Title: Small Pots and Automatic Transfers Impact Assessment	**Impact Assessment (IA)**
IA No: DWP0030	**Date:** 21/05/2012
Lead department or agency: DWP	**Stage:** Development
Other departments or agencies:	**Source of intervention:** Domestic
	Type of measure: Other
	Contact for enquiries: Nik Percival (020 7449 7623)

Summary: Intervention and Options

RPC: AMBER

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
£6.4bn	£6.4bn	n/a at this stage	n/a at this stage	n/a at this stage

What is the problem under consideration? Why is government intervention necessary? From October 2012 individuals will begin to be automatically enrolled into their employers' pension scheme. It is anticipated that this will help 6-9 million people save into a pension for the first time, or save more into their existing scheme. However, many of these individuals will save into their employers' pension scheme for only a short period before changing jobs. As a result there will be a significant increase in the number of small dormant pension pots, which are costly and inefficient for schemes to administer and which can be difficult for individuals to keep track of and subsequently convert into pension income upon retirement. The existing system relies on individuals to initiate a transfer, and it is known that inertia acts as a significant barrier to individual engagement in pensions.

What are the policy objectives and the intended effects? For pension providers and employers the Government are aiming to remove inefficiencies - by reducing the number of small dormant pension pots they have to administer. For individuals, the Government are aiming to make it easier for them to engage with their pension and secure an adequate income in retirement - by consolidating their savings and supporting low cost provision.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base) Four options have been considered – 1) do nothing; 2) automatically transfer small dormant defined-contribution (DC) pension pots to the individual's new workplace DC scheme when they change jobs; 3) automatically transfer small dormant DC pension pots to an 'aggregator' scheme; and 4) virtually consolidating pension pots through a central database.

The preferred option is Option 2 – for pots to move automatically when people change jobs. The Department's assessment is that only this option would achieve the Government's objectives for both providers and individuals. Option 3 would allow for only limited consolidation as it would apply only to the smallest unprofitable pots (to ensure the aggregator scheme did not monopolise the market) and because individuals would always have an aggregator pot in addition to their existing pot. By contrast Option 2 would make use of individuals' existing pensions (consolidating funds into a single scheme), and would not have to be limited to the smallest pots – allowing for both more consolidation (and engagement) and significant long-term resource cost savings. Meanwhile, Option 4 would have no impact on the number of pots that actually have to be administered. It could however (unlike the Option 2 or 3) cover all pots across all schemes, thereby allowing for greater engagement, and so the Department would be interested in exploring this further as a complementary solution.

There will be some initial short-term costs from the preferred option, from both processing the transfers and setting up a system that enables pots to be identified and automatically transferred – and further work is needed with stakeholders to understand how such a system could best be implemented. Until this is completed the Department is unable to provide an assessment of the net cost to business per year (EANCB) - this will be provided in an updated IA alongside secondary legislation. However, this does not change the conclusion that only Option 2 could achieve a significant reduction in the number of dormant pensions - which the other options would not – thereby meeting the Government's objectives for both providers and consumers.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:**

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO2 equivalent change in greenhouse gas emissions? (Million tonnes CO2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: Date: 21/05/12

Summary: Analysis & Evidence

Policy Option 1

Description: Do nothing

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	**PV Base Year** 2012	**Time Period Years** 39	**Net Benefit (Present Value (PV)) (£m)**		
			Low: 0	**High:** 0	**Best Estimate:** 0

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	0	n/a	0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

Description and scale of key monetised costs by 'main affected groups'

N/A

Other key non-monetised costs by 'main affected groups'

N/A

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	0	0	0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

Description and scale of key monetised benefits by 'main affected groups'

N/A

Other key non-monetised benefits by 'main affected groups'

N/A

Key assumptions/sensitivities/risks | **Discount rate (%)** | 3.5 / 3

N/A

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			**In scope of OIOO?**	**Measure qualifies as**
Costs: 0	**Benefits:** 0	**Net:** 0	n/a	n/a

Summary: Analysis & Evidence

Policy Option 2

Description: Pensions move with people from job to job

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2012	Time Period Years 39	Net Benefit (Present Value (PV)) (£m)		
			Low: 2,150	High: 7,900	Best Estimate: 6,400

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low			80	**1,500**
High			225	**4,300**
Best Estimate			185	**3,500**

Description and scale of key monetised costs by 'main affected groups'

There will be a one-off cost to both the ceding and receiving provider from processing each transfer, which may in turn be passed onto the consumer in the form of higher charges.

Other key non-monetised costs by 'main affected groups'

There will be transitional costs involved in moving to a system that enables pots to be identified and automatically transferred. One potential model of implementation would require building a central register that enables providers to track existing pension pots. There would be costs associated with updating the records on this database. The Department needs to undertake further work with stakeholders to understand how this system could best be implemented, and so at this stage are unable to estimate these transition costs. As a result, an assessment of the direct impacts on business has not yet been provided.

There are likely to be some potential costs to government from regulatory oversight.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low			215	**3,650**
High			715	**12,200**
Best Estimate			580	**9,900**

Description and scale of key monetised benefits by 'main affected groups'

Providers will see long-run resource savings from not having to administer as many small dormant pension pots, which it is expect over time would be passed onto consumers in the form of lower charges.

Other key non-monetised benefits by 'main affected groups'

Over the long-run, individuals should benefit from seeing lower charges – from no longer being penalised by deferred member penalties, and as a function of the long-run savings that industry make from a lower number of dormant pots in aggregate.

By consolidating pensions into their existing scheme, it should also help individuals keep track of and engage with their pensions, and buy an annuity on the open market option.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5 / 3

The benefit to industry is dependent on the ongoing savings they will make from no longer having to administer each small dormant pension pot and the cost of processing each transfer. This is likely to vary across providers. The impact on industry is also dependent on the frequency of changes of employment, and pattern of those movements. Those who find the cost of a transfer higher or the administrative savings lower will tend to see less benefit, whilst employers or providers who see a large number of individuals returning to their scheme will also see less benefit.

There is a potential risk of detriment to members from moving away from a scheme with certain rights or guarantees. More generally individuals may benefit or lose from moving to a scheme with different charges and investment performance.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs:	**Benefits:**	**Net:**	n/a at this stage	n/a at this stage

Summary: Analysis & Evidence — Policy Option 3

Description: Pension automatically transferred to an aggregator scheme

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2012	Time Period Years 39	Net Benefit (Present Value (PV)) (£m)		
			Low: - 1,150	**High: 800**	**Best Estimate: - 150**

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low			70	**1,400**
High			125	**2,500**
Best Estimate			100	**1,950**

Description and scale of key monetised costs by 'main affected groups'

There will be a one-off cost to both the ceding provider and the aggregator scheme from processing each transfer, which may in turn be passed onto the consumer through the charges they pay.

Other key non-monetised costs by 'main affected groups'

There will be transitional costs in setting up an aggregator pension scheme, and potentially a longer-term funding requirement to cover the cost of administering unprofitable small pots – unless or until there is sufficient consolidation of pension pots.

The Department would need to do further work with stakeholders, and clarify the details of the scheme/schemes before providing an assessment of these costs (and as a result have not provided an estimate of the transition costs or the direct impact on business).

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low			85	**1,350**
High			135	**2,200**
Best Estimate			110	**1,800**

Description and scale of key monetised benefits by 'main affected groups'

Providers will see long-run resource savings from not having to administer as many small dormant pension pots, which the Department would expect over time to be passed onto consumers in the form of lower charges.

Other key non-monetised benefits by 'main affected groups'

Depending on the level of charges and investment approach chosen by the aggregator(s) – individuals would benefit from seeing lower charges on their small dormant pension pots.

It could also help individuals with multiple small pension pots keep track of and engage with their pension, and buy an annuity on the open market option – although the extent to which pots are consolidated into the aggregator scheme will be limited by the need to impose a low pot size limit, to avoid the scheme monopolising the market.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5 / 3

The benefit to industry is dependent on the ongoing savings it will make from no longer having to administer each small dormant pension pot and the cost of processing each transfer. This is likely to vary across providers and those who find the cost of a transfer higher or the administrative savings lower will tend to see less benefit.

Setting a low pot size limit (to minimize the impact on the industry) introduces a risk that the scheme will not generate sufficient consolidation to generate significant net savings, and in turn significant benefits for individuals.

BUSINESS ASSESSMENT (Option 3)

Direct impact on business (Equivalent Annual) £m:			**In scope of OIOO?**	**Measure qualifies as**
Costs:	**Benefits:**	**Net:**	n/a at this stage	n/a at this stage

Summary: Analysis & Evidence

Policy Option 4

Description: Virtual consolidation

FULL ECONOMIC ASSESSMENT

Price Base Year 2012	PV Base Year 2012	Time Period Years 39	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	**High:** 0	**Best Estimate:** 0

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low			0	**0**
High			0	**0**
Best Estimate			0	**0**

Description and scale of key monetised costs by 'main affected groups'

n/a

Other key non-monetised costs by 'main affected groups'

There will be transitional costs involved in building a central register that enables individuals to see all their pension pots, and costs involved in updating the records on this database. The Department would expect the requirements to be broader than a register that enables providers to track pots (under option 2), potentially covering all schemes and having a simple member interface that allows members to easily find pots and understand how much has been accumulated.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low			0	**0**
High			0	**0**
Best Estimate			0	**0**

Description and scale of key monetised benefits by 'main affected groups'

n/a

Other key non-monetised benefits by 'main affected groups'

Virtual consolidation should help individuals keep track of and engage with their pensions. If underpinned by a simpler, more efficient voluntary transfer process, it could also encourage more individuals to initiate a consolidation of their pots to achieve their optimum retirement income - but the Department has not seen any evidence to suggest that it would achieve this on a large scale.

Key assumptions/sensitivities/risks | **Discount rate (%)** | 3.5 / 3

BUSINESS ASSESSMENT (Option 4)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs:	**Benefits:**	**Net:**	no	n/a

Problem under consideration

1 From October 2012, employers will for the first time be required to automatically enrol their employees into a workplace pension scheme, and to make a minimum contribution to it. These new duties will address the barriers which are preventing people from saving enough for their retirement, helping 6-9 million people either save into a pension for the first time, or save more into their existing scheme.

2 However, the reforms will at the same time result in a significant increase in the number of small dormant pension pots. With employees working for an estimated 11 employers on average during their working life (and a quarter working for more than 14 employers)[1], in many cases automatic enrolment will result in individuals saving into one employers' pension scheme for only a short period before moving to a new employer and new pension scheme, accumulating multiple small pension pots in the process.

3 In December 2011 DWP published *Meeting future workplace pension challenges: improving transfers and dealing with small pension pots* (Cm 8184)[2], opening a consultation on changes the Government and pensions' community could make to address this proliferation of small pension pots, and outlining three broad approaches. Since then the Government have listened carefully to the views expressed by stakeholders, and carried out further work to understand the implications of small dormant pension pots for employers, the pensions industry and individuals and of the different options for dealing with them.

Rationale for action

4 DWP research and previous consultation with stakeholders identified that a multitude of small, dormant pension pots is likely to make both individuals and the pensions industry worse off[3].

Pensions Industry

5 For the pensions industry, having to administer multiple pots for a single individual is inefficient, and maintaining small dormant pots can be unprofitable if the revenue earned is insufficient to cover the costs of administering those pots. Previous estimates have indicated that, for a particular set of assumptions about fund growth, charges and administrative costs, a pot of £1,500 will generate a net present value loss of £140 for pension providers[4].

6 Up until now trust-based occupational pension schemes have been able to mitigate the cost of administering small pension pots by offering short-service refunds. These rules allow individuals to take their pension contributions back if they leave their job in less than two years. Employer contributions can either remain in the scheme and be used to offset future contribution or administration costs, or in defined contribution schemes, where the rules allow it, be returned to the employer. However, the Government have announced that they will abolish the use of short-service refunds for defined-contribution (DC) occupational schemes, on the basis they can prevent individuals from building a pension pot if they move jobs frequently, thereby jeopardising the Government's objective of helping people save for retirement[5].

7 Where pension providers are unable to circumvent the costs of administering small dormant pots (for example, through short-service refunds), the Department would expect them to pass these costs on to members through higher charges, for example in the form of deferred member penalties. This undermines the Government's aim of helping individuals secure an adequate income in retirement, and can be unfair, penalising individuals just because they move jobs.

[1] See *Meeting future workplace pension challenges: improving transfers and dealing with small pension pots*, December 2011, p.18
[2] http://www.dwp.gov.uk/consultations/2011/small-pension-pots.shtml
[3] Ibid, p.15
[4] See the Impact Assessment accompanying *Meeting future workplace challenges: improving transfers and dealing with small pension pots* http://www.dwp.gov.uk/docs/short-service-refunds-impact-assessment.pdf
[5] Ibid.

Individuals

8 In addition to the detrimental impact of higher charges, individuals might also be penalised when they try to convert small pension pots into income, particularly if they do not have the option of trivially commuting it into a lump sum payment (either because they have already taken their lifetime trivial commutation or because they have a defined benefit pension in payment which takes them above the threshold[6]). This is because most annuity providers require a minimum pot of at least £5,000 or £10,000, and so individuals with a small pot (which they are unable to consolidate – perhaps due to the barriers discussed below) may not have the same access to an Open Market Option, and in turn access to as competitive rates.

9 Furthermore, there is a significant risk that individuals will lose engagement with, and lose track of, their retirement savings if they are dispersed across a number of small pension pots. Research has found that one in six people have no idea where their pension is saved[7], and that moving jobs was found to be by far the biggest reason, with nearly 70 per cent of those using the Pensions Tracing Service stating they had lost track of their pension due to moving on from a previous employer[8]. The lost income can be significant with previous estimates putting the total value of unclaimed pensions at around £3 billion[9].

10 Despite the problems associated with small pension pots, there are supply- and demand-side barriers which stop people from transferring and consolidating their pension pots.

Barriers to transfers

11 Providers are not currently required to accept any particular pension transfer, and many do not if the scheme has particular features, such as those with protected rights (e.g. pensions that include an element of Guaranteed Minimum Pension) or those with special pension sharing arrangements as a result of divorce[10]. The administrative costs that make small pots unprofitable may also lead schemes to impose a minimum transfer amount.

12 Transferring a pension can be a complex and time-consuming process. The industry has in recent years introduced significant efficiencies, with Origo Options, a web-based standardised service for transfers, reducing the time taken to transfer a pension from over 50 days to 11 days.[11] Nonetheless, some transfers remain protracted and complex, particularly when they are processed outside Options or involve occupational schemes (many of whom do not use Options, either because of the complexity of their rules – including the need for trustee assent – or due to their computer systems being incompatible with Options)[12].

13 A recent research report found that in many cases, getting the correct information from the member requesting a transfer was often the most time-consuming part of the process. But it is the reliance on the individual to make a request for a transfer in the first place that is perhaps the biggest problem with the current system.

14 Research has previously shown a general lack of engagement in pensions, particularly among low to moderate earners. Complexity, financial short-sightedness and inertia often leave inaction as the default option when it comes to pension saving and financial decision-making, and these factors can act as a barrier to transferring pensions even when it is in the individuals' best interests to do so.

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[6] Trivial commutation allows individuals with a pension fund of less than £2,000 to take the whole amount as a lump sum, providing they are at least 60 years of age. The member must make all such commutations within a period of 6 months before or 13 months after become entitled to the pension. Where the entirety of a person's pension benefits (added together) does not exceed £18,000, the entire sum may be taken as a trivial commutation lump sum.

[7] Shury J and Koerbitz C, The *Pensions Tracing Service: A quantitative research study to establish who is using the service, and their outcomes*, Department for Work and Pensions Research Report No 697, p.7

[8] Ibid. p.25

[9] Ibid

[10] Wood A, Young P, Crowther N and Toberman A, *Processes and costs of transferring a pension scheme: Qualitative research with pension providers and third-party administrators*, Department for Work and Pensions Working Paper 107

[11] Quarterly provider performance figures can be found at http://www.origoservices.com/options/performancefigures.

[12] Wood A, Young P, Crowther N and Toberman A, *Processes and costs of transferring a pension scheme: Qualitative research with pension providers and third-party administrators*, Department for Work and Pensions Working Paper 107

15 As a result, it has been estimated there are already in excess of a million dormant DC pension pots in the system containing less than £5,000 that are no longer being contributed to (and half a million containing less than £2,000) - which would reduce to 0.7 million (0.3 million) if all DC pots held by individuals were consolidated[13]. The scale of the problem will grow significantly when automatic enrolment is introduced.

Policy Objectives

16 In keeping with the above, the Government aim to:

a. help individuals save persistently for retirement, by supporting low cost provision and making it easier for them to engage with their pensions;

b. help remove inefficiencies for pension providers, by reducing the number of small dormant pension pots that they will have to administer.

17 In doing so, any policy intervention needs to be affordable for government and consistent with wider policy.

Options considered

Improvements to the current framework

18 The Government's consultation document outlined three potential approaches to addressing the problem of small pots, including improvements to the current member-initiated transfers system.

19 However there was general agreement during the consultation that improvements to the current system would be insufficient. The pension industry has in recent years already made significant efficiencies, and with the introduction of a standardised automated process through Options, addressed many of the problems that have dogged the transfer process.

20 The majority of providers now use Options for the majority of their transfers, and those that do not are likely to have made the decision not to on the basis that the cost outweighs the potential efficiency gains.

21 Whilst there remains scope to reduce the time it takes to transfer a pension – the time taken to process a transfer through the Options service has continued to fall steadily and in 2011 Q4 there were some providers that managed to complete transfers in less than 7 days on average – further improvements to the current system will not address the inherent problem that it relies on individuals to initiate the transfer (and there is little evidence that a more efficient transfer process will have a dramatic impact on individual behaviour in this regard).

22 Therefore, whilst the Government are keen to support the pensions industry in bringing about the further improvements which can be made to the transfer process and will be needed to underpin broader changes, they do not believe that by themselves these changes would be sufficient to address the challenges identified.

Automatic transfers

23 The Department has considered in further detail the two additional options presented in the consultation document, whereby pensions are transferred automatically to either:

a. an 'aggregator scheme'; or
b. the individuals' new workplace DC pension scheme.

[13] Crawford R and Tetlow G, *Fund holdings in defined contribution pensions*, IFS Briefing Note BN127. These figures include personal pension schemes.

24 Under both options, individuals would have the opportunity to opt-out of the transfer if they wished, but there would be no requirement to provide advice. If they do not make an active decision the pot would be moved.

Virtual consolidation

25 A third option, which was identified by a number of stakeholders during the consultation process and has been considered in further detail, is a virtual consolidation of pension pots - a central database which would provide individuals with an overview of all their pension pots.

26 These three options are compared against the fourth option of doing nothing. In summary, the following four options have been considered:

Option 1 - Do nothing;

Option 2 - Pots automatically transferred to the persons' new DC workplace scheme;

Option 3 - Pots automatically transferred to an aggregator scheme;

Option 4 - Virtual consolidation.

Key Assumptions and Evidence

Volume projections

27 The number of dormant pension pots and transfers generated under the four options has been estimated using PENSIM2; a dynamic micro-simulation model used by the Department to project pensioners' incomes, and used to inform much of its work on pension reform.

28 The model draws on a number of different sources to create a detailed dataset of individuals' characteristics, and then simulates the life course of these individuals to project their pension entitlement in retirement. It models (amongst other events) their participation in the labour market, whether and what type of pension scheme they are saving into and the value of that pension after fund growth and charges. From this the Department is able to project the number of dormant pension pots that will be generated each year, the size of those pots, and whether the individual has joined a new scheme or whether they have retired.

29 In estimating the impact of the different options the Department has considered dormant pension pots across all workplace DC and group personal pension (GPP) schemes – including NEST – but not those in defined benefit (DB) or in (non-workplace) personal pensions schemes.

Cost of administering small dormant pension pots

30 It is assumed that the marginal cost of administering a small dormant pension pot (and in turn the saving from no longer having to) is £25 per annum.

31 This figure is consistent with what the Department has used in previous impact assessments[14] and what employers with occupational pension schemes are charged by fund administrators to cover the maintenance of pension pots (regardless of size)[15]. It also reflects the findings from research with providers of contract-based pension schemes, carried out by an independent research organisation, on behalf of the Department in the winter of 2011[16].

32 The contract-based providers taking part in the research found these costs difficult to estimate and as a result, only a handful were able to respond, with estimates varying from £25-£55. Therefore,

[14] See the Impact Assessment accompanying *Meeting future workplace challenges: improving transfers and dealing with small pension pots* http://www.dwp.gov.uk/docs/short-service-refunds-impact-assessment.pdf
[15] *Meeting future workplace pension challenges: improving transfers and dealing with small pension pots*, December 2011.
[16] *DWP Pension Landscape and Charges Survey 2011: summary of research findings*. Available at http://research.dwp.gov.uk/asd/asd5/summ_index_2011_2012.asp.

the Department also sought stakeholders' views on the potential cost savings from no longer having to administer dormant pots during the consultation period.

33 The providers consulted faced the same difficulties as providers in the research, and provided a similarly wide range, but some indicated that for them the saving could be significantly lower. Some made a distinction between marginal costs (for example, processing statements), and fixed costs (such as IT and overheads) which would be incurred regardless and which accounted for the bulk of their ongoing administrative costs.

34 It is believed that the estimate from the independent research, which largely comprises internal time, provides the most reliable estimate of the saving that providers will make on average. However, it is realised that there is a degree of uncertainty over the estimates, and the savings are likely to vary across providers and for some will be lower than what the research suggests. As a result the lower-end of that range has been used. The Department would be interested in any ongoing evidence that stakeholders are able to provide that could reliably inform its understanding of the average marginal costs of administering pots across the industry.

Cost of processing transfers

35 Research carried out for the Department in winter 2011 estimated that the marginal cost of the most straightforward transfer through Origo Options is approximately £50 for each provider (£105 in total). The cost was found to be chiefly made up of internal time, but also included the cost of making the transfer itself (through BACS or CHAPS).

36 Whilst the majority of providers currently conduct the majority of their transfers through the Options service, the Department has considered the position of trust-based providers who are currently less likely to use Origo Options and who can face additional barriers to transferring pensions. It is recognised that in some cases the cost of a transfer might currently be higher for them - the research found that the cost of processing a transfer can be significantly higher for more complicated transfers and when processed outside of Options - however, it is believed that it is appropriate to assume a uniform cost of £105 for all schemes when considering the impact of automatic transfers.

37 It is believed that the cost of a straightforward transfer is likely to be more representative of the vast majority of automatic transfers - and even then may be too high, since there is likely to be less interaction with the individual - which is where the research found the process to be most time-consuming. It is therefore assumed that the cost of a transfer is £105 on average for all schemes.

38 It is assumed that the cost of processing a transfer is the same whether the pot is moved to an aggregator scheme or to the individuals' new workplace pension scheme. Once an existing pot is identified, the process (and therefore push and pull costs) are likely to broadly the same under the two options – and a central database or other mechanism that matches individual members' to their pots should make identifying existing pots relatively straightforward.

39 No account has been made for economies of scale. Under either option there is the potential to reduce costs if multiple pots were transferred at the same time. This would depend on the timing of transfers (e.g. whether it was initiated at the point the individual leaves or joins a scheme, or at set points during the year).

Up-rating

40 It is difficult to predict how these costs are likely to change over time (due to, for example, productivity and technological changes). However, since the costs of administering a pension pot and processing a transfer largely reflect internal labour time, they have been up-rated in line with the latest OBR forecasts for average earnings growth.

Option 1: Do nothing

Description of policy

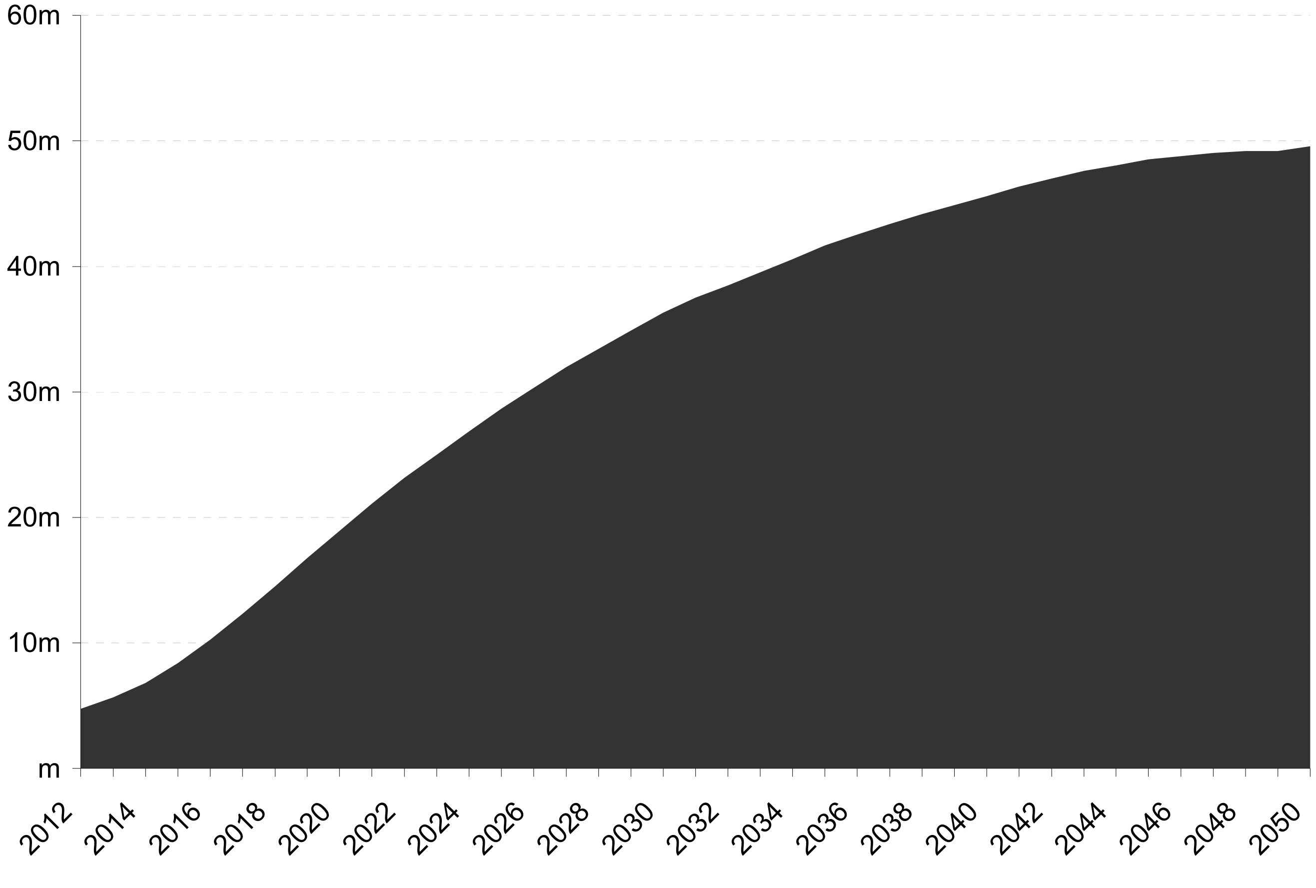
41 The current system allows individuals to request a transfer, but places the onus on them to pursue this, and allows trustees and providers ultimate discretion over whether to accept the movement of the pot.

Costs and benefits (including administrative burden)

42 There would be no additional costs or benefits if the current system was maintained, but the Government predict that it would leave the pensions industry with a large number of costly small dormant pots to administer. It is anticipated that the combination of individual inertia (operating as a significant force against individuals pursuing a transfer) and automatic-enrolment will result in a pensions' landscape overwhelmed with small, inactive pension pots.

43 The Department's latest projections suggest that in total there will be around 50 million dormant workplace DC pension pots within the system by 2050, and that over 12 million of these will be under £2,000 (in 2012 earnings terms). This is the challenge which the Government are seeking to address and the backdrop against which the other options are considered.

Chart 1: Projected total number of dormant pots under current arrangements



Source: PENSIM2

Option 2: Pot follows member

Description of policy

44 Under this option, when an individual is automatically enrolled into a new DC workplace pension scheme, their provider will check whether they have an existing pension pot, and (if the individual does not choose to opt-out) will automatically transfer the pot into their scheme. If the individual leaves a scheme but is not saving into a new one (for example, due to a period of unemployment or opting-out of their new employers' scheme), the pot will remain dormant in the scheme until they do. Further consideration will need to be given as to the appropriate timing of the transfer, to minimize burdens on business and individuals.

45 The consultation raised a number of concerns around the potential detriment to individuals from having their pension moved away from a scheme with particular features or to a scheme with higher charges. The Government believe that the quality requirements built into the automatic enrolment system should offer significant protections, but intends to do more work with stakeholders to understand whether and what schemes should be exempt from automatic transfers to protect members from being significantly worse off. Individuals will continue to have the right to opt out of a transfer.

46 A maximum size limit for pots that would be subject to an automatic transfer would add further protection to members, but would need to be set at a level that enables sufficient consolidation to benefit both the industry and individuals.

47 The Department has modelled the impact of four potential limits which would provide a balance between consolidation and member protection – £2,000, £5,000, £10,000, and £20,000 – with the upper and lower limits used for the high and low estimates presented in the summary sheet. The Department's central estimate is based on £10,000 – there was some support for this in the consultation, as the point at which the individual has better access to the open market when purchasing an annuity. However, this has been chosen purely to illustrate the potential range of impacts, and does not necessarily reflect the Government's preferred policy.

48 The Department has not modelled any minimum pot size limit, but in light of suggestions made by some respondents to the consultation, the Government could consider partially replacing the abolition of short-service refunds with a refund of very low levels of contributions. This would provide a balance between locking savings into pensions whilst ensuring that industry are spared the cost (and consumers the charges) of transferring pots, if this is disproportionate to the pot's value.

Costs and benefits (including administrative burden)

49 No decision has been made on an implementation date and this would be dependent on the timetable for supporting primary and secondary legislation amongst other factors. For the purposes of modelling the Department has considered the impact of introducing changes from 2015/16, on the basis this is the earliest date the Department believes it would be possible to introduce automatic transfers.

50 In advance of the further work to consider the coverage of different schemes, and in the absence of detailed data on the features of different pension schemes, purely for illustrative purposes it is assumed that all DC workplace pension pots are eligible. It is assumed that pots which become dormant from 2015/16 – regardless of when they were created - will be automatically transferred if the individual moves to a new employer and a new automatic enrolment DC scheme[17], and those which become dormant before this date will remain dormant in their existing schemes[18]. In practice, the Government could instead limit the scope to pots created after the date that automatic transfers are introduced.

[17] The Government could alternatively restrict transfers to those pots created from the date that automatic transfers are introduced.
[18] Although the individual will continue to have the right to initiate a transfer

51 No adjustment has been made for individuals opting out of the transfer as the Department does not have sufficient evidence to inform the likely scale of this, although relatively few are expected to do so given the inertia which characterises pension saving and which the Department is trying to address (particularly if larger pension pots and certain pots with rights and guarantees are excluded). As a result, the estimates may over-estimate the number of transfers and under-estimate the number of dormant pots which remain in the system.

52 It is assumed that automatically transferring dormant pots to the individuals' new scheme will have no effect on the amount of money saved in pensions[19], and therefore the pension industry's revenue – its impact will simply be in terms of the number of pots that these savings are distributed across. Administering the same amount of pension savings across fewer pots should generate cost savings for the pensions industry – and the Department would expect in turn, everything else being equal, for this to be passed onto individuals in the form of lower charges – but to achieve this they will have to incur the cost of transferring pots.

53 Chart 2 shows the total number of dormant pots the Department projects there would be if the pot follows the individual from job to job, compared to what it projects would exist under the current arrangements. Table 1 compares this reduction to the Department's estimate of the number of transfers, and presents its estimate of the recurring administrative cost savings which would arise as a result (i.e. the saving from no longer having to administer dormant pots net the cost of the transfers). Providers would see a cost in the early years after go live as they incur the upfront cost of processing transfers, but over time this will be outweighed by the savings they make from having to administer fewer and fewer dormant pots.

54 The dormant pots which remain in the system include those which are created before an automatic transfer system is introduced; those which are too big to be transferred; and those which remain dormant because the individual does not enter a new DC scheme (for example because they have opted out, have not re-entered work or have entered a defined-benefit scheme).

55 A higher pot size limit will result in larger resource savings in the long-run but also generate larger costs in the short-term (as more pots are transferred). The initial costs would be lower if only pots created after the date that automatic transfers are automatically transferred – because fewer pots would be eligible in the early years after go-live. The Department's estimates therefore provide an upper-estimate of the initial impact.

56 To facilitate the automatic transfer of pensions between schemes, a mechanism that enables providers to match members' details to existing pension pots will be needed, along with a process for updating this. Most respondents to the consultation that commented on a solution flagged a central database as being a key feature although an alternative utilising the tax system was also suggested.

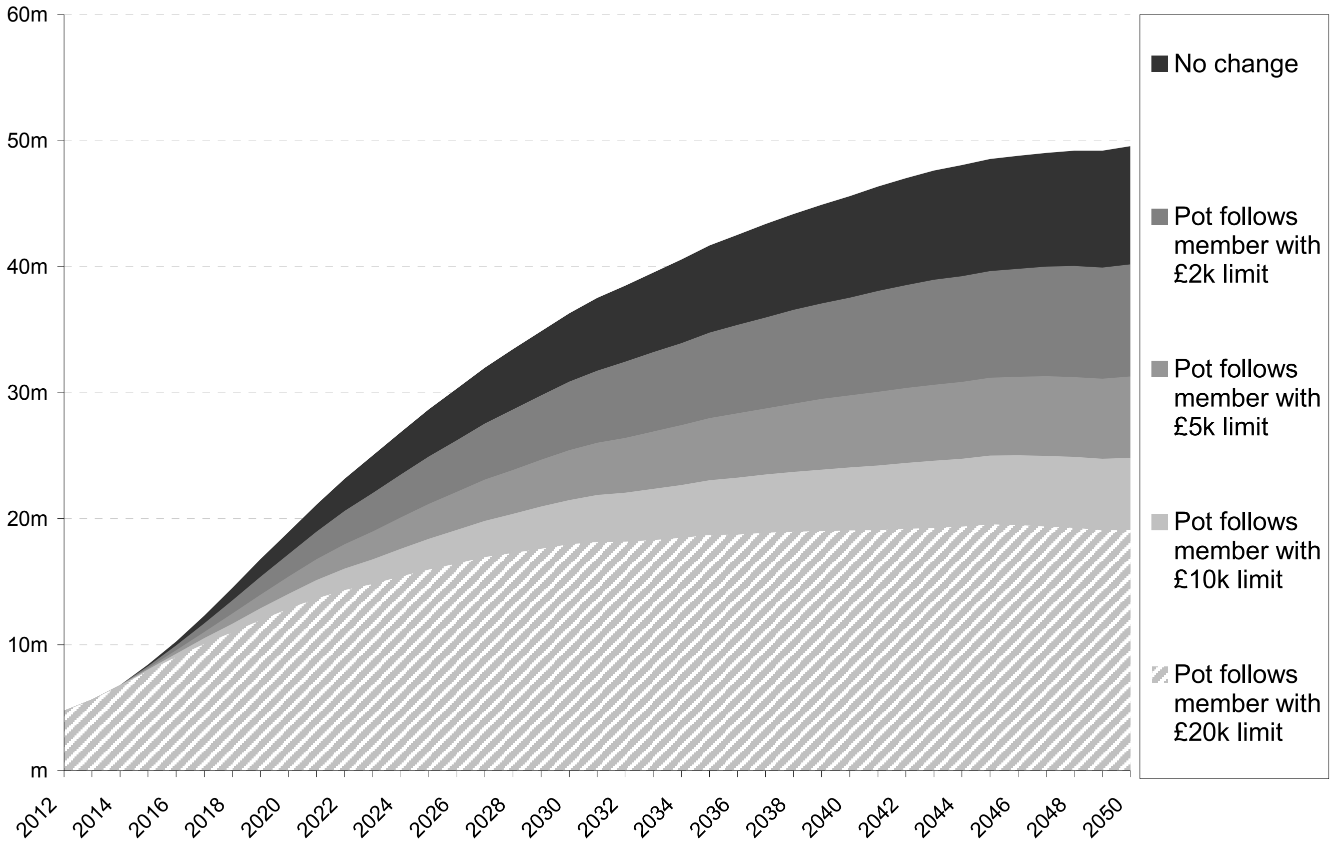
57 The Government have been in discussion with industry representatives to understand the challenges and opportunities associated with implementing a database. It is aware that there are a number of complexities that need to be worked through, and is keen for any IT-based solution to be industry led.

58 As a result, whilst it is believed the costs should be relatively small in comparison to the long-term benefits from automatically transferring pots from job to job (in terms of reduced administrative burdens), at this stage the Department is unable to present an estimate of the transitional costs associated with developing a solution that facilitates this (including it's design and implementation, and any transitional changes providers will need to make to their processes and infrastructure), as well as the ongoing costs of maintaining and updating it.

59 The Government will do further work with stakeholders to develop a better understanding of how to move towards an implementation solution, and the potential costs of doing so, including any impacts on government in terms of regulatory oversight and governance.

[19] The possibility that larger pots, built up through consolidation, will have behavioural effects in terms of saving, has been ignored.

Chart 2: Projected total number of dormant pots if the pot follows the member from job to job



Source: PENSIM2

Table 1: Estimated impacts if pot follows member from job to job

	£20,000 limit			£10,000 limit			£5,000 limit			£2,000 limit		
	No. of transfers	Reduction in dormant pots	Cost	No. of transfers	Reduction in dormant pots	Cost	No. of transfers	Reduction in dormant pots	Cost	No. of transfers	Reduction in dormant pots	Cost
2015/16	0.5m	-0.5m	£40m	0.4m	-0.4m	£30m	0.3m	-0.3m	£20m	0.1m	-0.1m	£10m
2016/17	0.7m	-1.2m	£50m	0.6m	-1.0m	£45m	0.4m	-0.7m	£30m	0.2m	-0.3m	£15m
2017/18	1.1m	-2.2m	£65m	0.9m	-1.8m	£50m	0.6m	-1.3m	£40m	0.3m	-0.6m	£20m
2018/19	1.3m	-3.5m	£60m	1.1m	-2.8m	£45m	0.8m	-2.0m	£35m	0.4m	-1.0m	£20m
2019/20	1.4m	-4.8m	£30m	1.1m	-3.9m	£25m	0.8m	-2.8m	£20m	0.5m	-1.4m	£15m
2020/21	1.4m	-6.1m	-£5m	1.1m	-4.9m	-£5m	0.8m	-3.5m	£0m	0.5m	-1.8m	£5m
2021/22	1.5m	-7.4m	-£35m	1.2m	-6.0m	-£30m	0.9m	-4.3m	-£20m	0.5m	-2.1m	-£5m
2022/23	1.6m	-8.8m	-£65m	1.3m	-7.1m	-£50m	1.0m	-5.2m	-£35m	0.5m	-2.5m	-£10m
2023/24	1.6m	-10.2m	-£110m	1.3m	-8.2m	-£90m	1.0m	-6.0m	-£60m	0.5m	-3.0m	-£20m
2024/25	1.5m	-11.4m	-£160m	1.3m	-9.3m	-£125m	0.9m	-6.8m	-£90m	0.5m	-3.4m	-£35m
2030/31	1.6m	-18.3m	-£410m	1.3m	-14.8m	-£325m	1.0m	-10.9m	-£235m	0.6m	-5.4m	-£105m
2040/41	1.6m	-26.5m	-£855m	1.3m	-21.5m	-£695m	1.0m	-15.8m	-£505m	0.6m	-8.0m	-£240m
2050/51	1.5m	-30.4m	-£1.25bn	1.3m	-24.7m	-£1.00bn	0.9m	-18.3m	-£750m	0.6m	-9.4m	-£370m
NPV			**-£7.90bn**			**-£6.40bn**			**-£4.60bn**			**-£2.15bn**

Notes:
1. Based on PENSIM2. Assumes automatic transfers begin in 2015/16
2. Volumes rounded to the nearest 0.1m.
3. Costs expressed in constant (2012) prices and rounded to the nearest £5m. Savings expressed as negative values. NPV calculated over 39 years and rounded to the nearest £0.05bn.
4. Pot size limits set in 2012 and up-rated in line with the average earnings growth.
5. The reduction in dormant pots under a £2,000 pot size limit is lower than the total number of dormant pots below £2,000 that estimated will be in the system by 2050 – because some pots will remain dormant (e.g. because the individual has not enrolled in a new scheme).

Benefits to individuals

60 The Department's assessment is that fewer small dormant pots - as well as reducing administrative burdens on business – would also be of benefit to individuals, who will see their pension savings spread across fewer schemes, as shown in Table 2.

61 The benefit will largely be felt amongst those who would otherwise accumulate a large number of dormant pots. The Department's projections indicate that the large majority of individuals would continue to reach retirement age with at least one dormant pot if their pension savings followed them from job to job (under any of the size limits). However, only one in a hundred of those reaching retirement age between 2050 and 2060 would do so with five or more dormant pots if pots below £20,000 followed them, and around one in thirty would do so if pots below £10,000 followed them - compared to over a quarter under the current system. Furthermore, the majority would reach retirement age with at most two dormant DC pots. A lower limit would result in a more modest impact; with around one in ten of individuals reaching retirement age with five or more pots under a £5,000 limit, and around one in six doing so with a £2,000 limit.

Table 2: Number of dormant workplace DC pots individuals have if pot follows member

	Counterfactual	Pot follows member			
		£2,000 limit	£5,000 limit	£10,000 limit	£20,000 limit
No dormant pots	10.3%	10.5%	11.3%	12.3%	14.5%
one	17.2%	20.9%	26.4%	33.6%	43.7%
two	17.5%	20.7%	25.3%	27.9%	27.4%
three	16.3%	18.2%	18.0%	15.6%	10.5%
four	12.9%	12.6%	10.0%	7.0%	3.0%
five or more	25.8%	17.1%	8.9%	3.6%	1.0%

Notes:
1. Figures based on PENSIM2
2. Percentages relate to individuals who reach retirement age between 2050 and 2060.

62 Everything else being equal, the Department would expect this to result in lower charges for individuals, and generate higher incomes in retirement. For example, it is known that members of some trust- and contract-based schemes currently pay lower charges when they have larger funds[20].

63 The introduction of automatic transfers may impact scheme charges in various ways – for example, by introducing costs in the short-run (from processing transfers) and by reducing the amount of time over which providers may be able to recoup the up-front cost of setting up pension pots, it could put upward pressure on the charges they initially set. However, over the long-run, as the overall administrative costs providers face is reduced (as demonstrated in Table 2), the Department would expect average charges to reduce as these efficiency savings are passed on to members.

64 Meanwhile, at present individuals can pay higher fees when they stop contributing to a pension scheme. Recent research has found that active member discounts have become increasingly popular, with providers charging a higher annual management charge (AMC) on deferred pots that are no longer growing and could otherwise become unprofitable. The average discount applied to the AMC was found to be between 0.45 and 0.55 percentage points[21]. The Department would expect more individuals to benefit from active member discounts if their pot followed them to their new job, and so in addition to benefiting from generally lower charges, individuals would be less likely to face different charges depending on whether they changed jobs or not.

65 These benefits would represent a transfer from the pensions industry to individuals – but in large part would arise from them sharing in the reduced administrative burdens for industry.

[20] Ibid
[21] *DWP Pension Landscape and Charges Survey 2011: summary of research findings*. Available at http://research.dwp.gov.uk/asd/asd5/summ_index_2011_2012.asp.

66 Whilst lower charges should benefit individuals during accumulation, consolidation of pension pots should also benefit individuals during decumulation - both by reducing the risk that they lose track of their pensions (as a result of having fewer pots – as demonstrated in Table 2) and by giving them greater access to the Open Market Option when purchasing an annuity.

67 There remains however a risk that some individuals could be made worse off from having old pension pots moved automatically to their new scheme – particularly if in the process they lose certain rights or guarantees attached to the old scheme. The Government would seek to mitigate such potential losses by considering whether certain schemes (i.e. those with particular rights or guarantees) should be exempt from automatic transfers.

68 Individuals who see their pot transferred multiple times could see the value of their savings eroded gradually each time through buy and sell spreads, dealing fees and dilution levies, and could lose out if schemes set high upfront costs and low ongoing charges – all of which would work against the benefit they see from lower charges overall. Meanwhile, individuals who do not re-enter work would not see the same benefits as those who do.

69 Meanwhile, consolidating pension savings into the individual's current scheme may result in less diversification to manage investment risk. Although each individual automatic enrolment scheme should provide an appropriate and diversified allocation of assets, the performance of the individual's current scheme will still have a greater impact on the individual's eventual retirement income. Even so, an individual's savings will otherwise be spread across schemes in a largely random manner, rather than based on a deliberate diversification strategy that is appropriate to the individual's risk profile.

70 More generally, individuals may be better of worse off depending on whether their new scheme has higher or lower charges and/or a lower or better performing investment fund than their previous scheme(s) - or if the market moves up or down over the period the transfer takes place. It is not possible to assess the impact of this as it will vary in each case – according to which schemes they leave/join and the two funds' performance during the period in question. However, the Department would expect the gains and losses from differences between scheme charges and investment performance to cancel out on average, and with certain protections - including exemptions for particular schemes and a pot size limit (which would limit the impact that differences in percentage-based charges and investment choice can have) – a system of pensions moving automatically from job to job could potentially benefit significant numbers of individuals.

Risks and Assumptions

71 Besides the unquantifiable risk to individuals described above (which the Government would seek to mitigate), there is a risk that some providers will not experience the resource savings projected in Table 1.

72 The uncertainty surrounding the assumption over the savings that providers will make from no longer having to administer dormant pots has already discussed. The wide range of estimates provided in the research and in discussions with stakeholders suggests there may be some genuine variation across providers, and those which are more efficient at administering pots will not see the same benefit from automatic transfers. To the extent that smaller schemes have higher administrative costs (due perhaps to economies of scale) it might be expected that this risk is greater for larger providers.

73 Whilst £25 represents the Department's best estimate of the annual saving providers will make from not having to administer each dormant pot, a saving of just £10 a year on average (with no change in the cost of transfers[22]), would reduce the net present value to;

a. £0.6 billion with a £20,000 pot size limit;
b. £0.45 billion with a £10,000 limit;
c. £0.25 billion with a £5,000 limit; and
d. a small net present loss (of £0.05 billion) with a £2,000 pot size limit[23].

[22] Providers who see lower administrative cost savings might also be expected to face lower transfer costs.
[23] Estimated over 39 years and rounded to the nearest £0.05 billion

74 Meanwhile, whilst the cost of administration and transfers has been up-rated in line with earnings (on the basis they reflect mainly labour time), trying to estimate the cost of administrative processes many years ahead is fraught with difficulties and is a key uncertainty over the estimated cost savings. Similarly, the number of small dormant pots generated under automatic enrolment remains by necessity uncertain - depending on future labour market participation and savings behaviour. However the model used to project this is a trusted source that has been used extensively to analyse the impact of previous pension reforms.

Option 3: Aggregator scheme

Description of policy

75 Under this option, whenever an individual leaves a workplace DC scheme, if their pot is below a certain size it will be automatically transferred to an aggregator scheme – a holding scheme which consolidates all the small pots accumulated by an individual in one place. Individuals who remain with their employer but stop contributing to a pension (perhaps because they are earning below the automatic enrolment qualifying threshold) would not have their pension automatically transferred.

76 The scheme would accept all small pots and allow the member to easily see the funds they have accumulated. Further work would be required to determine whether there would be one or multiple aggregator schemes, and the particular characteristics of the scheme(s) – including its charges and investment approach. Similarly to option 2, the Department would need to determine whether certain schemes should be exempt.

77 A pot size limit would need to be set at a level that was sufficiently low that only the smallest unprofitable pots were transferred to the scheme, to ensure that the scheme did not monopolise the market and affect the viability of other pension providers. The Department's modelling has been based on a pot size limit of £2,000 – this is the level that was suggested in discussions with providers and is equivalent to the trivial commutation maximum.

Costs and benefits (including administrative burdens)

78 The Department's estimates are shown in Chart 3 and Table 3. It has again been assumed for the purposes of modelling that all pots which become dormant after 2015/16 are in scope, and that all DC workplace pension pots below the pot size limit are automatically transferred.

79 For a given pot size limit, the number of transfers and dormant pots (and therefore cost savings) should not be significantly affected by the number of aggregator schemes[24], but the impact will depend on whether dormant pots are transferred to a newly set up scheme, or are aggregated in NEST or another large existing master-trust scheme.

80 Using an existing scheme such as NEST would be more efficient as it would:

a. reduce the number of transfers (a large number of small dormant pots will be created within the scheme and therefore not have to be transferred); and

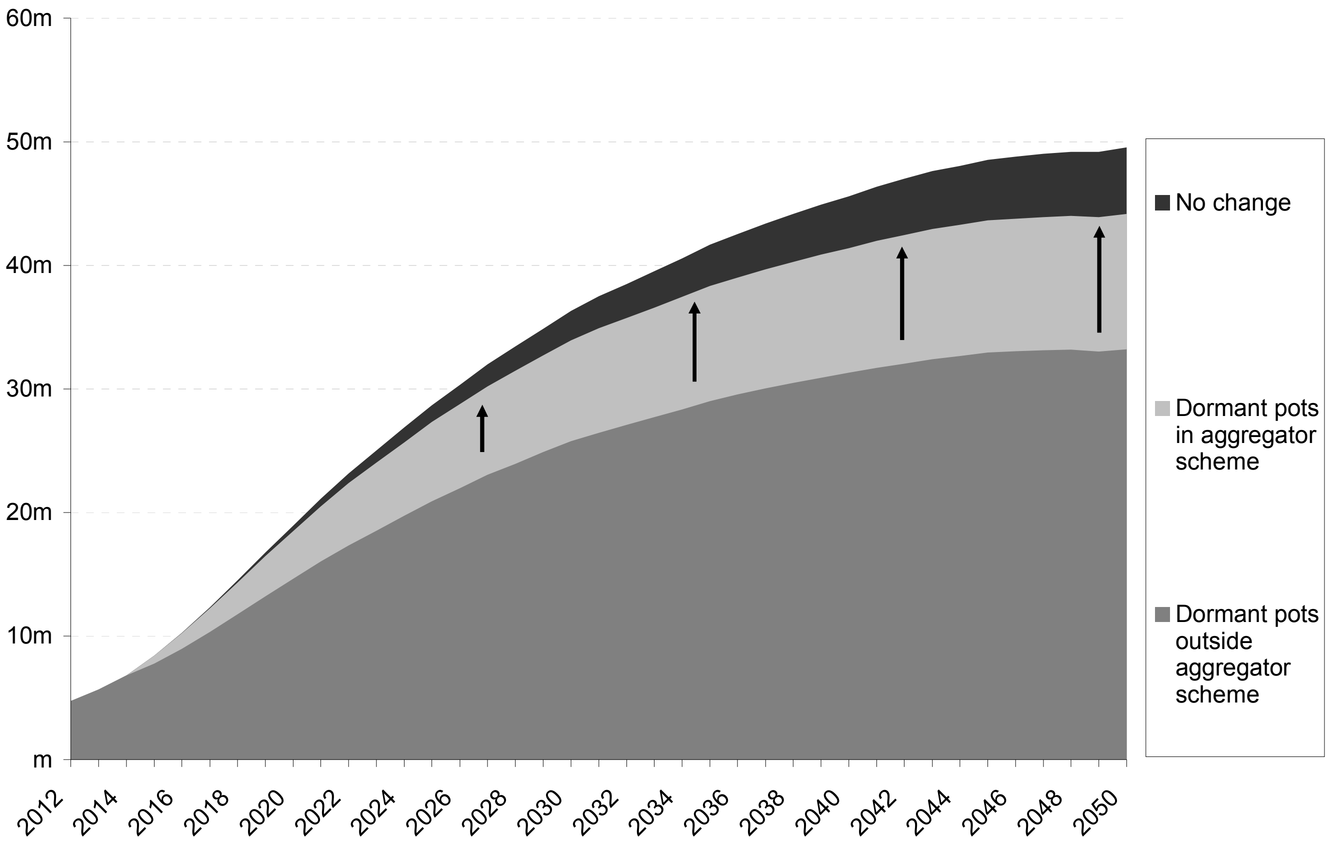
b. reduce the number of dormant pots (active members will be saving into the same scheme that their dormant pots are aggregated into).

81 The Department has estimated the impact of aggregating pots in NEST as well as a newly set-up scheme, and presented the mid-point of the two as its central estimate.

82 The aggregator scheme has the advantage that dormant pots are transferred when the individual leaves their scheme (rather than when they join a new DC scheme) – as a result the number of transfers tends to be higher under this option.

[24] Providing that an individual has only one aggregator pot

Chart 3: Projected total number of dormant pots under an aggregator scheme



Source: PENSIM2. Numbers correspond with the central estimate in Table 2 below.

Table 3: Estimated impacts under aggregator scheme with £2,000 limit

	Aggregate into a large existing scheme, e.g. NEST			**Central estimate (mid-point)**			**New scheme**		
	No. of transfers	Reduction in dormant pots	Cost	No. of transfers	Reduction in dormant pots	Cost	No. of transfers	Reduction in dormant pots	Cost
2015/16	0.4m	0.0m	£45m	0.5m	0.0m	£60m	0.6m	0.0m	£70m
2016/17	0.4m	-0.1m	£45m	0.5m	0.0m	£60m	0.7m	0.0m	£75m
2017/18	0.4m	-0.2m	£45m	0.6m	-0.1m	£65m	0.7m	0.0m	£85m
2018/19	0.5m	-0.3m	£50m	0.7m	-0.2m	£75m	0.8m	-0.1m	£95m
2019/20	0.5m	-0.4m	£45m	0.7m	-0.3m	£75m	0.9m	-0.1m	£100m
2020/21	0.5m	-0.7m	£40m	0.7m	-0.5m	£70m	0.9m	-0.2m	£100m
2021/22	0.5m	-0.9m	£35m	0.7m	-0.6m	£70m	0.9m	-0.4m	£100m
2022/23	0.5m	-1.1m	£30m	0.7m	-0.8m	£65m	0.9m	-0.5m	£95m
2023/24	0.5m	-1.3m	£25m	0.7m	-1.0m	£60m	0.9m	-0.7m	£95m
2024/25	0.5m	-1.6m	£20m	0.7m	-1.2m	£55m	0.9m	-0.8m	£90m
2030/31	0.5m	-3.0m	-£30m	0.7m	-2.4m	£20m	0.9m	-1.8m	£70m
2040/41	0.5m	-5.1m	-£140m	0.6m	-4.2m	-£65m	0.8m	-3.2m	£10m
2050/51	0.5m	-6.5m	-£235m	0.7m	-5.4m	-£135m	0.8m	-4.3m	-£35m
NPV			**-£0.80bn**			**£0.15bn**			**£1.15bn**

Notes:
1. Based on PENSIM2. Assumes automatic transfers begin in 2015/16
2. Volumes rounded to the nearest 0.1m.
3. Costs expressed in constant (2012) prices and rounded to the nearest £5m. Savings expressed as negative values. NPV calculated over 39 years and rounded to the nearest £0.05bn.
4. Pot size limits set in 2012 and up-rated in line with the average earnings growth.
5. The estimated reduction in dormant pots is lower than the total number of dormant pots below £2,000 that estimated will be in the system by 2050, because a number of pots remain inactive in the aggregator scheme.

83 However, it will have much less impact on the number of dormant pots. This is for two reasons. First, unlike option 2 which consolidates dormant pots into the scheme the individual is actively contributing to, this option requires the creation of a large number of new aggregator pots alongside the scheme they are actively contributing to – resulting in at least two pots, and reducing the level of consolidation and resource savings. This is shown in Chart 3, whereby much of the initial reduction in dormant pots is replaced by new aggregator pots (aggregator pots are included in the dormant pot figures in Table 3).

84 In the early years after go-live, the saving from no longer having to administer dormant pots is simply replaced with the cost of administering new aggregator pots - dormant pots are simply moved from one scheme to another generating transfer costs but no savings. Resource savings are only generated when individuals have two or more pots transferred to the aggregator scheme, and therefore it takes much longer for them to materialise (and outweigh the cost of the transfers).

85 Secondly, the extent to which this option consolidates pots and generates resource savings in the longer-run is constrained by the low pot size limit, which limits the number of small pots eligible for automatic transfers (but which would be necessary to minimize the impact on industry). For many individuals - those who have only one eligible small dormant DC pot - the scheme will remain uneconomical, and result in no consolidation. As a result, analysis indicates that an aggregator scheme with a £2,000 pot limit is likely to result in relatively small savings over the long-run.

86 Furthermore, whilst the estimates in Table 3 incorporate the ongoing cost of administering pots within the aggregator scheme, they do not take account of the costs of setting up the scheme (either at the level of the scheme as a whole or for each member). During the consultation the Government have sought views on the scope for industry or NEST to take on the role of an aggregator scheme. Until more details - including whether one or multiple schemes are introduced and the schemes' characteristics - are worked through, it is difficult to provide an assessment of the potential build costs for the system, but given the potential size of the scheme and the time it could take before the scheme becomes profitable, it is believed that there could be a significant additional funding requirement at least in the short- to medium-term.

Benefits to individuals

87 Depending on the level of charges and investment approach chosen, an aggregator scheme could enable all individuals with small dormant pension pots to be protected from unfairly high charges – including those who do not move into a new DC scheme. It could also lower the risk of detriment resulting from variations between schemes (that is, moving dormant pots to a scheme with higher charges or worse performing fund).

88 However, as indicated above and as Table 4 shows, it would result in only limited consolidation, and tend to leave individuals with a number of dormant pension pots – it would slightly reduce the number of individuals reaching retirement with five or more dormant pots (from one in four to between one in five and one in six). This largely reflects the low pot size limit – the impact is similar to pots under £2,000 following the member from job to job. However, it also partly reflects the fact that – unlike Option 2 - individuals will have an aggregator pot on top of any other dormant pots they have accumulated (for example pots which are not automatically transferred because they exceed the pot size limit)[25].

89 All individuals reaching retirement age with at least one dormant pot under the current arrangements would continue to under this option (the pot would simply be in the aggregator scheme rather than stay dormant in its original scheme) – and many individuals could simply be left with a small pot within the aggregator scheme which they may subsequently be unable to buy an annuity with through the open market option (OMO).

[25] This means they will often have one more pot under this option than when the pot follows the individual from job to job.

Table 4: Number of dormant workplace DC pots that individuals have if pots under £2,000 are sent to an aggregator scheme

	Counterfactual	Aggregator scheme		
		New scheme	Central estimate (mid-point)	In large existing scheme, e.g. NEST
No dormant pots	10.3%	10.1%	10.2%	10.3%
one	17.2%	18.8%	19.2%	19.6%
two	17.5%	20.2%	20.7%	21.1%
three	16.3%	18.1%	18.1%	18.2%
four	12.9%	13.5%	13.3%	13.1%
five or more	25.8%	19.3%	18.5%	17.7%

Notes:
1. Figures based on PENSIM2
2. Percentages relate to individuals who reach retirement age between 2050 and 2060.
3. Pots in the aggregator scheme which are not being actively contributed to are counted as dormant.
4. In some cases the aggregator scheme could actually increase the number of dormant pots individuals have. Under current arrangements, if an individual leaves and then subsequently returns to a scheme their pot will be dormant for the intervening period only. By contrast, if the pot is automatically transferred to an aggregator scheme, it will remain dormant there even after they begin to save in their original workplace DC scheme again.

Risks and Assumptions

90 As with option 2, the costs and benefits for providers depend upon the ongoing savings they will make from no longer having to administer dormant pension pots, and the cost (to both providers and the aggregator scheme) of processing a transfer – both now and in the future - for which there is both some uncertainty and variation across providers.

91 The cost of setting up an aggregator scheme could be significant, and there is a risk that a low pot limit would involve a longer-term funding requirement from government, given the low level of aggregation it would generate and the unprofitable nature of small pots.

Option 4 – Virtual Consolidation

Description of policy

92 Under this option, whenever an individual joins a new workplace DC scheme their existing pot would remain dormant within its existing scheme, but the providers of all pensions would be required to input records of the pot onto a central database, to enable individuals to see the value of their pension entitlements across all the different schemes they have saved into.

93 Because no physical transfer takes place, all pots – including those in defined-benefit (DB) schemes and those with certain rights and guarantees – could be included, regardless of their size. To minimize the burden on providers, records could be updated at set times (for example, at the same time as annual statements are sent)

Costs and benefits (including administrative burdens)

94 In the absence of any behavioural effects, a virtual consolidation of pension pots would not change the number of dormant pension pots in the system, and therefore not generate any resource savings for the industry. Providers would be able to forego the cost of processing transfers, but would also have to continue incurring the cost of administering a large number of small dormant pension pots. The Government intend to discuss the potential behavioural effects with stakeholders to explore this issue further.

95 Meanwhile, there would be transitional costs associated with developing the database that matches members' details to their pension pots, and recurring costs to schemes from updating this on a periodical basis. The requirements of such a database – and therefore its costs - are likely to

be broader than that for the automatic transfer solutions, since all pots/entitlements across DC, DB and perhaps state accrued historically could potentially be covered - if the virtual consolidation is to provide suitable information to individuals seeking their pots. It would also need to have a simple member interface, so that members are easily able to find pots and understand how much has been accumulated. Over time however, this single virtual system could reduce the demand for the Pensions Tracing Service, releasing some resource costs.

Benefits to individuals

96 A virtual consolidation is the only option that could allow individuals to see all their pots across all types of schemes. It is therefore more likely to help individuals keep track of all their pots and has potential for promoting member engagement. If underpinned by a simpler, more efficient voluntary transfer process, a virtual pot database could encourage more individuals to initiate a consolidation of their pots and achieve their optimum retirement income.

97 However if individuals take no further action and their pots remain in their existing schemes, they will see little benefit from this option in terms of the charges they face.

Preferred Option

98 The Department's analysis indicates that there are potentially significant benefits to a system of automatic transfers in which pots follow the individual from job to job over the medium to long-run – in the form of reduced administrative burdens for industry, and greater engagement, lower charges and higher retirement incomes for members.

99 Automatically transferring pensions into a new aggregator scheme rather than individuals' existing pension scheme is less efficient and does not achieve the same level of consolidation or administrative cost savings. A virtual aggregator would also not reduce the burden of small pots for industry (or have any impact on the fees that individuals are charged on their dormant pension pots) – although as the only option which could potentially cover all pension pots (regardless of size) across all schemes, the Department would be interested in exploring this further as a complementary solution.

100 It is recognised that there are some potential risks of consumer detriment in automatically transferring pots to the individuals' new workplace scheme – and will need to give further consideration to the treatment of different schemes and the appropriate pot size limit to ensure the necessary protections are in place.

101 There are also short-term transitional costs and implementation challenges – particularly with developing a mechanism to enable schemes to track existing pots - which the Department is not yet able to quantify and which still need to be worked through (without which it is possible to present a full assessment of the costs and benefits).

102 However, these costs do not change the view that only Option 2 – the pot following the member – would achieve significant consolidation and long-term cost savings, and deliver across the Government's objectives for providers and employers, and individuals.

Direct costs and benefits to business calculations

103 Given the further work that is needed to understand the short-term transition costs for industry and employers, the Department is not yet able to present a full assessment of the net cost and benefit to business (EANCB). An assessment of this will be provided in an updated IA alongside secondary legislation, once the further work has been completed.

Small and micro-business

104 The majority of automatic transfers will involve employees working for large and medium-sized employers – as they employ the majority of individuals - but small and micro-businesses may see proportionately more transfers in and out of their workplace pension schemes as they tend to have slightly higher rates of job-churn[26].

105 However, it is anticipated that the vast majority of small and micro-businesses will use large pension schemes to fulfil their automatic enrolment responsibilities, and it is these schemes (rather than the small and micro-businesses) that will be impacted by the proposals outlined above.

106 The Department recognises that there may be additional burdens on some small and micro-businesses, but anticipates that any upfront costs will fall outside of the moratorium period for all new domestic regulation, and that - based on the costs of processing transfers and administering pots presented above – the small and micro-businesses impacted by the proposal should see net benefits commensurate to the savings presented for the industry as a whole.

[26] http://www.dwp.gov.uk/docs/pensions-bill-2011-ia-annexb.pdf - pp. 37-38