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Response from the Pensions Management Institute to DWP all for evidence ‘Addressing the challenge of deferred small pots: a call for evidence’

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Response from the Pensions Management Institute to DWP call for evidence: 'Addressing the challenge of deferred small pots: a call for evidence'

Introduction

PMI is the professional body which supports and develops those who work in the pensions industry. PMI offers a range of qualifications designed to meet the requirements of those who manage workplace pension schemes or who provide professional services to them. Our members (currently some 7,000) include pensions managers, lawyers, actuaries, consultants, administrators and others. Their experience is therefore wide ranging and has contributed to the thinking expressed in this response. Due to the wide range of professional disciplines represented, our members represent a cross-section of the pensions industry as a whole.

PMI is focused on supporting its members to enable them to perform their jobs to the highest professional standards, and thereby benefit members of retirement benefit arrangements for which they are responsible.

We trust that the feedback in the following pages proves helpful.

Q1. 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?

The PMI broadly agrees the key and main criteria as a call for evidence are captured in Section 1 of "Addressing the challenge of deferred small pots: a call for evidence", published 30 January 2023. However, we would emphasise strongly an issue somewhat captured in point 4 of your cross industry working group, point 8 in your wider industry engagement and 9 in systemic inefficiency. The point we'd like to empahises strongly as our main and overarching concern being, that the long term solution/resolution of the small pots issues may be temporarily additive to the industry problem and not create an immediate cure.

We believe there is an extremely high potential for administrators and platform providers as service suppliers to the industry, to have an exponentially increased demand for automatic transfers whatever the path of agreed resolution of small pots as a destination. Our input and suggestion to your evidence, would be to avoid a further systemic market risk, possibly leading to a capacity crunch may be to "phase" the dates at which certain pot values are dealt with in tranches/waves i.e. if moving to <£2k as a de-minimis limit, perhaps you consider commencing movement of pots in waves from the smallest first to the largest. 1) Up to £500 2) add in including £500-1,000 3) add in £1,000-1500; and 4) >£2,000 in manageable waves that the industry can cope with.

Q2. How do you think we can increase member-initiated consolidation and what are the opportunities, risks, and limitations of member-initiated consolidation?

We consider that the most likely cause of member-initiated consolidation will be Pensions Dashboards acting as a driver for this as you note. However, we do have concerns that Dashboards could lead to pressure for inappropriate consolidation which is not in members' best interests. Other recent consultations, such as from the FCA, have addressed this point. We do not believe that there should be any further drives to increase member-initiated consolidation because of the risk this poses to any party that advertises this to a member, be that employer, trustee, provider or even government.

Q3. 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?

The PLSA and ABI working group, comprised of many industry representatives, explored several options for market innovation to solve the small pots problem. We believe that their final report sets out the limits of how far market innovation can go in this area, without legislative mandation.

We are unsure what you are referring to in paragraph 25 but we would not be keen on providers "encouraging" active members to transfer their previous pensions into their active pot because this might not be in the member's best interests – note we differentiate this from automatic transfers mandated by legislation such as pot follows member with suitable member protections built in.

Q4. 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.

We can see an argument for each of these figures being the upper threshold for automatic consolidation. However, on balance we believe that £5,000 is an appropriate sum because at that level a pot in isolation will not secure a significant retirement income for members and that level will also lead to significant consolidation leading to cost-savings for the industry. However, we would not support the upper threshold being as high as £10,000 since this will start being a material amount of pension savings for most people and therefore decisions about it should be carefully considered rather than being done automatically.

Q5. 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?

Whilst the PMI is not a pension provider, we provide an industry answer collectively on overarching points relating to question 5-9 inclusive. (See 9 below)

Q6. What is the average cost of a pot transfer (ceding and receiving) for your scheme, within AE charge capped default funds?

Whilst the PMI is not a pension provider, we provide an industry answer collectively on overarching points relating to question 5-9 inclusive. (See 9 below)

Q7. Would the increase in pot transfers associated with an automated small pots solution affect your investment strategy? If so, how, and why?

Whilst the PMI is not a pension provider, we provide an industry answer collectively on overarching points relating to question 5-9 inclusive. (See 9 below)

Q8. 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?

Whilst the PMI is not a pension provider, we provide an industry answer collectively on overarching points relating to question 5-9 inclusive. (See 9 below)

Q9. What is the breakeven point for administering pots for your scheme, does this differ for active/deferred pots?

As per comments above, the PMI recognises that we are not a pension provider. However, in relation to a collective answer on this group of related questions as an industry voice and body, we would remark to re-emphasise the point made in our answer to question 1. The key point to emphasise here is this is not only an explicit cost equation, there are implicit costs not captured by these questions.

Quite aside from the cost to the member, and the cost to the provider as an overt P&L transaction either to the member as born out in Total Expense Ration (TER) paid as basis points (bps) over their fund holdings i.e. Assets under management (AuM), or to the provider as £GBP physical cost or outlay in an operational business P&L, there is an opportunity cost and risk to bulk transfer automated processes that is not captured in your questions i.e. a pension provider may know the data to answer each of your questions. But, the over-arching business impact to all service providers requiring the prioritisation of legislative requirements to perform bulk processing tasks for small pot transfers, may detract from business as usual client onboarding or exiting customers/fund switching/other bulk processes which require time, money, risk controls and processing power. Adding compulsion for a further requirement for bulk processes which could potentially triple the entire industry transfer volumes needs a deeper impact assessment in its own right. In other words, this is not something providers at large will be able to pick up easily, without significant and systemic process change to support.

Q10. 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 answer to this will be linked to the answer to Q.4 about the maximum pot size – it is likely that the larger the maximum pot size, the larger the minimum pot size to be in scope. However, in all scenarios it seems to us that pots of less than £250 are of nugatory value and that the majority of savers would be better served by getting some form of refund of their contributions.

Additional comments based on experience of the previous refund rules are that refunds should be based on pot size not length of service and that consideration should be given to employer contributions being included in the sum paid to the member so that they do not lose this additional value. However, as we note in our answer to Q.19, from the provider perspective, refunds could create additional work pressures.

Q11. 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?

We agree that setting a prescribed period is the most appropriate and straightforward option. We believe that setting a period of one year would cover the majority of genuine deferred cases without generating excessive “false positive” returns.

Q12. Do you agree with the above summary of potential benefits and implications of the default consolidator/s approach, and if not why?

As per 5-9, we answer questions 12-15 collectively as an industry body, not as a service provider. See answer to question 15 as this collective response below.

Q13. 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?

As per 5-9, we answer questions 12-15 collectively as an industry body, not as a service provider. See answer to question 15 as this collective response below.

Q14. Who should be able to be a consolidator; should there be a limited number, and, if so, how many, and why?

As per 5-9, we answer questions 12-15 collectively as an industry body, not as a service provider. See answer to question 15 as this collective response below.

Q15. 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?

We would merely observe a possible conflict in the potential of this approach for anti-competitive behaviour and adherence with the law in having a default consolidator. This conflict also goes in to regulation i.e. arguably is anti-freedom and choice and would need as a bare minimum to be "undone" by the consumer. I.e. should a member choose in future to remove their assets from the default consolidator, a withdrawal or transfer process would need to be designed to allow.
Further, we would also emphasise the increase risks i.e. pension liberation, data security, dashboard developments and consumer choice in creating a repository for member assets without their choice or consent, either advised or non-advised.

On the flip side, we do appreciate and recognise there is a governmental cost consideration on how this suggestion/solution might relieve pressures on the pension tracing service.

Q16. Do you agree with the above summary of potential benefits and implications of the pot follows member approach, and if not why?

We agree.

Q17. What are the key benefits / risks of a pot follows member, including impacts on the wider pension market, and employers?

The concept of pot follows member has been discussed for nearly a decade now and is well understood in the industry.

The biggest risk to savers is probably being automatically transferred into a "less-good" scheme than their previous scheme, for example with higher charges. However, market competition and the charge cap makes this less of an issue than it was a decade ago and safeguards such as members' right to opt-out of automatic transfers will mitigate against this.

However, one possible consequence of members being able to opt-out of automatic transfers is that savers will choose to do so as a "knee-jerk" reaction. If this happens *en masse* then this would

defeat the objective of consolidation. But factors such as setting a long period (see Q.11) before automatic consolidation is triggered would mitigate against this.

We note you state there is a risk of members reaching the maximum pot value limit for automatic consolidation. We do not agree with this: if the value limit is appropriate then pots of that size will be meaningful for savers and not disproportionately expensive for providers to run. So there should be no downside to pots reaching that limit.

Q18. Of the two solutions set out above what is your preferred approach, and why?

We believe Pot Follows Member is the most pragmatic route and choice, supporting better member outcomes in a healthily competitive environment and most closely supporting other government objectives. However, we would again call out our concerns for the capacity of the transfer processes of industry to support.

Q19. Are there any further / fresh or hybrid solutions that are worthy of consideration?

Current data supports (Broadridge) master trusts are likely to become the pre-dominant market workplace schemes of choice within the next 5-10 years. As such, it is noteworthy that the master trust regulations and approval regime may need to accommodate any changes required from legislation/regulation introduced.

A possible hybrid or alternative "revival" solution could be, to include a reintroduction of previously allowed returns of contributions net of tax benefits deducted or re-directed. Our only concern with this approach would be that it contradicts the reasons government stopped this in the first place and would add to our capacity constraint concerns for the PfM approach. Arguably, this would create more work as a "refund" would need to be directed not just to a member and their sponsoring employer, but also to HMRC if net pay scheme(s).

Finally, it is possible, albeit dependent on the potential or likely success and take up of new CDC models as yet to gain traction, as to whether or not refunds for very short service or very small entitlements would need to be reintroduced, so as to not inadvertently causing a detriment to remaining members of pooled arrangements. This is clearly not an issue for today, but a possible future consideration in CDC design.

Q20. 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?

As per answers above (Question 1) the initial focus should be on new pots from the commencement date. Back-dating previous small pots, in our opinion, should be phased in to appropriately manageable tranches or waves.

Q21. 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?

As you have noted, this possibility has been explored by industry in recent years. We understand that one of the biggest issues about this is dealing with protected pension ages. We believe that this will require intervention by government to resolve.

Q22. Could a member exchange form part of a hybrid model alongside one of the largescale consolidation solutions discussed in Section 5, or with a large-scale consolidation solution acting as a backstop?

We envisage that any member exchange system will largely be used in the initial phase of any consolidation solutions to reduce the number of stock small pots. If this is successful and if a large scale consolidation solution works as intended then we do not think that there will be on-going need for member exchange.

Q23. 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?

In principle we believe that same scheme consolidation benefits savers. However, we do recognise that this could require some legacy administration systems to be updated.

Q24. If your scheme currently does not undertake same scheme consolidation, what are the reasons behind this and what would be required to overcome this?

As an industry organisation, we are not in a position to answer this.

Q25. 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.

Our only comment on this is that automatic consolidation is more likely to affect lower paid individuals who change jobs frequently. This is not a protected group but should still be kept in mind when considering policy in this area.