

DWP

By email only to:
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5 September 2023

Dear DWP team

LCP's response to "Ending the proliferation of deferred small pots"

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We have a specialist DC practice and advise nearly 150 DC schemes, with assets in excess of £60bn in total, which provide for well in excess of 6 million UK DC savers. This includes both single sponsor arrangements and master trusts.

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Introduction

LCP supports the continued work by the DWP to address the issue of Small Pots, particularly for DC savers who may lose track of these micro savings. We are pleased to see some proposals being considered in more detail and, despite there being more work to do on the specific design choices we believe that with further careful consideration these proposals could help individual savers and not just commercial Master Trusts. As an overriding comment, the communication process between members, ceding schemes, receiving schemes and any third party will be very important and must be clear and not misleading.

Whilst the consultation sets out some clear principles, many points of detail need to be worked through in order for this policy to succeed – and in our view it is key that this policy must be evidenced in how UK DC members outcomes will be improved by this legalisation – clear cost benefit analysis will be an essential next step. Therefore, we believe that the proposed delivery group must include all segments of the impacted industry and be given a clear mandate with sufficient time to achieve this.

Now that the decision has been made to adopt a multiple default consolidator model and that data has been provided to support this approach, we intend to contribute positively to achieving the best outcomes for members under it, despite our previously stated and continued belief that Pot Follows Member has many advantages over the consolidator model.

We are happy for our answers to be quoted by you in future documents.

Response to specified questions

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?

Of the two choices you propose, we prefer in principle the proposal of a central clearing house. If a clearing house is backed by the government, and presented as such, then it has the advantage of potentially being seen as a “trusted service” to members to deal with low engagement and inertia. But, as you note, this introduces additional complexity and cost and, as you also note, the Dashboards project shows that this is likely to cause delay. So there have to be concerns about whether government can set this up in a reasonable timescale. However, in our view, getting this right with the result that DC savers have a positive experience, is more important than the issue of small pots continuing to build in this time period.

In theory, we believe that a clearing house could be built upon the forthcoming Dashboards ecosystem and this has some appeal to it. However, we would not support shoehorning additional functionality to deal with deferred small pots into the Dashboards infrastructure if this were to cause further delay to that project, which we consider to be a greater priority than solving small pots.

Please note that we do not think the registry model, as described in the consultation, will be compatible with the current design of the Dashboards ecosystem. It is not intended that Dashboards will store member data so it is unclear how they could form the basis of a small pots registry. We also believe that sections of the industry where the employer pays administration costs directly (rather than members) would not want the burden (or to be charged by their administrator for the burden) of using the registry.

We presume that government will want to fund a clearing house through a levy or the equivalent on the pensions industry, and if that is the case then in our view setting that levy in an equitable manner will itself be a challenge. We note that a clearing house or registry would not be required under Pot follows Member. There will also be issues to resolve about the governance structure of a clearing house and data controller issues. We suggest that the delivery group looks at this issue in detail as part of its remit.

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?

We are pleased that you propose that members be given the option to choose their designated consolidator or to opt-out if they choose, however we agree with you that member engagement will remain an issue.

Of the two options you suggest, we think allocating deferred pots to the consolidator scheme with a member’s current largest deferred pot (option B) is preferable from a member’s perspective – and we believe that has to be the overriding policy purpose. With option B there will be some justification for making that transfer as opposed to making a transfer to a random consolidator under option A. However, option B does presume that a member will already have a link to a consolidator scheme which is not certain in all situations, for example, employees joining the workforce for the first time, as well as depending on the actual number of consolidator schemes. We suggest that this is considered as an analysis point by the delivery group, and that group should look to understand the size of the potential multiple consolidator market.

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?

We agree that under the default consolidator there has to be an authorisation regime. We understand, after discussions with you, that you are not proposing that *all* master trusts should be *compelled* to apply to be default consolidators. We agree with this since we believe that most non-commercial authorised master trusts would not be suitable to, or wish to, act as default consolidators, and we understand that many commercial Master Trusts also do not want this business. For the avoidance of doubt we wish to state that, if you are actually intending that all master trusts must apply to be consolidators then we strongly disagree with that.

The essential principle for authorisation criteria has to be that the consolidators will offer better member outcomes for the overwhelming majority of members who are automatically transferred into them. Therefore, consolidators will have to offer a clear VFM advantage and a key component of this will be to ensure that members are not

automatically transferred into consolidator schemes charging considerably higher fees than, for example, the best DC single-employer trusts. Therefore, default consolidators should be subject to a specific charge cap which should be set substantially lower than the existing charge cap of 0.75% for default arrangements.

When stating this, we note that the best occupational DC schemes in the country are extremely well governed and some do not charge their members any fees at all, or charge reduced fees, with the employer meeting the balance of the cost. It does not appear to us that consolidation into a commercial provider will improve outcomes for such members and therefore, whilst we are strongly supportive of members being given the option not to consolidate we worry there may be pressure in the market to do so and therefore we suggest that trustees of these schemes should be able to opt their scheme out of automatic consolidation if they can justify doing so on grounds of VFM – this would not prevent individual savers transferring out their small pots if their own circumstances mean it is better for them to do so.

It is also very important that there is alignment between the treatment of DWP/ TPR regulated trust-based pensions and FCA regulated contract-based pensions. This is so that individuals see the same treatment across all their pensions, no matter the regulatory regime, and are not confused as a result. Therefore, we are pleased to read that you are working with the FCA to ensure alignment and we suggest it is worth exploring whether the FCA's new Consumer Duty will be sufficient by itself to enable FCA regulated firms to act as consolidators, or whether specific FCA permissions are required.

Several times in the consultation the issue of ensuring competition between consolidators is referred to and this is cited as a reason not to adopt a single consolidator solution. If a competitive consolidation market is a priority for DWP then will you be putting provisions in place to prevent mergers and take-overs of consolidator firms? (We note that the number of authorised master trusts has reduced since that regime was introduced, and that general expectations are that it will reduce further.)

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

We are comfortable with the limit of £1,000. We note that the data you have gathered shows that there are roughly 12m pots under £1,000 and therefore substantially reducing that number through consolidation would be beneficial to the industry. However, once legislation has progressed and there is evidence that this policy improves member outcomes then, we would favour setting a higher limit because we believe that a higher limit will lead to more consolidation, more usefully-sized pension pots and better outcomes for **members** (we say this despite noting your comments in paragraphs 69 and 70 about employment patterns). Therefore, we agree that the limit should be regularly reviewed.

We also suggest that as well as a broad review, automatic increases for this limit should be put into legislation, eg annually in line with inflation.

We are disappointed that you have decided against refunds for the smallest micro-pots and we think this position should be looked at by the delivery group as we still have concerns that the cost of transfer would significantly outweigh the benefits of moving these micro pots.

In regard to the proposed 12-month time period for a pot to be treated as deferred, we would like to see more evidence on this not inadvertently impacting vulnerable groups, in particular with safeguards for those on maternity leave or impacted by long term illness for example.

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

We agree with your position to continue to encourage same scheme consolidation where possible, but not to mandate it at this time. We note that this is not possible for many commercial Master Trusts as members' pots will be associated with different employers and therefore will most likely have different commercial terms attached to them so will be charged different amounts and therefore cannot be combined.

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?

We have been clear supporters of Pot Follows Member and remain so. As should be clear from our response here, we continue to have concerns about the default consolidator model – but we intend to work constructively with you to find solutions to these concerns.

We are not convinced that the decision to proceed with multiple default consolidators over either single consolidator or Pot Follows Member is proven and we believe that many of the reasons given for that decision could equally apply to the other options.

Your consultation assumes that there will be interest from commercial organisations in becoming a default consolidator. However, with the exception of the handful of Master Trusts that have significant small pot issues, we have not seen any evidence of such interest and have struggled to think *why* a commercial organisation would want to take on liability for and incur an administration burden for millions of small pots which – based on your own analysis – it appears will be difficult to make a profit on. Our concern is that in order to make any profit, such consolidators will have to trim back customer service/ and or charge the full 75bp charge cap to the detriment of members – this is something we have seen **and continue to see** a lot from legacy/ “zombie” providers. We’d be happy to share many examples with DWP and already have shared our concerns with the FCA on specific legacy providers service levels in the past.

Whilst we are supportive of the issues faced by the Master Trusts who have most of these pots, and understand and support the need for them to reduce their small pot burden, we have concerns that this could detrimentally impact other savers not in these schemes – who will suffer transaction costs and likely move from a low cost, good VFM scheme to a provider that reduces service and increases costs to ensure these consolidated pots are profitable.

We also think that it will be difficult for any potential consolidator to assess what profitability there *may* be without knowing what potential share of the small pot consolidation market they are likely to receive – and this share can’t be predicted without knowing how many consolidators there are likely to be.

Further, it still appears to us that building the required IT infrastructure and making the required legislation to enable this framework means that in practice it will still be several years until this comes into effect and that along the way there still remain many decisions to be made about the details of the process.

We suggest that if you pursue a consolidator model over Pot Follows Member that you reconsider a Single Consolidator over Multiple Consolidators as an option with the delivery group. This was largely dismissed on the belief that it could lead to market distortion but, based on the figures in the consultation, we do not agree with this. Paragraph 66 of your consultation states that deferred pots worth less than £1,000 only account for about £4bn or less than 3% of assets in the occupational DC market and in paragraph 89 you note that the estimated growth in deferred pots under £1,000 was less than 2% of the master trust market in 2022/23. If this is correct, then we do not think that consolidating these pots into a single consolidator could be considered a distortion of the market. We also note that in paragraph 89 you are content to state that an oligopoly of consolidators is unlikely to lead to significant market impact and so we are surprised that you think a single consolidator will.

Although it is not directly within the control of DWP, as mentioned in our answer to Q.3, it is important that the issue of enabling consolidation transfers from contract-based schemes under FCA rules must also be addressed. This would also enable Member Exchange to be better achieved – and we think that this could lead to significant consolidation for the benefit of providers.

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 that individuals in protected groups are less likely in general to engage with this process due to a lack of understanding of the system. Therefore, communications will be key to making this a success. We continue to have concerns about members invested in ethical and Shariah funds and we were pleased to see this acknowledged in the consultation.

Conclusion

We would like to thank DWP for the consultation and would value taking part in the Delivery Group you intend to establish in late 2023.

Yours sincerely

By email only 16.40 5 September 2023

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