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By email to regulatory.differences@dwp.gsi.gov.uk

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Dear Ms. Weddell,

FairPensions welcomes this opportunity to respond to DWP's consultation, '*Meeting future workplace pension challenges: improving transfers and dealing with small pension pots*'. FairPensions (Fairshare Educational Foundation) is a registered charity established to promote responsible investment practices by pension providers and fund managers. FairPensions champions greater transparency and accountability to the millions of people whose long-term savings are managed by institutional investors and other professional agents. We are a member organisation and count amongst our members a growing number of globally recognised NGOs and trade unions, as well as over 8000 individual supporters.

We agree that improvements to the current transfer mechanisms are unlikely to be sufficient to deal with the problem of small pots since they do not overcome the problem of individual inertia. Pending further evidence, we would favour the government's suggestion that NEST could act as an aggregator scheme, since we believe this offers the highest degree of consumer protection and the best potential for good member outcomes of all the government's proposed options.

This position reflects our recent work on investment governance, discussed in our response to the previous consultation '*Regulatory differences between occupational and workplace personal pensions*'. This work can be found on our website at <http://www.fairpensions.org.uk/fiduciaryduty>. Of particular relevance is chapter 2 of our 2011 report, '*Protecting our Best Interests: Rediscovering Fiduciary Obligation*', especially pages 47-52. We will shortly be publishing further research on investment governance in insurance companies, and will be hosting two roundtables in April to develop the ideas in our 2011 report. DWP is due to be represented at these roundtables.

Below we respond in more detail to relevant consultation questions.



Question 3: Would any or all of the proposals under this option be an effective way to facilitate more transfers and reduce the number of small pension pots?

We agree with the government that improvements to the current regulatory framework are unlikely to resolve the problem of small pots by themselves, since they do not overcome the problem of individual inertia. The evidence from Australia cited on page 25 reinforces the predictions of behavioural psychology that such an approach is unlikely to deliver satisfactory outcomes. The consultation paper notes that the Australian government is now implementing an auto-consolidation system following the failure of voluntary measures to halt the growth in small pots. This provides an opportunity for the UK government to learn from the Australian experience, rather than implementing ineffective measures now and being faced with a similar situation in the future. As the consultation paper notes, it is vital to tackle this issue effectively *before* auto-enrolment gets fully underway.

The ‘opt-out’ principle of auto-enrolment relies on harnessing individual inertia and is based on the behavioural insight that relying on individuals to take action about their pensions is unlikely to deliver the necessary levels of saving. It would therefore seem inconsistent for the government to take an approach to consolidating small pots that relied on individuals to make active choices and was based on the belief that individual inertia could be overcome. In this respect, we would suggest that this option does not meet the government’s final principle of ‘compatibility with wider pension reform’.

Question 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?

The many practical issues involved in implementing either of these options are outside our area of expertise, and so we comment only from our perspective on the likelihood of each option delivering good consumer outcomes. On this basis, the aggregator scheme seems preferable to the alternative of moving individuals’ pension pots with them from job to job. The consultation paper rightly notes that transferring pension pots to a new employer’s scheme carries the possibility that the new scheme will have lower costs and better standards of governance than the old scheme, which should balance the risk of it having higher costs and poorer standards of governance. However, as currently outlined, the aggregator proposal seems likely to result in less consumer detriment overall.

Under the proposal as outlined, the aggregator scheme would have certain features to ensure that it served savers’ interests – for example, low charges and an appropriate investment approach. This suggests a more stringent standard than the relatively minimal qualifying criteria for schemes eligible for auto-enrolment. As a result, an aggregator scheme would seem more likely to deliver good consumer outcomes overall than individuals taking ‘pot luck’ on whether a new employer’s scheme was better or worse than their existing scheme. Of course, in some respects this observation strengthens the case for government to make the qualifying criteria more robust, to take further steps to ensure good investment governance in default funds, and/or to exercise its powers to cap charges for qualifying schemes. However, in the absence of such measures, there are clear advantages to the proposal for an aggregator scheme.

The aggregator scheme is also a simpler system and should make it easier for savers who do wish to engage with their pension savings to make an informed choice about whether to opt out of transferring. Such savers will always be comparing their existing scheme with the aggregator scheme, about which clear and straightforward information could be made publicly available to facilitate such comparisons. By contrast, comparing their new

employer's scheme with their existing scheme every time they change jobs could be much more difficult, not least since the information is often not available to enable consumers to easily make direct comparisons between schemes. Automatically transferring pension pots from job to job therefore creates the risk of moving some consumers to an inferior product without them having the tools to assess whether this is in their interests. This is problematic regardless of whether other consumers may benefit from such transfers.

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

Yes. FairPensions believes in accountability to pension savers and aims to empower them to engage with their money should they wish to do so. Although we recognise that this will never be the case for all or even the majority of savers (see our response to Q3) we believe it is important that this option remains open for those who do wish to have a say in how their money is invested.

In particular, engaged savers may not want to transfer their money if they have chosen particular options within their existing scheme (for instance, ethical options or particular levels of risk) which are not available to them in the new scheme. Individuals who have not made such choices may also prefer to opt out of transferring if they have more confidence in the design and governance of the default fund in their existing scheme.

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

Yes, although we would suggest that good governance should also be included as a key characteristic of an aggregator scheme. As indicated in our response to the consultation on Regulatory Differences, the quality of governance varies significantly across the pensions market. In particular, our forthcoming survey of leading insurance companies provides evidence that fears of a 'governance gap' in contract-based pension provision may be justified. Given the increasing evidence that good governance is vital to member outcomes, we would suggest that any aggregator scheme must be subject to certain minimum governance requirements. If the chosen aggregator scheme was contract-based, it would be vital that mechanisms were in place to compensate for the lack of a fiduciary structure and ensure that it sought to understand and act in its members' interests.

Question 13: Could the pensions industry offer an aggregator scheme with these characteristics?

We assume that this question is aimed primarily at the pensions industry. We would simply note that NEST was established precisely to deal with a perceived market failure since it was not in the interests of the pensions industry to provide for NEST's target demographic. Although new market entrants have since emerged to compete with NEST, the aggregator scheme's role would seem even less attractive to commercial providers due to the need for it to accept even the smallest pots. It is therefore not immediately obvious that the pensions industry would be able or willing to fill this gap.

Question 16: What are the advantages of NEST acting as the aggregator scheme?

As the consultation paper observes, the demographic affected by the issue of frequent job transfers is likely to be similar to the target demographic for NEST, and the characteristics required of an aggregator scheme likewise mirror the characteristics of NEST. There would therefore seem to be a strong prima facie case for NEST acting as an aggregator scheme providing they felt able to take on this role without undue detriment to the rest of their membership. As well as fulfilling many of the key criteria set out by the government for an aggregator scheme, NEST has also established market-leading standards of governance, another criterion we identify in our response to Question 12 as crucial to any such scheme.

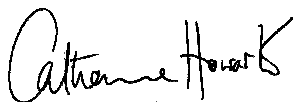
As the consultation paper notes, this would necessitate lifting the current ban on transfers into NEST. Along with an increasing number of commentators and policy experts, we would favour the lifting of this ban as a matter of urgency irrespective of which option the government chooses to proceed with. Even if NEST is not to become the default aggregator scheme, it would seem nonsensical for NEST to be excluded from accepting transfers in a context where the government is seeking to encourage or mandate transfers in the rest of the market.

Question 20: Are the existing protections for individuals sufficient for this option where pensions follow people from job to job?

Please see our response to Question 5 and our response to the previous consultation on Regulatory Differences. We would favour measures to strengthen the qualifying criteria for schemes eligible for auto-enrolment, and to ensure adequate standards of investment governance, particularly in contract-based provision.

We remain at your disposal and would be pleased to meet with you to discuss any of the above issues in more depth. We would also be pleased to share with you an advance copy of the research referred to in our response to Question 12 if this would be useful.

Yours sincerely,



Catherine Howarth
Chief Executive, FairPensions