Financial Services Consumer Panel

AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Dear Ms Weddell

DWP Consultation Paper: Meeting future workplace pension challenges Improving transfers and dealing with small pension pots

This is the Financial Services Consumer Panel's response to the DWP consultation on improving transfers and dealing with small pension pots.

The Financial Services Consumer Panel

The Panel is an independent statutory body set up to represent the interests of consumers in the development of policy for the regulation of financial services, so our work focuses primarily on advising and challenging the Financial Services Authority as it develops policy, to ensure the consumer interest is taken into account. The Panel also takes a keen interest in broader issues for consumers in financial services however, including non-FSA related pensions matters, where it believes it can help achieve beneficial outcomes for consumers. Consequently the Panel is not in a position to respond to all the detailed questions raised in this DWP Consultation Paper, but we have focused our response on those issues in which the Panel has particular interest and expertise.

Overview

We fully support many aspects of the proposals, such as action to remove barriers to the transfer of small pension pots of £2,000 or less, including the provision of clear, standardised information for members; mandatory acceptance by schemes of all small pots; and the removal of deferred member penalties. For many consumers – large numbers of whom are likely to be new to pensions savings in the post-NEST workplace – access to advice will be essential in helping them to make good decisions about savings and transfers and we would like the question of the provision of advice, and the role of the Money Advice Service (MAS) in this, to be debated more widely.

The Panel is opposed however to any automatic transfer of small pension pots, either to an aggregator scheme or to an employee's new scheme. The cost of a transfer as a proportion of a small pot is too high and could represent a significant reduction in an individual’s pension savings, which low earners would find it difficult to make up.

We think that further consideration should be given to making it easier for individuals to consolidate their pensions savings at the point at which they secure their retirement income, rather than during the pensions accumulation period. We have, for instance, set out in our response to question 4 below a proposal for a simple mechanism for recording basic details about each individual’s pensions savings that would move with them throughout their working lives – portable information is far cheaper and easier to manage than portable savings. This could be used by scheme members to keep track of their pension pots and could also help to cut the time spent (and cost of) securing retirement income. In addition the log book could be a useful component of the kind of ‘defined ambition’ pension scheme supported by the Pensions Minister in his interview with the Observer newspaper last month.

There is a need for consumers to be more engaged with saving for their retirement, including making choices about what are the best pensions options for them. ‘Nudging’ should drive engagement rather than facilitate apathy. We acknowledge that this is more challenging than relying only on ‘automating’ consumers through a pre-designed system, but we believe that this will produce better outcomes for consumers and is entirely consistent with the Government’s policy for encouraging a cultural shift towards making pensions saving the norm.

Our answers to a number of the specific questions within the consultation paper are set out below.

Questions

Chapter 2 – Small pension pots: the case for change

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

No, the Panel has not conducted research in this area so we are unable to help.

2. Do you agree that the barriers listed on page 17 are the current barriers to transfers?

We agree with the list in section 2.3 of the Paper, but we would like to emphasise the impact of pensions complexity on the demand-side, where consumers may well not have access to affordable independent advice to help them make decisions on pensions savings. This is a real barrier to transfer and is an issue that requires wider timely debate. The Panel believes that MAS and its partner The Pensions Advisory Service should be taking more leadership in ensuring advice provision in this area. We would expect this to include co-ordinating with employers’ and employees’ organisations in order to ensure delivery of a better service to scheme members and prospective scheme members. We also believe that product providers of group pension schemes should be encouraged to provide helplines for members of these schemes so that they have an easily accessible mechanism for requesting specific information, such as details of charges and fund performance.

Chapter 3 – Improvements to the current regulatory framework

3. Would any or all of the proposals listed on pages 24 and 25 under this option be an effective way to facilitate more transfers and reduce the number of small pension pots?

We wholly support any moves to make transferring easier and to provide more information to scheme members in standardised and where possible, simple language. This, together with access to advice, should go some way towards helping members to take a more informed decision about their pensions savings.

4. 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?

We agree that measures to promote existing services such as the Pensions Tracing Service should be explored, but we believe that more could be done to help individuals keep track of their small pension pots when they choose not to transfer or aggregate them. We have in mind a pension 'log book'. This would be a record of essential information for each individual, such as:

- National insurance number
- Date of joining the scheme
- Date of leaving the scheme
- Name of the scheme and any reference number.

It should be possible to include also a value at the date of leaving, which would be useful.

This personal record would move from job to job with the member in the same way as national insurance and tax records and could even form part of, or be an annex to, a P45. Alternatively, such information could be provided and required by former and new employers as part of the usual new employee process.

The pension log book could facilitate amalgamation of pots at the point of annuity purchase (or other form of vehicle to secure income in retirement) by cutting down on the delay and expense of tracing 'forgotten' pensions savings. It would make sense for the counterpart record to the log book to be maintained by the Pension Service. If the kind of defined ambition pension scheme envisaged by the Pensions Minister were to be developed, the log book would form a vital role in tracking an individual's savings and calculation of likely pensions income.

Chapter 4 – Automatic transfers

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

We do not think it is a question of which of the models has most merit. Although there might be some potential benefits to automatic transfers, these are outweighed by the likely drawbacks.

Our view is that members should not be compelled to transfer, no matter what the size of their pension pot. Tools for 'nudging' good consumer behaviours, like 'automation' should be used in a way which encourages engagement, rather than simply defaults people through a system, in which the individual scheme member takes no active part. Understanding behavioural triggers and how these can be used to improve public policy implementation is still in its infancy and we recommend that the DWP give further consideration as to what will drive people to engage more with their pensions savings, rather than less.

Members should be permitted to transfer small pension pots, but should also have the option to keep their pensions savings where they are. In this respect we believe there is a need to address the issue of deferred member penalties (also referred to as active member discounts) which effectively place an additional financial burden on those who wish to keep their pensions savings where they are when they change employment. This is particularly relevant where individuals are taking time out of the UK labour market either to work overseas or to take a career break for family or other reasons. Although their employment may have formally ceased, some of these people will subsequently return to work with the same employer.

If transfers are to be facilitated, clearly legislative steps also need to be taken now to enable NEST to accept transfers from other pension funds.

8. Do you agree that under an automatic transfer system, members should have the right to opt out?

We are opposed to an automatic transfer system, as we have already set out. If it was decided to proceed on such a basis however, we strongly support the right to opt out. This could well be the right decision for some consumers depending on their circumstances and in the case of small pots in particular, the cost of transfer as a proportion of savings is disproportionately high. This would leave low earners, and those working in industries where frequent job moves are typical of the sector, having to constantly recoup savings lost in transfer charges.

We also believe there should be a straightforward redress mechanism for those members whose pensions savings are automatically transferred to a scheme and who suffer financial detriment as a result.

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

We do not think advice should be mandatory, but it should be available to those that need it.

Chapter 5 – An aggregator scheme for small pots

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

Given that an underlying concern is the cost and administrative burden of transfers, all the indications are than an aggregator scheme would impose a relatively high management charge for what would, by necessity, be low risk funds. It seems doubtful therefore that such schemes would represent value for money for individual members.

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

We agree with the characteristics set out in the Consultation Paper, but as we have indicated in response to question 11 we are sceptical that an aggregator fund would deliver an appropriate investment approach with low charges, as noted in paragraph 95 of the CP. Multiple aggregator schemes would simply add another layer of complexity and another set of decisions for members to make.

17. 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.

Our view is that small pension pots should be defined as those of £2,000 or less. This is, of course, currently the maximum level at which members can take their pension pot in the form of cash, rather than being required to annuitise or otherwise secure retirement income. As we have said, we are opposed to compulsory transfers. If a decision is taken to impose such a policy however, we recommend that only pots of £2,000 or less should be automatically transferred and that all schemes should be required to accept them, regardless of individual pot size. We fully expect that switching will become more commonplace and that industry will be able to adapt existing operating procedures to accommodate the demands of pensions savers.

Chapter 6 – Pensions move with people from job to job

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

As already stated, we are opposed to automatic transfers. If the DWP opts to impose automatic transfers however, the maximum pot size should be £2,000. Pots over this amount should remain with the existing scheme unless or until the member chooses another scheme into which the monies should be transferred.

Yours sincerely

Adam Phillips

Chair, Financial Services Consumer Panel