automatic transfer to take place alongside auto-enrolment into the new scheme. However this presents a challenge where a small pot could be held for some time if the member has a gap in employment or opts out of the new employer scheme.

The other consideration is that people with frequent job changes would have their savings pot transferred many times. There are costs associated with this which include both transfer costs and the potential for investment losses since transfers have to be made via cash.

In the long term, we can envisage a position where it would become standard to take your pension pot with you on each job move, from employer to employer. This would enable the ultimate "big fat pension pot" to be achieved. Employees could opt-out of the transfer, and must envisage that some employees taking control over their pension would decide to make their own arrangements, such as transfer to a SIPP.

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