



Equisoft UK

OPEN CONSULTATION RESPONSE:
ENDING THE PROLIFERATION OF DEFERRED SMALL POTS

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1 CONSULTATION DETAILS

1.1 Consultation Introduction

“The first part of this [consultation] sets out the feedback the Department for Work and Pensions (DWP) received to the call for evidence which ran between 30 January 2023 and 27 March 2023.

The call for evidence concentrated on widening the evidence base on the scale and characteristics of the growth in the number of deferred small pots and on the potential solutions to tackle their continued growth. It focussed on two large-scale automated consolidation solutions – a ‘default consolidator’ model and a ‘pot follows member’ model – whilst recognising the potential positive impact of other actions, including member exchange and enabling greater member engagement.

The second part of this [consultation] sets out the Government response and a consultation with further policy questions to gather additional views and evidence on the proposed automated consolidation solution to address the growth of deferred small pots.”

1.2 Automated Consolidation Solution

53. Our call for evidence explored two large scale consolidation solutions designed to address the growth of deferred small pots – a default consolidator model and pot follows member and asked for respondents’ views on the potential benefits and implications of both solutions. From the responses we received, it is clear that both solutions have their merits and would support the first key criteria we set out: the delivery of net benefits to members through the reduction of deferred small pots. However, there was no collective agreement across the responses on the optimal approach.

54. Pension schemes, enabled by private pensions policy, have a role to play in enabling greater security in retirement for their members and in supporting economic growth across the country. As part of our plans to drive further consolidation and ensure scale provision in the DC market, we will review the Master Trust authorisation regime, introducing higher Value for Money standards and reassessing duties on schemes laying the foundation for a market formed of a small number of larger pension schemes providing better outcomes for their members. This more consolidated pensions market, will ensure that schemes have the scale and capability to invest a greater proportion of their much more substantial asset pool into productive assets in the UK economy, boosting economic growth.

55. Given this realignment of the pensions landscape, it is important that we consider the solution to the growth of deferred small pots with this context in mind. At the same time the overall aim of delivering net benefits to members must remain the priority. We have carefully considered the potential benefits of both pot follows member and a default consolidator model. Respondents have been clear that both approaches, if designed correctly, would enable the consolidation of deferred small pots and therefore further enable consolidation of the market, whilst reducing the financial burden on providers of the most unprofitable deferred pots.

56. In relation to the pot follows member approach, there was a strong view from respondents that this approach may be simpler for members to understand given their deferred pension would follow them from employment to employment. However, many responses highlighted the risk that a member could move from a well performing scheme to a poor performing scheme which would risk putting the member in detriment, although this risk will reduce over time as a result of our proposed Value for Money framework. Further to this, some schemes suggested that due to the frequency of transfers likely required as part of a pot follows member approach this would require their scheme to become more liquid and reduce their capacity to invest in illiquid assets, working counter to our productive finance focus.

57. Alongside these challenges, our call for evidence outlined the risk that with a pot follows member approach members’ pots may quickly reach the maximum limit for consolidation (even if the maximum pot limit was increased over time) and therefore get stuck with potentially multiple unconsolidated small pots. This would limit the overall level of consolidation unless a

significantly higher pot value is set, – however, this would run counter to the feedback received in the call for evidence that suggested that we should start with a lower maximum limit. Additionally, respondents raised other risks including the possibility that a member’s pot will not catch up with them due to frequent job changes and that multiple job holders, who have more than one active pot, present a further complication.

58. On the other hand, when considering the default consolidator approach, it is clear that this approach could align more effectively with our desire for a more consolidated workplace pensions market, with a small number of authorised default consolidators, acting as a consolidator for deferred small pots providing greater value for their members through the economies their scale brings them. Further to this, the proposals for an enhanced authorisation criteria for schemes to act as a default consolidator, discussed further in Chapter 3, could ensure that there is less risk of detriment to members’ deferred pots that are transferred to a consolidator as the consolidator scheme will be required to demonstrate the highest levels of value for money. These small number of consolidators, will be able to generate scale at a greater rate opening opportunities to invest in productive finance benefitting the wider economy.

59. On this basis, we have concluded that the multiple default consolidator model is the optimum approach to addressing the deferred small pots challenge and has the potential to provide greater net benefits to members, ensuring that members eligible deferred pots are consolidated into one scheme.

60. We recognise that this approach will not eliminate the future flow of deferred small pots. However, this approach will result in a significant reduction in the current stock of deferred small pots, whilst also enabling the consolidation of future deferred small pots created. Our call for evidence explored whether priority should be given to addressing the stock or flow of deferred small pots first. There was no clear consensus about whether either should be prioritised. However, respondents noted that neither a default consolidator nor pot follows member approach would truly eliminate the flow of deferred pots as the pots would have to sit deferred for a period of time before becoming eligible for consolidation.

61. In order to stop the creation of new deferred small pots, a more fundamental change to the automatic enrolment framework may be needed. In the future, a simpler system of ‘stapling’, as seen in Australia, (where the members active pension pot is assigned as their pot for life, unless they actively choose an alternative provider) may emerge. This would create an environment which is easier for a member to engage with but is clearly some way off in the UK.

62. In this consultation, we have set out the core framework for a multiple consolidator approach and seek views from respondents on whether they agree with the proposals.

1.3 Consultation Responses

The Department for Work and Pensions welcomes input from: pension scheme providers; trustees; scheme managers; members of workplace pension schemes; employee representatives; trades unions; consumer groups; employers and employee representative groups; pension industry professionals; and members of the advisory community and any other interested stakeholders.

Responses must be submitted by 05/09/2023 and can be emailed to smallpots.policyteam@dwp.gov.uk

2 INTRODUCTION

2.1 Equisoft response to DWP's Policy Proposal

Equisoft were surprised to read the summary of the previous consultation provided by DWP and the ultimate decision made to choose a consolidator model over the previously selected pot follows member approach. We have seen near unanimous support for the latter in our engagement with industry with the only opposition coming from those who would seek to be consolidators.

We still feel pot follows member delivers a much clearer solution for consumers whilst avoiding the complexity and cost of centrally procured Government infrastructure. We also feel that some of the issues cited as to why pot follows member was not the right choice are not necessarily well resolved by the DWP's proposed solution.

The default consolidator model, while not relying on it, still attempts to engage individuals who are by the nature of small pots not engaged. The communications suggested in the process are reliant on consumers making decisions about things they likely do not fully understand, and we feel is unlikely to result in any action and may in fact lead to concern or confusion.

We also have reservations over the proposed value limits as again, engagement from already disengaged individuals is unlikely to happen until meaningful pot sizes are achieved.

The proposed solution puts much of the operational effort on the ceding scheme whilst it feels the consolidator gets the benefit from the ultimate transfer of assets and the resulting economies of scale.

The item of most concern, however, is the concept of a central government clearing house or register. This is in complete contrast to the current dashboard project where not creating a central register was deemed an absolute must. It would also be a potential target for cyber-attack. Critically though, projects of this nature are often complex, expensive and can take significant time to deliver. In the meantime, the small pots problem continues to grow and consumer's disparate pots are diminished through scheme charges.

Given this is the DWPs chosen route however, we feel there are opportunities to use existing open transfer standards and elements of the originally proposed pot follows member solution to create a federated model of consolidator information, expediting solution delivery, negating the need for central registries or pot data and only needing a simple solution for the allocation of pots to a default consolidator if at all.

We have outlined our thoughts on this in our responses to your questions below and would welcome the opportunity to discuss them in more detail.

3 CALL FOR INPUT – EQUISOFT UK RESPONSES

3.1 The Consolidation Process

3.1.1 A Clearing House or a Central Registry?

Proposal: We propose that a central clearing house is created to act as a central point informing schemes where to transfer a members eligible deferred pot.

Q1: 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?

- We agree that a clearing house would be a better solution than a central registry however we still feel that a centralised system is not the best approach.
- Centralised government procured systems do not have a great track record and Pensions Dashboards is an example where this has not worked out particularly well so far.
- We feel a centralised system incurs greater cost, risk and complexity and creates a single target for cyber-attack. We strongly feel that a federated design would be better suited.
- Potentially utilising the ISP ecosystem already emerging for Pensions Dashboards, consolidators can utilise their ISP capability and the data therein (albeit with newly delivered interfaces) to create a federated register of consolidated pots and default consolidator records. This model could even utilise a blockchain approach if deemed useful/necessary.
- Rather than a central clearing house performing the majority of the decision making, the schemes and consolidators can communicate amongst themselves, only needing a central solution to decide on the default consolidator where none exists or is chosen.
- We feel any central system should just allocate pots in a round-robin approach which would mean absolutely no member/pot data would be stored centrally. This would result in data only being held where it naturally belongs with the providers of the schemes the member is engaged with.
- In fact, the model could go further than this and schemes could select the default consolidator where none exists or has been selected, either through choice or more likely through a round-robin allocation.
- We would also strongly urge the re-use of the well-established UKETRG/ViaNova open standards for pension transfers to move the pots to the consolidator. These mechanisms provide the necessary capability to move the member's pot efficiently and at very low cost while giving schemes and consolidators choice of solution provider in a competitive market.
- The process we would propose therefore would be as follows:
 - The scheme identifies an eligible deferred small pot and sends a message to all consolidators asking if any of them are the default consolidator for or hold a pot for the member.
 - Based on the responses received the scheme communicates with the member asking if they wish to opt out and if they don't, which consolidator the pot will be moved to (if a default already exists) or where they would like to move their pot to (from a full list of consolidators or a subset if a subset already hold pots)
 - If the member responds and has opted out, no action is taken.
 - If the member responds, has not opted out and a default already existed:
 - The scheme sends a message to the default consolidator providing the pot and member details, who in turn initiates the transfer of the pension utilising open standards.
 - If the member responds, has not opted out and has selected a default consolidator:

- The scheme sends a message to the chosen consolidator providing the pot and member details, who in turn notes themselves as the default consolidator and initiates the transfer of the pension utilising open standards.
- If the member responds, has not opted out, but has not selected a default consolidator or the member does not respond:
 - If exactly one consolidator had identified themselves as holding a pot for the member, this consolidator is used as the default.
 - If more than one consolidator identified themselves as holding a pot for the member, the largest pot would be used as the default consolidator.
 - If no consolidator is the default or holds an existing pot, the scheme selects a default consolidator for the member in a round-robin fashion.
 - The scheme then sends a message to the chosen default consolidator providing the pot and member details, who in turn records themselves as the default and initiates the transfer of pension utilising open standards.

3.1.2 **What happens when a member fails to choose a consolidator?**

Q2: 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?

- Of the two options stated, B would be our recommendation. Allocation based on market share does not feel particularly fair. It is unlikely to drive competition in the market or innovation to deliver good consumer outcomes. It also tends towards a single consolidator which we also don't feel is a good consumer outcome unless government controlled. Option A could also result in no consolidation where a consumer already has a pot but where their additional small pot is moved to an alternate consolidator.
- Option B however, does not state how a pot would be allocated when no other consolidator pot already exists. In this scenario we would suggest a round-robin approach.

3.1.3 **Authorisation to act as a consolidator.**

Q3: 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, there must be an authorisation regime in place to ensure good consumer outcomes and to allow ceding schemes to trust the consolidator and meet their obligations.
- We are not well placed to comment on essential conditions, but all parties should ensure seamless, automated and timely communications and ultimately transfer to ensure lowest possible costs for all involved.

3.2 **Eligible pot criteria**

3.2.1 **Pot Size**

Proposal: The pot size limit will initially be set at £1,000, with a statutory requirement on the Secretary of State to review this limit at regular intervals.

Q4: 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?

- No. We feel that the £1,000 limit is too small. While we recognise the concerns raised by some, we feel that the real solution to erasing small pots is to create true member engagement. We feel this is only likely to happen when amounts are consolidated to a size that piques interest. We don't believe this would happen quickly enough by only moving small

amounts under £1,000. People earning a living wage could still create multiple pots over a £1,000 which do not consolidate by staying in each job for around a year.

- In addition, we have seen the detriment of charges to such small pot values. Not consolidating pots that lie just over the £1,000 limit may deliver a worse outcome than if they were consolidated.
- We feel that an initial limit of £5,000 is more suitable rising fairly quickly to the original £10,000 limit defined by previous working groups in 2015.

3.3 Same scheme consolidation & Member exchange

3.3.1 Same scheme consolidation

Proposal: We do not propose to mandate schemes to undertake same scheme consolidation, however, we would encourage schemes to undertake this where possible.

Q5: Do you agree with this proposal not to mandate schemes to undertake same scheme consolidation at this current time?

- No. Schemes should be consolidating now and not doing so is a detriment to the consumer.
- Not consolidating could also result in the consumer having pots with more providers than they started with if they held two pots, one under the chosen monetary limit and one over the limit which would not be consolidated.
- Consolidation within the same scheme could also remove the need for a transfer to a consolidator altogether (if the individual pots fell under the monetary limit while the sum was over) negating unnecessary cost and effort.
- We feel it should be mandatory for schemes to consolidate before any automatic consolidation scheme is enacted and to be required to do so on an ongoing basis.

3.4 Summary

Q6: 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?

- We do have concerns with the approach proposed focussed on two areas.
- First, we feel the default consolidator does not provide as easy a solution as pot follows member would for consumers to understand. In fact, a single consolidator model would be better for consumers to understand, although may not drive healthy competition in the market.
- Secondly, again unlike Pot Follows Member, the solution requires the procurement and operation of centrally delivered infrastructure. Having been involved in such projects including the recent Pensions Dashboards project we know how difficult this can be and can lead to lengthy timescales (something the small pots problem could do without) and high costs.
- We much prefer federated solutions (as described in our responses above) delivered by industry and would urge the DWP to keep any central infrastructure to a minimum.
- Re-use of existing industry capability such as the newly created dashboard ISP ecosystem and the well-established UKETRG open transfer standards could help deliver a more cost-effective industry solution in a shorter timeframe.

Q7: 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 are not well placed to comment, however we would recognise the role a clearing house could have in defining and controlling communications with individuals from protected groups.

In the federated model we propose, strict guidance should be issued to schemes regarding their communications to members and protected groups in particular.

END OF DOCUMENT