

Summary

- Small pots are a growing problem for savers and schemes.
- The government has proposed a solution to commence in 2030 as part of its DC roadmap.
- In September a feasibility review made proposals on the digital systems approach to make this a reality.
- Secondary legislation and governance also needs establishing, but schemes can start preparing now.

Fixing Britain's DC small pots problem

✎ Thisbe Titley explores how efforts for the automatic consolidation of DC small pots are progressing, and the impact this change will have on the industry and pension savers

The introduction of automatic enrolment into workplace pensions in the UK, combined with high levels of job mobility, has resulted in most private-sector employees accumulating a number of DC pension pots during their working life, most of them small in value. This results in fragmented pension entitlements, pots being lost by their holders, and inefficient administration that ultimately drives higher charges to members.

Data from the government's Small Pots Delivery Group report, published last year, estimates that there are roughly 13 million pots worth less than £1,000; their average value being around £330. Research from the Pensions Data Project further illustrates the issue, finding that out of 11.8 million inactive deferred pots across five of the largest master trusts, more than half were below £1,000.

The government's planned solution

The government and the pensions industry have worked together for over a decade to consider potential solutions to reducing the number of pots through



some form of automatic consolidation.

The solution the government has settled on is the multiple default consolidator (MDC) model where schemes will be required to transfer eligible dormant pots under £1,000 to an authorised 'default consolidator', with an opportunity for the member to choose their desired consolidator, or opt-out of consolidation.

Draft legislation to enable this is contained in the current Pension Schemes Bill.

"There are obviously different ways of doing consolidation," Pensions Administration Standards Association (PASA) chair, and former executive director at The Pensions Regulator, David Fairs, states, "but I think that this is a perfectly viable solution".

How will this work in practice?

The 2024 Small Pots Delivery Group convened by the government tackled many detailed questions on implementing the MDC model, but one key area was left unresolved: how to design the Small Pots Data Platform (SPDP) to facilitate the process, including identifying which consolidator should receive the transferred small pot.

Therefore, the government asked Pensions UK to carry out a Digital Systems Feasibility Review to tackle this question, with KGC Associates and Lumera engaged to co-author.

"Throughout the work, we were continually asking how straightforward this would be to implement, and how we could reduce cost friction as much as possible so it could be delivered quickly", KGC Associates MD, Kim Gubler, explains.

The review recommended a federated design for the SPDP, where a scheme needing to give up an individual's small pot (called a 'ceding scheme') communicates directly with all authorised consolidators, to identify which, if any, of them are the individual's default consolidator. This would be largely facilitated by service providers using existing standards and messaging infrastructure.

"We concluded there was no real benefit from creating new central infrastructure – it wouldn't reduce the key demands on ceding schemes or consolidators, and hence would just add unnecessary complexity and cost," Lumera commercial director for data and dashboards, Maurice Titley, says.

One key reason the authors state for this conclusion is the challenge around the process called 'matching' – that is checking if the member with the small pot is indeed the same person who already has a pension with the consolidator – a similar process to that carried out for pensions dashboards.

Gubler explains: "Small pots do not involve the consumer directly, the

pension saver. So a key aim was to mitigate, as far as possible, any risk of consumer detriment, particularly the risk of consolidating into the wrong person's pot."

Therefore, Titley adds: "The only workable option is for the consolidators themselves to carry out the matching but using a prescribed approach to ensure consistency."

The review also emphasised the need for a strong governance model, allowing standards to be developed to support areas like matching.

According to Gubler, "progress now needs to be made very, very quickly".

"The most important next step is putting the secondary legislation in place," she adds.

How does small pots consolidation interact with other upcoming reforms?

The government's wide-ranging roadmap sets a target of commencing small pots consolidation in 2030, after other reforms have been implemented such as annual value for money (VFM) assessments for all DC schemes.

As authorised consolidators are likely to meet a high bar in their VFM assessments, the risk of small pots being consolidated into schemes delivering lesser value should be mitigated.

Importantly, VFM is not just about charge levels, but about good long-term outcomes.

"If the pension scheme has got really high levels of governance, really good communication, and tools that can allow you to plan and work out whether you're saving enough, some of those things mean that your pension scheme might have higher charges, but gives you better VFM," Fairs explains.

The roadmap also makes the assumption that the number of DC schemes holding small pots will have reduced by 2030 due to further scheme consolidation.

"The timeline in the roadmap is feasible," Pensions UK deputy director of

external affairs, Dirk Paterson, says.

"Whilst it will require a coordinated government, regulator and industry approach, we remain confident that if other areas of the bill are delivered on time, then a workable small pots solution by 2030 is achievable," he adds.

"Without a foundation of quality data these initiatives cause unnecessary resource and financial burden"

Is everyone a winner?

Evidently the proliferation of small pots can often be negative for savers, but are there any drawbacks to their consolidation?

For Paterson, consolidation brings a number of benefits. "Savers will greatly benefit from this solution. This will allow them to benefit from greater economies of scale, potentially less charges and reduces the risk of their pot being lost," he states.

However, "secondary legislation will need to be crafted carefully to ensure any downsides for savers are mitigated against", Paterson adds.

One such downside, PASA DC Working Group chair, Jessica Rigby, highlights is that "if a member is unengaged or doesn't get round to opting out they could find themselves in a scheme providing less value".

However, initiatives like the VFM assessment should lower the risk, she says.

In addition to any potential downside for savers, small pots consolidation could present challenges for the wider market.

According to Fairs, "there is a lot of surrounding infrastructure around pension schemes, and if you drive consolidation there are less appointments to go round, so we might see some participants are forced out or choose to leave the market".

How can DC schemes and master trusts start preparing now?

As with any pensions reform, a key element of preparation for schemes is around improving the data they hold, and in this case the member contact details that will be used for matching will be a priority.

"We talk about it time and time again but without a foundation of quality data these initiatives cause unnecessary resource and financial burden," Rigby states.

She adds that specifically schemes "need to consider the multiple memberships that a member can hold, if there are discrepancies with the data this could cause a member to be captured under the small pots regime unnecessarily".

Another area of concern is the demands on industry to actually carry out such a large volume of pot transfers.

Gubler warns that "we need to look at the fundamentals of how transfers work, and make sure they can operate at scale for existing stock, and then on an ongoing basis, recognising there will be peaks and troughs over time".

In some ways, small pots transfers may prove quicker to process than member-initiated transfers. Fairs explains: "As an administrator, you've got to make sure that you've done all the right checks and balances to make sure somebody's not being scammed. And that introduces delays into the transfer process. In small pots consolidation that shouldn't be a consideration."

All in all, there are a number of areas DC schemes and master trusts can begin looking at to prepare for the consolidation of deferred small pots.

As Gubler concludes: "We can't just keep talking about it. We actually have to do something."



Written by Thisbe Titley, a freelance journalist