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Ending the proliferation of deferred small pots

On 11 July 2023, following the Chancellor of the Exchequer's [Mansion House speech](#), the DWP published a further [consultation](#) on small pots, which includes a response to a call for evidence on the issue, run earlier this year. This document is part of a number of documents published by the DWP "all designed to drive better outcomes for pension savers".

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Background

The DWP issued a call for evidence at the beginning of 2023 on possible consolidation options for addressing the growth of small DC pots, focusing on a default consolidator model and a 'pot follows member' solution. Details of this previous consultation can be found in our FYI dated 23 March 2023 ([Addressing the challenge of small pots](#)).

While there was support for both options in the feedback to the consultation, there was no clear consensus on one option being the better overall.

However, the DWP has chosen to proceed with the default consolidator model, as it could align more effectively with the DWP's desire for a more consolidated workplace pensions market, with a small number of authorised default consolidators, acting as a consolidator for deferred small pots providing greater value for their members through the economies their scale brings them.

On this basis, the DWP has concluded that the multiple default consolidator model is the optimum approach to addressing the deferred small pots challenge and with the potential to provide greater benefits to members, ensuring that eligible deferred pots are consolidated into one scheme.

This new consultation on the framework for this model runs until 5 September 2023. There are seven questions.

The default consolidator framework

The DWP is seeking to maximise the number of members who can benefit from the consolidation of their deferred small pots whilst minimising the administrative burden on pension schemes.

Identifying where a small pot should be sent

Trustees or providers seeking to transfer out a pot are not currently able to see where that member has other deferred or active pots, which is a problem when establishing a multiple consolidator solution. There will need to be a central point or system to store and manage the data – allowing sending schemes to identify where a member’s deferred pot should be transferred.

Two options are considered to support this approach:

A clearing house - to act as a central body to communicate between the sending and receiving pension schemes, and also to contact the member in cases where no active decision has been made regarding the chosen consolidator.

A central registry - which providers would have access to in order to match their member’s deferred pots to their chosen consolidator.

The consultation considers the arguments for both options, but the DWP is proposing to create a clearing house to act as a central point informing schemes where to transfer a member’s eligible deferred pot.

Failure to choose a consolidator

The default consolidator model is designed for members to actively choose which consolidator they would like their deferred pots to be transferred to. However, the DWP does recognise that this solution needs to accommodate situations where members don’t engage with the process.

Two options are set out in the consultation to cover this:

Option A: Allocate all small pots between the providers who meet the criteria to be a consolidator at a level proportionate to their market share.

Option B: Given the likelihood that a member will have a deferred pot already with a consolidator scheme, this scheme would be allocated as the member’s consolidator scheme. (Should a member have pots with multiple schemes that are authorised consolidators, their deferred pots pot could be allocated to the consolidator scheme holding their largest deferred pot.)

Proposed process

The consolidation process would consist of four steps, with the ceding scheme pushing the deferred member towards a default consolidator:

1. A scheme will identify an eligible deferred pot. At this point they will have two key roles, firstly to contact the member providing them with the relevant information to help them decide whether to opt out of automatic consolidation or not.
2. The scheme will then contact the clearing house to identify the member’s chosen consolidator schemes.
3. In cases where a member has not yet chosen a consolidator scheme, the clearing house will contact the member notifying them of their options to choose a consolidator, and explain what will happen if the member does not make an active decision within a set time period.
4. Following this process, the scheme holding the deferred pot will receive notification from the clearing house of the designated consolidator scheme chosen by the member or allocated to the member and will begin initiating the transfer of the deferred pot.

Authorisation to act as a consolidator

The DWP intends to create a default consolidator regime which will enable the FCA and The Pensions Regulator to authorise a small number of schemes to undertake this role – consistent with its objectives to move towards a more consolidated workplace pensions market. In practice, master trusts will be required to apply to be default consolidators. Alongside this, the DWP will work with the FCA in the development of the regime to ensure alignment where needed, for example, on whether contract-based providers could seek authorisation to act as a consolidator in relation to a contract-based scheme that they operate.

Eligible pot criteria

The responses to the call for evidence earlier this year outlined the importance of leaving a prescribed period of between 6 and 18 months after contributions cease to be made, before a pot is classed as deferred for the purposes of any consolidation solution.

The DWP is proposing that a pot should be eligible for automatic consolidation 12 months after the last contribution was paid.

Pot sizes

The call for evidence also considered the right pot value for deferred small pots to meet the criteria for automated consolidation solutions. There was no clear consensus among respondents as to the maximum value to be set, but the DWP is proposing the pot size limit will initially be set at £1,000, although this should be subject to regular reviews.

The DWP is also proposing that there will be no minimum pot value for a pot to be eligible for automatic consolidation.

Comment

The issue of the ever-growing number of deferred small DC pots is clearly not going to be resolved without action being taken.

This is an issue that has been under consideration since the early days of automatic enrolment, with the impending arrival of pensions dashboards having shifted the focus from the need to ensure members don't lose track of their pension savings, to the increasing costs for pension schemes of servicing these deferred pots.

The DWP is clearly mindful to resolve the small DC pots issue, with a second consultation this year. The fact that further consultation is necessary perhaps indicates the DWP's tacit acknowledgment that it does not yet have all the answers and welcomes further engagement with the pensions industry to ensure the right path is taken to combat the proliferation of small pots.

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