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Dear Ms Weddell

**Meeting future workplace pension challenges: improving transfers and dealing with small pension pots**

ICAEW is pleased to respond to your request for comments on *Meeting future workplace pension challenges: improving transfers and dealing with small pension pots*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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## ICAEW REPRESENTATION

### **MEETING FUTURE WORKPLACE PENSION CHALLENGES: IMPROVING TRANSFERS AND DEALING WITH SMALL PENSION POTS**

**Memorandum of comment submitted in March 2012 by ICAEW, in response to Department for Work and Pensions consultation paper Meeting future workplace pension challenges: improving transfers and dealing with small pension pots published in December 2011**

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## INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *Meeting future workplace pension challenges: improving transfers and dealing with small pension pots* published by Department for Work and Pensions on 15 December 2011, a copy of which is available from this [link](#).

## WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
4. This response reflects consultation with the ICAEW Business Law Committee which includes representatives from public practice and the business community. The Committee is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies.

## GENERAL COMMENTS

5. We agree that there is a proliferation of small pension pots and that, with implementation of automatic enrolment, this will only increase over time and therefore we are supportive of this initiative to increase their aggregation. Given the likely low levels of engagement and sophistication for the relevant deferred members, we would support a high degree of automation in order to overcome inertia in helping to reduce the number of small pots and we believe this would give rise to benefits for employees and also for employers/schemes.
6. We propose that NEST should be the automatic national aggregator fund, but with employees (at their option) being able to override this automatic transfer by requesting a 'follow-me' transfer to their new employer. These automatic and follow-me transfers would both be subject to *de minimis* limits. We make some suggestions in our detailed comments below regarding how the potential adverse distorting/disrupting effects for NEST could be reduced/mitigated.
7. We note with concern that there is a lack of detail/practicality in the consultation paper, in particular, in relation to the suggestion that the pensions industry develop an electronic platform/database for all Money Purchase members. The consultation does not deal with who would fund this. We also note that employers would no longer be receiving short-service refunds but would be subject to additional costs.

## RESPONSES TO SPECIFIC QUESTIONS/POINTS

### Chapter 2 – Small pension pots: the case for change

#### Q1. Do you have evidence on the scale of the current problem of small pension pots?

8. We are aware of a DC scheme that has been in operation for 9 years and already has 288 deferred members with fund values between £2k and £5k, with a further 45 deferred members who have fund values of under £2k. We note that this scheme is not in a sector with a

particularly high turnover of staff, and therefore we anticipate that employers with higher churn (eg in the retail sector) would have much larger numbers of deferred members with small pots.

**Q2. Do you agree that the barriers listed on page 21 are the current barriers to transfers?**

Yes, we agree with the DWP's assessment of the current barriers to transfer, which include lack of engagement from employees (especially among low to moderate earners), the high cost and administrative complexity of transfers and the restrictions imposed by many potential transferee schemes.

**Chapter 3 – Improvements to the current regulatory framework**

**Q3. Would any or all of the proposals listed on pages 27 and 28 under this option be an effective way to facilitate more transfers and reduce the number of small pension pots?**

9. Whilst we would support the measures outlined to reduce the number of small pots, such as guidance to encourage members to initiate transfers and simplification of the process, in our view these would not go far enough to overcome inertia. We believe that (in order to prevent the proliferation of small pots, especially once auto-enrolment has been introduced) there should be a higher degree of automation, rather than leaving transfers to be initiated by the member.

**Q4. Are there other ways to reduce costs further and make it easier for people to find any small, dormant pension pots – during the accumulation phase and at the point of retirement?**

10. We note that the Pensions Tracing Service is already in place to assist deferred members in tracing pension funds (based on the member's National Insurance number).

**Chapter 4 – Automatic transfers**

**Q5. Taking account of our principles for reform, which of the two models in Chapters 5 and 6 do you think has the most merit?**

11. We believe a combination of these two models should be introduced, with automatic transfers to a national aggregator scheme (on the assumption, and proviso, that this is NEST), combined with an optional 'follow-me' system under which the employee would have a right to request a transfer to their new employer (where such request would override the automatic aggregator transfer, and there would be a requirement that the request is accepted by the transferee scheme). See also our answers below, which provide more detail on our proposed combined approach.

**Q6. Do you have any other suggestions for a process to overcome problems associated with small pots and improve transfers?**

12. See also our answers at Q5 above and Q11 below. We note that there could be adverse distorting/disrupting effects for NEST if it is used as a national aggregator scheme (as outlined in paragraph 100 of the consultation paper). However, we consider that there should be **one** national aggregator scheme and that NEST is the **only** suitable candidate. Therefore, the DWP needs to give more consideration to overcoming these issues and developing ways in which this can be achieved without adversely impacting NEST's active members. We suggest one idea below at Q10, as we think having a delayed and possibly phased approach to 'legacy' pots would help avoid the impact of transferring the existing stock of small pots on NEST too soon after it has been launched. Further ideas to explore could include consideration of whether the costs of administering these funds should be borne by the funds (so as not to impact on NEST's active members).

**Q7. Although the solutions in this paper deal with small pots in defined contribution (DC) schemes, we would be grateful for views on how defined benefit (DB) schemes should be treated and whether we should also consider applying any transfer solution to DB rights?**

**13.** A key point regarding small pots within DB schemes is that sponsoring employers are much more active in dealing with low-value DB pension pots because they can readily see the advantages in reducing liabilities. There is no such incentive in money purchase schemes.

**Q8. Do you agree that under an automatic transfer system, members should have the right to opt out? We believe that the guidance on this subject is helpful. However, etc.**

**14.** Given we are only considering small pots, in our view the member should **not** have the right to opt out of the automatic transfer to the national accumulator fund (which as we explain above we believe should be NEST). However, we would support the member having a right to 'override' the automatic transfer by requesting a 'follow me' transfer to their new employer.

**Q9. Do you agree that individuals should not be required to take advice in an automatic transfer system, provided sufficient safeguards are put in place?**

**15.** Given we are only considering small pots (which we agree need aggregating), we agree that individuals should **not** be required to take advice. In our view, the default transfer into NEST should be sufficient safeguards as NEST charges should be sufficiently economical. Where an individual voluntarily requests a 'follow-me' transfer, it would be their choice as to whether to take advice on that transfer.

**Q10. Do you agree that solutions to address the expected rise in small pots after automatic enrolment should also be designed to take account of the existing stock of small and dormant pension pots?**

**16.** Yes, we believe that (over time) the solutions should be extended to deal with 'legacy' small and dormant pots. However, in order to mitigate the potential adverse effect on NEST (as outlined in paragraph 100 of the consultation paper), we believe that opening up automatic transfers to such 'legacy' pots should be after a transitional period (to be determined by DWP but for example after 2017, to allow NEST, auto-enrolment and the automatic transfer regimes to bed in), and should perhaps also be phased in order to mitigate the impact on NEST. We also believe that the treatment of legacy pots may need to be split between member-initiated and scheme-initiated transfers. For instance, consideration could be given to enabling employees to request 'follow-me' transfers of legacy pots sooner than permitting scheme-initiated transfers (which, if permitted, may require member consent).

## **Chapter 5 – An aggregator scheme for small pots**

**17.** We would like to query the upper box on page 37, which appears (erroneously?) to suggest that having several aggregator schemes would reduce competition.

**Q11. What are the particular challenges and benefits created by introducing one or several aggregator schemes?**

**18.** Two substantial parts of the problem are i) members losing track of small pots and ii) members not having the resources, or the will, to track down where they are if/when they do remember them. Only a single aggregator addresses these causes/issues. See also our answers at Q6 above and Q15 and Q16 below.

**Q12. Do you agree with the aggregator scheme characteristics set out?**

**19.** Yes, we agree with the required characteristics outlined on page 36 of the consultation paper, and we believe these could be delivered by NEST (if its rules were amended to permit transfers-in).

**Q13. Could the pensions industry offer an aggregator scheme with these characteristics?**

**20.** No. To avoid the implications/drawbacks set out in paragraphs 96 and 97 in the consultation paper (ie, for either periodically rotating/transferring a 'sole' aggregator around different providers, or having more than one aggregator fund that gives rise to complexity in trying to identify/match/aggregate pots into one of the available funds), we consider that NEST is the obvious and only choice.

**Q14. Have we correctly understood the implications of there being one or several aggregator scheme(s)?**

**21.** Yes, which is why we suggest using NEST.

**Q15. Should there be several aggregator schemes or one?**

**22.** We believe there should be **only one** aggregator scheme and that it should be NEST, because NEST should have appropriately low charges and this would also result in economies of scale where a member moves jobs several times as his small pots can be aggregated within NEST (and subject to one admin charge), and the member may even be an active member during employment with employers using NEST to comply with their auto-enrolment duties. Using more than one aggregator scheme would not bring these benefits and so would be illogical. See also our answer at Q11 above.

**Q16. What are the advantages of NEST acting as the aggregator scheme?**

**23.** As we explain at Q15 above, NEST should have appropriately low charges, and would also give rise to economies of scale where a member moves jobs several times as his small pots can be aggregated within NEST (and thus be subject to one admin charge). Further benefits would arise if the member becomes an active member during employment with employers using NEST to comply with their auto-enrolment duties. Please also see our comments at Q6 where we acknowledge the need to mitigate any potential adverse distorting/disrupting effects for NEST if it is used as a national aggregator scheme (as outlined in paragraph 100 of the consultation paper). See also our answer at Q11 above.

**Q17. What is the best approach to defining a small pot for this option? Would it be preferable for:**

- **Default transfers to be compulsory if the pot is under a certain size.**
- **Default transfers to be voluntary for schemes.**
- **Default transfers to be compulsory under a certain size, but voluntary within a band.**

**24.** We believe (on the basis of using NEST as a national aggregator scheme) that **automatic** default transfers should be **compulsory** for schemes if the pot is under a certain size. The Government should set a figure (DWP to consult with providers to help them establish the appropriate fund value, balancing individual and scheme interests), and we consider on balance that it is probably sufficient and simpler for DWP to review it periodically (as opposed to indexing it). We believe the employee should have a right to request a 'follow-me' transfer - such request would override the automatic aggregator transfer - and that, for simplicity, the *de minimis* limit for this should be the same as the *de minimis* limit below which a short service refunds are still permitted (see Q18 below). (For completeness, we do not support such transfers being voluntary for schemes, and we would also not support a Government-set band within which schemes would have flexibility to determine whether transfers are made automatically because, whilst on the face of it this would appear to balance clarity for individuals and flexibility for schemes, we believe it would increase complexity and lead to unfairness.)

**Q18. Should there be a transfer limit on pots below a certain size and if so, what should happen to the pot?**

**25.** We believe there should be a *de minimis* limit, below which we consider short-service refunds should continue to be permitted to be made directly to the individual (as the costs of such a refund would be significantly lower than the cost of transferring to another scheme). We believe the DWP should consult with scheme providers in order to determine the appropriate level for such *de minimis* refunds, which should exclude the employer contribution. Care needs to be taken in pot valuation as it would be a poor outcome for member protection if a provider could transfer a person out because a pot very briefly dropped below the threshold, for instance on the day of a stock market crash, and therefore appropriate protection would be needed in this respect.

**Q19. Given the default nature of the transfer, which of the member, the transferring scheme or the aggregator scheme should pay the default transfer costs?**

**26.** It should not be the transferring scheme. It should be the aggregator scheme (with the costs being funded by/re-couped from the transferred fund). See also our comments at Q18 above on the need for a *de minimis*, below which we believe a short-service refund should be permitted to be made directly to the individual (see Q18 above).

## **Chapter 6 – Pensions move with people from job to job**

**Q20. Are the existing protections for individuals sufficient for this option where pensions follow people from job to job?**

**27.** In our suggested approach, there would be inherent protections because the ‘follow-me’ would be optional, with a default transfer into NEST as the default aggregator scheme (meaning the default would be economical, should a ‘follow-me’ transfer not be in the interests of the member).

**Q21. Should a pot size maximum be applied to pension pots that are automatically transferred? If so, what should the maximum be?**

**28.** We believe the DWP should collect data in order to determine the appropriate maximum size for automatic transfers (above which transfers would remain member-initiated).

**Q22. How could a central database successfully match members with their pension pots?**

**29.** See our comments at Q23 below.

**Q23. To what extent could the pensions industry deliver a suitable electronic platform/database?**

**30.** It is very difficult for the industry to develop a practical solution without an easement in data protection law to allow exchange of information where it is considered to be in the data subject's best interests. Without this the system remains subject to member consent, ie, Member engagement, the lack of which is the definition of the problem. We are also concerned that there is a lack of detail/practicality in relation to this suggestion that the pensions industry develop an electronic platform/database. The consultation does not deal with who would fund this.

**Q24. What should happen to pots when an individual does not join an employer for a long time?**

**31.** In our proposed system (described at Q6 above), in these circumstances the small pot would be automatically transferred to NEST (which we believe should be the national aggregation scheme).

**Q25. What should happen to an individual's older dormant pension pots in this proposed process (those pots in DC schemes), where pensions follow people from job to job?**

**32.** See our comments at Q10 above regarding a transitional period in relation to 'legacy' dormant pots.

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