Aggregation is the key

Retirement saving nirvana for consumers

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SUMMARY

- This paper is concerned with the automatic consolidation of pension pots and other retirement savings. This would help deliver economies of scale to the individual, leading to higher incomes in retirement and lower welfare costs.
- The DWP is laudably taking steps to facilitate pot consolidation, but its approach lacks ambition.
- This paper makes the case for aggregation, rather than the DWP-favoured "pot follows member" (PFM) mechanism. Aggregation, combined with a central clearing house and database, has the potential to achieve far more for consumers, and significant cost savings for the industry.
- The DWP would appear to have ignored what most stakeholders actually want: its own survey found that 21% of respondents expressed a preference for PFM whilst 61% preferred an aggregator approach.
- Physical aggregators offer many advantages. They can:
  - pool today's dormant pots with live pots (PFM only consolidates today's live pots with future live pots: today's dormant pots are completely ignored);

- pool all private sources of retirement income, including SIPPs, Stakeholder products, and even ISAs. PFM is irrelevant to the majority of adults, as less than 28% of the workforce is participating in an occupational pension scheme. It also excludes the self-employed; and,
- offer a simpler communications network than PFM, as well as avoiding unnecessary transfer costs.

- In addition, web-based virtual aggregators can help to engage people with retirement saving: the visual impact of virtual aggregation, combined with additional functionality that enabled people to initiate pot transfers by themselves, could prove to be a powerful educational tool.
- This paper proposes the creation of PensionClear, a central clearing house, to act as an efficient, nationwide, pension pots consolidation service. It would be connected to a network of competing aggregators, both physical and virtual; and would harvest data from both the DWP and industry participants (presented to it using standard digital formats).
- PensionClear, with its back office focus, would be operating in an arena where, today, competitive advantage amongst providers is perceived, by consumers at least, to be slight.
- The DWP should "invite" the industry, via its trade bodies, to build PensionClear to a consumer-centric specification. The industry should then operate it as a not-for-profit, mutual organisation, adhering to the principles of public service.
- The paper considers pot consolidation from the perspectives of the four principal stakeholders: the state, the industry, employers and, most importantly, consumers. It also examines some of the main technical issues, notably data quality, receiver authentication and individual identification.

15 PROPOSALS

This paper makes 15 specific proposals.

Proposal 1: The proposed pot size limit on transfers should be scrapped.

Proposal 2: Employees (and others) should have a single default aggregator (identified on P60s and P45s), so that physical aggregation could operate without any input from the job-changing beneficiary. Individuals should, however, be able to opt out, and take any dormant pots to a new employer (i.e. PFM), or nominate a different aggregator.

Proposal 3: The DWP, and industry trade bodies, should visit the operators of the Netherland's Pensions Register to gain insights into the benefits (and challenges) of running a virtual aggregator.

Proposal 4: Virtual aggregation should not be limited to assets: it could include the individual's debts, particularly any serial consumer debt (with the interest rate charged clearly displayed).

Proposal 5: The DWP should initiate another round of modelling, without a transfer limit, with aggregations ability to immediately consolidate dormant pots appropriately recognised. In addition, employees' live pots should be modelled as if held within third party aggregators, thereby eliminating a bias in today's modelling: aggregation's dual administration costs (dormant pots and live pots).

Proposal 6: A national clearing house ("PensionClear") should be established to handle retirement savings and pension pot data inquiries, perform pre-transfer authentication and identification due diligence, provide a clearing and settlements service for savings and pot transfers, and provide "corporate services" to occupational schemes, including the safe custody of pension scheme assets.

Proposal 7: PensionClear could incorporate a central database (PensionData) of transferable retirement benefits, perhaps linked to HMRC to facilitate the payment of tax relief on pension contributions. Licenced industry providers and third party administrators (TPAs) should be able to interrogate it, but only in response to a consumer inquiry concerning virtual aggregation or a physical transfer.

Proposal 8: The Pensions Regulator (TPR) should assume responsibility for establishing an authentication process in respect of asset and pension pot transfers. It should maintain an on-line register of "qualifying" receivers (pension schemes and aggregators).

Proposal 9: The Government should commission the establishment of a standard digital identification capability, one purpose being to assist in the process of asset and pension pot transfers.

Proposal 10: The industry should create a standard pension statement, along the lines of the Dutch Uniform Pension Overview (UPO) and adopt it nationwide. If the industry were to fail to do this within a year, say, then the DWP should develop its own and, after consultation, impose it upon the industry.

Proposal 11: The DWP and the Pensions Regulator should jointly establish a set of standards to support the virtual aggregation and physical transfer of assets and pension pots. This should include standards for consistent measurement (transfer "fair value"), data formats, counterparty authentication and individual identification.

Proposal 12: The DWP should "invite" the industry to build PensionClear to a consumer-centric specification. It should then be operated, by the industry, on a not-for-profit basis, as a mutual organisation adhering to the principles of a public service. If, within a given timeframe, the industry were to fail to commit to deliver PensionClear then the DWP should commission it.

Proposal 13: The cost of building PensionClear, and its subsequently operation, would inevitably fall upon those who use it: the consumer. If the DWP were to finance PensionClear's construction, it should recover its costs through an industry levy.

Proposal 14: No consumer should be denied the opportunity to make use of PensionClear. If the industry were to fail to facilitate this, then participation, by all industry providers, should be mandatory.

Proposal 15: All physical and virtual aggregators making use of PensionClear's services should be licenced by TPR, to ensure that they adhere to DWP/TPR quality standards.

FOREWORD

The UK needs to develop a savings culture to ensure that people reach retirement with sufficient funds to live with dignity, and without an unsustainable reliance on the State. The latest ONS Pension Trends data release reveals the extent of the challenge: only 2.9 million (i.e. 12%) of the private sector workforce (of 24 million) is saving into an occupational pension.

The reasons for the decline in workplace pension saving in the private sector include consumers' lack of trust in the pensions industry. Restoring and maintaining that trust will be an essential part of ensuring that the current public policy of automatically enrolling qualifying workers into a workplace pension scheme, to encourage saving for retirement, is a success. There is still more to be done.

The DWP wants to ensure that individuals do not lose sight of their small pension pots (which will be an outcome of auto-enrolment over many decades), and to help ensure that the many small pots have every chance of being combined into fewer, but bigger, ones. This principle is a sound one, but needs to be championed from a consumer, rather than an industry, perspective.

The Government is keen to pursue the principle through pot follows member but such an approach carries significant risks.

We welcome the contribution this paper makes to the debate as it is written from an independent perspective, rather than in the defence of any vested interests. We believe it provides an opportunity to rethink this element of retirement saving with the interests of the individual uppermost, and to provide the industry with an opportunity to demonstrate true leadership, not least to regain the trust of the consumer.

Christine Farnish, CBE, Chair, Consumer Futures

Margaret Snowdon, OBE, Chair, Pensions Administration Standards Association

INTRODUCTION

Although few people appreciate it, consumers need an efficient pension pot transfer mechanism. When people move jobs, they sometimes leave behind a pension pot with their last employer, often resulting in multiple small pots over their working lives. Auto-enrolment, and the abolition of short-service refunds, could spawn some 50 million new small pots over the next 40 years. 12 million of these are expected to be under £2,000 and 33 million under £10,000, exacerbating the small pots problem.[1]

Without some form of automatic transfer process, consumers will lose out on the advantages of scale, and the pension industry is left administering far more pots than necessary, which is inefficient and expensive. For consumers, multiple small pots result in lower retirement incomes (with some dormant pots being entirely forgotten).

In parallel, the on-going demise in Defined Benefit (DB) provision, in favour of individually furnished Defined Contribution (DC) schemes, is dramatically increasing the volume of small

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[1] Based upon DWP modelling using Pensim2; see the DWP's response to the consultation *Improving transfers and dealing with small pension pots*, July 2012.

transactions, further adding to providers' administrative bottlenecks and costs. Consequently, pension pot consolidation is in the interests of both consumers and the industry.

Today, transferring a pension pot is frustratingly slow, taking weeks, if not months, plagued by all the inefficiencies of a predominately paper-based bureaucracy. Poor data quality, a lack of standardisation, and identification and authentication issues all conspire to slow the process, while heaping costs upon the industry (and therefore the consumer). This matters: Britain needs an economically efficient pot consolidation mechanism to optimise private savings, not least to reduce the prospect of pensioners falling back on the welfare state.

A vision

There is a better alternative, simple in principle if complex to implement: consumers should have online access to easy to use, secure, retirement savings information windows ("portals") that, ultimately, display all their sources of retirement income. This would include their State Pension accrued rights as well as private provision. Annual charges and fees should also be disclosed, and the portal should allow the user to project his expected weekly retirement income, based upon a user-determined retirement age and life expectancy.

Crucially, the portal should enable the user to transfer retirement assets, including occupational pension pots, between industry providers and aggregators, using a paper-free process. This functionality would encourage consumer engagement with saving, and ultimately lead to higher retirement incomes.

Realising this vision requires ministerial determination, as well as overcoming a variety of challenges (notably the provision of accurate data). But none render the vision unattainable.

Guiding principles

A transfer mechanism should:

- prioritise the needs of consumers ahead of the needs of the industry, whilst helping the industry to tackle its own inefficiencies;
- embrace simplicity and standardisation;
- promote improved retirement incomes; and
- encourage active consumer engagement.

An industry-provided solution is preferable to a state solution: ideally, the role of the state should be limited to that of a catalyst and a potential enforcement agency, not a deliverer of, for example, IT solutions.

Consumer (and national) interests should trump commercial interests. In the last resort, if the industry were to fail to deliver a transparent, pan-industry, transfer mechanism through, for example, a lack of collaboration, then state intervention of some sort may be justified. On top of that, policy makers should be aware of the financial services industry's profitable inefficiencies, and therefore its inherent resistance to reform, irrespective of whether any such change would be in the consumers' best interests. The prevailing strategy, of deflecting criticism through incrementalism (which essentially maintains the *status quo*), has to be confronted.

1. THE STATE'S PERSPECTIVE

1.1 A well-intentioned pensions minister

Steve Webb, the pensions minister, has, for some time, been pursuing what he calls "operation big fat pot". This is the admirable aim of encouraging the consolidation of tiny pensions, typically built up in short-term jobs, which in the best case result in extra charges and hassle, and in the worst case get entirely forgotten. The advent of auto-enrolment has now created a sense of urgency.

Central to the minister's strategy is the introduction of automatic transfers, as outlined in the Pensions Bill 2013. DC workplace pension pots (transferable benefits totalling less than a £10,000 limit) would follow the individual as he moves to a new job: "pot follows member" (PFM). Appendix I provides more detail.

1.2 The DWP's guiding principles

The DWP's initial consultation paper[2] defined its guiding principles for reform, for three key stakeholders:

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2 DWP*; Meeting future workplace pension challenges: improving transfers and dealing with small pension pots,* 15 December 2011.

(i) for **individuals**: to promote good retirement incomes and engagement with saving, fairness and simplicity;

(ii) for **schemes and employers**: to ease administrative burdens and tackle inefficiencies, and sustainability; and

(iii) for **government**: affordability, and compatibility with wider pension reform.

Noticeable by its absence is any reference to the pensions industry. This is unfortunate, because the industry is a key stakeholder, and its co-operation is, ultimately, required. Indeed, it should benefit from pot consolidation because this would help take unnecessary costs out of the industry.

1.3 The DWP's Impact Assessment[3]

During 2012, the DWP published its assessment of how PFM compares to an obvious alternative transfer mechanism, aggregation, a holding scheme which consolidates all of an individual's accumulated small pots into one place. The financial impact on the pensions industry was estimated, out to 2050-51, using three criteria:

(i) the number of transfers that would have to be processed;

(ii) the reduction in the number of dormant pots to be administered; and

(iii) the associated administrative cost savings (i.e. the saving from no longer having to administer dormant pots, net of the cost of the transfers).

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[3] DWP; Impact Assessment, *Small Pots and Automatic Transfers Impact Assessment,* 21 May 2012, followed by an ad-hoc release *Automatic pension transfers: estimated impacts under different pot size limits,* October 2012.

The DWP concluded that, over a range of different pot size limits, PFM would, on a net present value basis, deliver nearly double the administrative saving that the best form of aggregation (using existing large schemes) could achieve.[4] In addition, the Impact Assessment envisages that PFM would reduce the number of dormant pots by 30.4 million, saving £1.25 billion in 2050 (based upon a £20,000 size limit), whereas aggregation would cut the number by 24.5 million (saving £935 million).

The DWP identified two primary causes of aggregation's relative inefficiency:[5]

(i) with aggregation, anyone who moved jobs at least once would be left with *two* on-going administration costs: the accruing pot (within the current employer's scheme), plus the cost of an aggregator (holding the now dormant pots). In addition, the DWP's modelling suggests that around one in six individuals will retire with only one dormant pot. Furthermore, some of those who retire with more than one dormant pot would have only one pot that is below the size limit. In both cases, these individuals would not enjoy any consolidation benefits; and

(ii) an aggregator mechanism would require a low pot size limit ("probably around £2,000") to avoid market distortion.

Thus, the DWP's conclusion is heavily influenced by its own definition of what an aggregator's role should be. Why, for example, should an aggregator only house dormant pots, when

4 See Tables 1, 2 and 3 of DWP, *Automatic pension transfers: estimated impacts under different pot size limits,* October 2012.

5 Ibid., page 2.

it could include live pots? Other restrictions, imposed by the DWP within its own modelling, particularly penalise aggregation, notably the existence of a pot size limit.[6]

Essentially, it would seem to have been pre-ordained that PFM would enjoy a cost advantage over the aggregator model: but change the pre-conceptions, and remove the restrictions, and the DWP's analysis collapses, along with its conclusions.

Finally, and perhaps most significant of all, the DWP would appear to have ignored what most people actually want: the DWP's own survey found that 21% of respondents expressed a preference for PFM, whilst 61% preferred an aggregator approach.[7]

1.4 In the minister's defence…

By limiting his ambition, perhaps Steve Webb is simply being pragmatic, mindful of the implementation challenges. The exclusion of today's dormant pots from PFM, for example, does remove a lot of data quality issues (but it leaves the industry continuing to profit from high charging legacy (closed book) schemes). In addition, modern schemes (the source of future pots) have clearer charges, whereas many dormant pots originate from old schemes, containing mixed charging scales, as well as a plethora of guarantees.

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6 The proposed PFM restrictions (including the size cap, and ignoring today's dormant pots) will mean that many individuals will also (continue to) have multiple pots.

7 DWP consultation response, *Improving transfers and dealing with small pension pots,* July 2012. Specifically, 24% supported a single aggregator, 19% supported multiple aggregators and 18% supported an aggregator but had no preference for single or multiple models: 61% in total.

The minister may also intend to use PFM as a Trojan Horse: by setting quality criteria for receiving schemes, perhaps he hopes to drive improvements in the quality of governance across all (contract-based) schemes. Meanwhile, he can draw some satisfaction from knowing that the Film Industry Pension Scheme has already embraced PFM, with a new multi-employer, auto-enrolment compliant scheme for film and video production staff. Pots will follow the employee instead of being tied to an employer.

2. THE INDUSTRY'S PERSPECTIVE

2.1 Where's the ball?

The DWP is yet to finalise a PFM transfer mechanism. The Pensions Bill 2013 contains a broad legal framework which refers to two alternative approaches:[8]

(i) an IT solution to match pots to members. This throws down the gauntlet to the industry to build it; or

(ii) a member-driven approach, whereby new joiners would be required to hand to new employers a "Pensions Transfer Information Document" (akin to a P45 form), to transfer their most recent (now dormant) pension pot into their new employer's scheme. Whilst this sounds simple, the wisdom of creating yet more paper, requiring administration, should be questioned.

The DWP is now working with "interested parties" to nail down the transfer process; this essentially means the industry. This is unfortunate because "the industry" is not a *single* entity; in reality it is deeply divided. In addition, notwithstanding the

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8 DWP; *Automatic transfers: consolidating pension savings*, April 2013.

significant technical challenges (many of which are common to all transfer mechanisms) there are two fundamental barriers to overcome, before pot consolidation could become a reality: internal division within the industry and the industry's self-interest, which often occludes the interests of consumers.

2.2 The first barrier: internecine warfare

The UK's long-term savings industry is divided by two differently taxed product categories competing for the attention of one population of long-term savers: broadly, the life insurers versus "the rest" (including fund managers). Even within an insurance company, for example, savers ("policy holders") with units in a life fund (with an embedded life protection policy) face a different tax regime to other insurance company funds (although the underlying assets are often the same). A similar schism is apparent in our use of the separate terms "pensions" and "savings". Taxation is at the root of the complexity that defines the UK's retirement savings arena: blame successive governments.

If the DWP wants an industry-led solution to pension pot consolidation, developed through pan-industry collaboration, then it would help if it could first persuade the Treasury to harmonise the tax framework for all of the industry's investment products, thereby unifying the industry.

In the meantime, perhaps it is no surprise that the terrain laid out by the DWP, concerning the mechanics of pension pot consolidation, has become a battleground[9] in the on-going war between competing vested interests within the industry.

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[9] To add to trust-based versus contract-based pension scheme governance, for example.

(a) The life companies' perspective: mostly pro-PFM

The life companies' customer base predominately consists of contract-based corporate schemes. As a result, some life companies (though not all) see PFM as an opportunity to:

(i) shield their existing portfolios of larger (more profitable) pots from competition from the new providers, including NEST, The People's Pension and NOW Pensions, by lobbying for a pot size cap on transfers. Indeed, this is also a way of getting rid of their smaller, less-profitably, pots, particularly because NEST et al are focussing on the (transient) lower to moderate size market (most of these pots are likely to be under £10,000); and

(ii) reinforce their considerable operational advantage over new providers: incumbent life companies have huge portfolios of live and dormant pots, and can use the associated income to defend their position. For example, they could cross-subsidise their efforts to prise pots away from others, as well as warding off pot "predators".

The more pots that life companies have *ahead* of PFM's introduction, the stronger their competitive position; this explains their on-going marketing blitz on corporate schemes ahead of their auto-enrolment. Conversely, the new providers, with no reservoirs of historic customers, are unable to harness the economies of scale that the established life companies enjoy.

Consequently, the prospect of PFM has encouraged the established life companies to behave against the consumer interest, by lobbying, for example, for the pot size transfer restriction. Meanwhile, some life companies are producing alternative proposals. Aviva, for example, has suggested that employees' pots should remain with their *previous* employer when they move to a new job. This is perhaps the ultimate approach for entrenching the position of industry incumbents.

(b) The pension funds' perspective: pro-aggregation

The NAPF, acting on behalf of those involved in designing, operating, advising and investing in all aspects of workplace pensions, is in favour of aggregation, which resonates with its super trust agenda.

2.3 The second barrier: the industry's self-interest

The industry's intensive lobbying for the exceptions on pot size and past pots suggests a lack of desire to facilitate pot transfers. More generally, it has, to-date, taken no steps to merge small pension pots, although this would clearly be in consumers' best interests: what is best for consumers is unlikely to be best for the industry.

It is worth recalling why pension pot consolidation has become a discussion topic: excessive costs: Some parts of the industry are sustained by "profitable inefficiency".[10] Pot consolidation would inevitably highlight this. In addition, fewer pots would mean less income derived from deferred scheme members.

That aside, the task of administrating millions of dormant small pots cannot be commercially attractive: the DWP's modelling assumed an annual cost of £25 per pot. But the upside of transferring pots (industry cost savings) is perhaps occluded by a fear of loss (e.g. of assets).

The failure of many in the industry to put customer interests first risks inviting state intervention well beyond NEST, to protect both consumers' interests, and the interests of all taxpayers: it is they who field the consequences of an under-saving nation.

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[10] In this context, generating profits on administrative activities that would no longer be required.

3. THE EMPLOYER'S PERSPECTIVE

3.1 Background

For about 30 years, employers have been disengaging from pension provision, retreating from the risks and regulatory burden inherent in DB-based schemes. And whilst much of the hassle of sponsoring a DC scheme can be out-sourced (witness the growth in contract-based, rather than trust-based, schemes), lingering reputational risk remains, along with the un-quantified cost of management's time. That said, many employers continue to be willing to contribute to their employees' retirement provision, not least because salary sacrifice schemes, for example, offer tax incentives (through an arbitrage at the Treasury's expense, albeit, shockingly, un-quantified and therefore unreported).

3.2 In favour of aggregation

PFM would inevitably involve employers. It would mean, for example, assuming administrative responsibility for new employees' historical benefits. In addition, PFM assumes that when someone leaves a job, they join another pension scheme. This may not happen, so what would become of their pot? Is the former employer stuck with the on-going (dormant pot) administration cost? And what if employers lose track of where a former employee has moved to? Aggregation would avoid these and other pitfalls that would lead to an additional cost burden on employers, further dis-incentivising their involvement with pensions.

Consequently, the CBI, for example, supports *virtual* aggregation over an automatic transfer system, on the basis that it would be easier to implement and, crucially, avoids the risk of member detriment.[11] The EEF, the manufacturers' organisation, is also "disappointed" by the DWP's determination to press ahead with a PFM system.[12] It favours a small number of large-scale, low-cost aggregators (such as NEST).

Many employers are attracted to the idea of contributing to employee pots held within a (third party) aggregator, allowing them to shut their workplace schemes, thereby eliminating the administrative burden associated with scheme sponsorship. Furthermore, this would overcome, from the DWP's perspective, one cause of aggregation's economic disadvantage, namely that it always leaves anyone who is in a workplace scheme, and who also has at least one dormant pot, burdened with at least two sets of administration costs.

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11 Neil Carberry, Confederation of British Industry Director of Employment and Skills.

12 Stephen Radley, EEF Director of Policy.

4. THE CONSUMERS' PERSPECTIVE

4.1 Disengaged

The pensions and savings arena is a blizzard of complexity, jargon and meaningless terminology. Add an overlay of distrust and regulatory excess to an inherently uninteresting theme (that mostly offers only distant, and uncertain, rewards), and it is no surprise that, when it comes to pensions, consumers are confused, disinterested and therefore disengaged.

People want their pension problem dealt with by someone they can trust. They do not want to make decisions, confirmed by the experiences of many pension schemes, globally. Australian pension plans, for example, report default fund take-up rates in excess of 80%; 95% of scheme members of the Danish pensions giant ATP choose the default investment strategy. Now Pensions (ATP's UK operation, and NEST competitor) only offers a default fund, and while default fund uptake in the UK is, on average, roughly 85%, NEST has reported (July 2013) that an extraordinary 99% of its members have opted for its default fund.

The Government has recognised that there are opportunities to harness the power of consumer inertia, hence auto-enrolment and, now, its interest in a mechanism for automatic transfers.

4.2 A pot size limit for transfers: why?

Irrespective of which transfer mechanism is adopted, it must demonstrably serve consumers' interests *ahead* of those of the industry. So, what consumer purpose is served by limiting the size of pot that could be transferred? Indeed, under PFM, many savers would end up with a number of pension pots individually worth an amount at or below the cap.

The DWP's decision to introduce such a limit is on a par with its capping of NEST contributions (universally condemned by consumer groups and industry analysts) and the ban on transfers: this hints at the DWP having caved in to industry lobbying.[13] Neither are consistent with the pension minister's Operation Big Fat Pots.

> **Proposal 1:** The proposed pot size limit on transfers serves no consumer purpose: it should be scrapped.

4.3 Aggregation preferred

Consumer groups (including Age UK and Which?), the NAPF, the Pensions Administration Standards Association (PASA), the TUC, and others, all favour aggregation, in one form or another, over PFM. Its advantages are significant:

(i) An aggregator could pool an individual's dormant *and* live pots. Many employers would willingly make contributions to live pots in third party aggregators. Conversely, PFM only

[13] DWP has recently announced (July 2013) that the NEST restrictions will be lifted by April 2017.

consolidates today's live pots with future live pots: today's dormant pots are completely ignored. Consequently PFM would take years to deliver a return, both on the industry's investment, and to the individual (through harnessing economies of scale). Indeed, PFM could create *reduced* scale if, for example, a pot were transferred from a large scheme (with low per capita costs) to an employer with a small scheme.

(ii) The DWP's focus is only on consolidating pots created through workplace DC provision, but for most people this will only provide a part of their retirement income. To fully harness economies of scale, *all* private sources of retirement income (including SIPPs, SSASs, Stakeholder, FSAVCs and ISAs) should be in the same pot, particularly just prior to annuitisation. PFM could not deliver this, with its limited focus on workplace DC schemes. Indeed, PFM is irrelevant to the majority of employees, because less than 28% of the workforce is participating in an occupational pension scheme. This sub-divides as 12% and 93% of private and public sector employees, respectively.[14] Furthermore, PFM excludes the self-employed (the fastest growing employment sector).

(iii) If the DWP were to opt for a PFM transfer process based on IT-driven pot-matching, as seems likely, pots could move

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[14] Currently, of the 8.2 million active members of occupational pension schemes, 65% (5.3 million) are in the public sector (i.e. 93% of the 5.7 million state workers) and only 2.9 million are in the private sector (i.e. 12% of the 24 million private sector workers). Source: ONS Pension Trends, 2013 editions; *Chapter 6: Private Pensions, Chapter 7: Private pension scheme membership, and Chapter 8: Pension contributions*. 16 July 2013.

without employees even being aware that it had happened.[15] This would represent a lost opportunity to engage people with retirement saving, thereby encouraging them to assume more responsibility for their retirement income and perhaps help catalyse a savings culture. Conversely, the visual impact of virtual aggregation, in particular, combined with additional functionality that enables people to initiate pot transfers by themselves, would provide a powerful educational tool.

(iv) There are justifiable concerns that through PFM, pots could be automatically transferred to inferior schemes, perhaps with higher charges, poor governance or an unsuitable default investment strategy: "consumer detriment".[16] *In extremis* pots could even be transferred to a pensions liberation company.[17] Aggregation into existing (qualifying) schemes would avoid these risks, as well as reducing the regulatory burden on TPR. Rather than overseeing the PFM activities of numerous workplace schemes, TPR could concentrate its attention on a small number of (qualifying) aggregators;

(v) Aggregation would require a simpler communications network than PFM. Pension schemes would only need to communicate with a limited number of aggregators (a

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15 The DWP's alternative, member-driven, approach using "pensions transfer information documents" would provide for some consumer engagement.

16 See ToUChstone articles: *A small pension pot compromise?* by Nigel Stanley (30 August 2012) and *Pension transfers: the case for 'pot follows member' continues to unravel*, by Craig Berry (15 October 2012).

17 The pensions minister has acknowledged this PFM-related quality issue, suggesting that receiving schemes could be required to meet quality standards, related to governance, charging rates and the preservation of any guarantees. This could have significant implications for some contract-based schemes, in particular.

"many to few" problem), whereas, with PFM, every scheme, potentially, would need to be capable of communicating with every other scheme: a "many to many" problem.

(vi) The workforce of certain industries, such as construction, retail and catering, frequently change jobs: many workers are likely to oscillate between industry-focused schemes, leaving one for another, only to return to it a few months later. PFM-induced transfers could thus accumulate huge (and unnecessary) administration costs, which aggregation would avoid.[18]

(vii) The aggregation of retirement savings matters most at the time of annuitisation, when the buying power of a single, larger, pot can be harnessed. Today, the small size of many pots makes it difficult to annuitise them at all, let alone get good value. In addition, buying power is even better if open market options could be exercised in bulk, rather than by each individual case: aggregation could facilitate this.

(viii) Looking further ahead, PFM may also compromise Steve Webb's ability to encourage risk-sharing "defined ambition" schemes. The lack of deferred members (care of PFM) would reduce the lifetime of membership, with potential adverse implications for asset allocation and liquidity management. It is also unclear how Collective DC schemes would operate alongside a PFM framework. PFM, with its outgoing transfers of cash, would inhibit a CDC scheme's ability to invest in (higher return) illiquid assets, reducing its DB-like advantages.

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18 The pensions minister is aware of this issue and is considering periodic "transfer sweeps" (every year or two), rather than requiring a transfer at each employment event.

5. OPTIONS FOR AGGREGATION

There are two forms of asset aggregation: physical and virtual. The former facilitates scaling up by through the movement of assets to a specific vehicle, whereas the latter pulls assets together through an online representation: their actual location is irrelevant.

5.1 Physical aggregation

(a) One public service aggregator?

Some people believe that there should be a single, highly visible, nationwide, not-for-profit aggregator providing a public, not a commercial, service. A central home for the nation's pots would be well placed to serve the 80%+ of the population that is happy for their assets to be placed in default funds. It could corral the consolidated pots into packages (of £5 million to £50 million, say) and then auction them to default fund managers (who could only bid once they have met a set of quality criteria).

From the consumer's perspective, such an arrangement would have the fundamental merit of simplicity (no choice over *which* aggregator). In addition, the individual would, through the aggregator, be able to harness significant economies of scale. A central aggregator could also support The Pensions Regulator, in its monitoring of automatic-enrolment.

But there are doubts: monopolistic inefficiency and past public service failings would probably rule out a central aggregator.

(b) Multiple aggregators?

The risk of monopolistic behaviour could be addressed with multiple, competing, aggregators, either newly built or emerging from existing multi-employer providers, including NEST, NOW Pensions and The People's Pension. But the existence of multiple aggregators runs contrary to the concept of aggregation: people could end up with pots in more than one aggregator.

One way of resolving this conundrum would be for everyone to have a single default aggregator (which would meet quality criteria), perhaps initially identified for them by their employer, at the time of first auto-enrolment. Employees should subsequently be free to nominate a different aggregator (or opt out altogether) or, if moving into a new employer's scheme, take any dormant pots with them (i.e. PFM). An alternative approach would be for the regulator to operate a carousel-type allocation mechanism (perhaps only in respect of the self-employed, or employees not currently participating in an employer-sponsored scheme, i.e. most people[19]).

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[19] In 2011, only 2.9 million private sector workers were active members of occupational pension schemes, 12% of the private sector workforce, the lowest level since the 1950s. There were 5.3 million active public sector members; *ONS Pension Trends, Chapter 6: Private Pensions, 16 July 2013.*

One major attraction of a default aggregator system is that physical aggregation could then operate without *any* input from the beneficiary. The employee's preferred aggregator could appear on his P45, for example, so that when he moves to a new job, the new employer immediately knows which aggregator to pay contributions to.

All aggregators would have to meet a set of quality standards to perform such a role, concerning audit, costs, technical capability and transparency. They should also have a board of trustees to ensure they adhere to a fiduciary duty of care. Those physical aggregators that also *manage* assets would, of course, have to adopt the necessary independent governance criteria, as well as designing and managing high standard default funds.

Once "aggregation" entered the lexicon, consumers, with media assistance, would come to understand what aggregation is, particularly if they were provided with additional tools to encourage engagement, including virtual aggregation.

Proposal 2: Employees (and others) should have a single default aggregator (identified on P60s and P45s), so that physical aggregation could operate without *any* input from the (job-changing) beneficiary. Individuals should, however, be able to opt out, and take any dormant pots to a new employer's scheme (i.e. PFM), or nominate a different aggregator.

5.2 Virtual aggregation

(a) Objective: to catalyse engagement

Virtual aggregation has enormous potential as a *visual* communication tool to motivate people to engage with their retirement assets. It could help educate users by enabling them to view *all* of their retirement income-producing assets on a single webpage, including:

- current DC workplace pension provision, including assets on corporate and third party platforms (including NEST et al);
- dormant pots, from previous employment(s);
- personal pension savings products: SIPPs, stakeholder products, Small Self-Administered Schemes (SSAS) and Qualifying Recognised Overseas Pension Schemes (QROPS);
- DB pension scheme entitlement;
- free-standing additional voluntary contribution (FSAVCs);
- ISAs, which are being increasingly viewed as a primary source of retirement income; and
- state pension entitlement: the basic State Pension, State Second Pension (S2P) and its predecessors and, in time, the single-tier state pension. It is crucial to include state pensions because, for most people, they provide more than 50% of their retirement income.

The components that provide certainty of income would have to be expressed in terms of transfer (or "fair") values, determined on a consistent basis. If combined with an annuity calculator (to produce pension projections, expressed in today's money terms), virtual aggregator websites would provide valuable insights concerning potential retirement income. A separate webpage should list the assumptions that underlie any calculations, which would have to include asset performance in respect of DC-based savings, and an annuity rate. Users should be able to over-ride the default assumptions with their own, to see the impact on their projected retirement income.

Looking further ahead, given that releasing equity tied up in property could become a primary source of retirement income, websites could also indicate (conservatively assessed) property market values, net of any mortgage debt. There should be scope to include other assets too, such as endowment policies, other life policies, long-term care-related savings and any annuities.

In time, through using a website, people may come to appreciate what they have got (thereby focusing their attention on not losing it). Hopefully, some people will be shocked to realise just how small their retirement incomes will be, unless they save more. This is not easy to communicate. Many people do not intuitively understand retirement savings expressed in monetary terms, but research suggests that they more readily empathise with savings-related messages expressed in physical terms. For example, which aspects of the user's current lifestyle would not be affordable in retirement?[20] Would an annual holiday or a car be affordable or, conversely, would state aid have to be relied upon?

(b) An ability to transact: crucial

Virtual aggregation alone does not produce economies of scale. To be effective, and encourage consumer engagement, the websites must empower the user to act on the information they convey. He must be able to communicate with the industry by, for example, passing instructions to transfer pensions pots: user-initiated physical aggregation. "Pop-ups" could warn the user of risks associated with merging his particular pots, such as losing something valuable (perhaps a guaranteed annuity rate).

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[20] Based upon projected annuities, which would require the user to input data concerning current expenditure.

Another webpage should detail all the costs associated with each pot's assets, which would probably shock many people into looking for cheaper alternatives, including passive, rather than active, fund management.

(c) Virtual aggregation: a catalyst for competition

Virtual aggregation, combined with an ability to transact, could provide the key to introducing genuine competition into the financial services industry. Furthermore, the pensions minister has recognised the potential benefits of virtual aggregation:[21]

> *"A virtual amalgamation tool to help individuals see all their pension pots in one place, regardless of size of pot… is an interesting idea and is one which I would like to explore further with the pensions industry".*

(d) Virtual aggregation: domestic experience

Individual and corporate platforms provide a virtual aggregation capability, but this has been primarily developed as a tool for advisers, rather than the self-service market (i.e. individual consumers). Many are reluctant to offer such a capability to consumers because of the required investment (most platforms are under severe economic pressure[22]): such a move could also introduce an additional competitive threat.

(e) Virtual aggregation: international experience

State-sponsored aggregation vehicles are already in use in a number of countries: in this context, the UK is well behind.

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21 DWP; Government response to the consultation: *Improving transfers and dealing with small pension pots*, July 2012.

22 Platforms' 2011 costs exceeded revenues by £50 million, despite having assets under administration of nearly £250 billion.

The Netherlands has its Pensions Register,[23] which provides citizens with insights into their state and workplace pensions accruals (pillars one and two).[24] Set up by pension fund lobbying organisations, insurer representatives and the state's social security provider SVB, it was built at a cost of €6.5 million, and took 18 months to design and another 18 months to implement. It is free to use and prohibits commercial activity, and has clearly succeeded in attracting users: some 300,000 visitors accessed the site on its first day, and usage has since settled down to some 50,000 per day (equivalent to 200,000 in the UK).

The Dutch now intend to add the third pillar's data (private provision) to their Pensions Register, along with additional functionality to enable the user to see how a range of expectations for inflation, say, could impact their retirement income. They are rightly proud of their register, and there is an open invitation to other nations to go and see it in operation.

Proposal 3: The DWP, and industry trade bodies, should visit the operators of the Netherland's Pensions Register to gain insights into the benefits (and challenges) of running a virtual aggregator.

The Belgians are working to introduce a first and second pillar register, and the Danes and Swedes already operate virtual aggregators, with varying degrees of asset reach. (Sweden's, which emerged following consumer pressure, currently only incorporates state pensions).

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23 The Stichting Pensioen Register, launched in January 2011. The website was built by AtosOrigin, who also manage the digital register.

24 The Dutch have a three pillar pensions system: statutory state pensions, workplace pensions and private provision.

Europeans are also acting collectively. A consortium of six European pension funds and government agencies[25] is now working on a pan-EU data registry, at the European Commission's request. Their remit is to develop a single European data aggregator, containing people's national state pension, plus any workplace and private savings. They are starting with an assessment of current best practice around Europe, while also developing a data tracking system. The direction of travel is obvious (and common sense): pensions data will increasingly be aggregated.

Elsewhere, New Zealand's Commission for Financial Literacy and Retirement Income runs a website called “Sorted”, which provides elements of virtual aggregation and, sensibly, allows the user to include debt too. This latter feature is potentially important for promoting saving through “negadebt” (negative debt): repaying consumer debt probably offers the best risk/return of *any* savings proposition.[26] A virtual aggregator could, for example, enable the user to transfer cash balances (perhaps in a bank “high interest” savings account, but actually earning next to zero) directly to credit card websites, to eliminate serial deficits.

Proposal 4: Virtual aggregation should not be limited to assets: it could include the individual's debts, particularly any serial consumer debt (with the interest rate charged clearly displayed).

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[25] Three Dutch pension funds APG, PGGM and MN, the insurer Syntrus Achmea (12 million pension savers between them), PKA from Denmark and ETK of Finland (2.4 million members).

[26] A basic rate taxpayer who pays off his consumer credit debt (with a typical consumer credit card APR of 18%) is effectively saving at 22.5% per annum, *risk free*.

6. THE WAY AHEAD

6.1 Political considerations

It is improbable that the financial services industry will act collaboratively to deliver a pan-industry PFM mechanism for pot consolidation. In addition, an industry-funded mechanism will be forthcoming only if there is cross-party support for it. Investment, however, requires political certainty, and with a General Election due before PFM could be implemented, the Labour Party effectively holds a veto on aspirations for PFM.

In one sense the DWP has brought this problem upon itself. By presenting the PFM mechanism as a *fait accompli*, the DWP has divided the industry, discouraging collaboration. The result is a Mexican standoff, the industry being unwilling to invest without a clear assurance that there would be no policy U-turn, and policy makers being unable to provide the necessary assurance.[27]

This deadlock could be broken if the DWP were to leave open the question of *which* transfer mechanism it favours (a politically awkward U-turn), and start by addressing the three key technical

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27 As observed by Faisal Aziz of Cognizant Business Consulting.

challenges (see Chapter 7) that are common to all potential transfers mechanisms: data quality, individual identification and receiver authentication, each accompanied by a set of standards residing within a supporting regulatory framework.

If these three challenges were addressed, then market-based transfer mechanisms could flourish. Indeed, were consumer-initiated transfers to develop within a competitive market, then the PFM versus aggregator debate could evaporate.

6.2 Further modelling required

More immediately, the DWP should examine the PFM versus aggregator debate *without* any limit on pot size, and factor into its model the benefits that only aggregation could provide (such as its ability to capture today's dormant pots).

In addition, there is a risk that the DWP has significantly under-estimated the number of PFM transfers that would require processing, particularly by the new providers. NEST and others are focussed on the transient lower to moderate market: they are likely to experience much higher administration costs than currently envisaged by the DWP (most of their pots will be under £10,000). Conversely, the PFM-promoting life insurers' customers are primarily higher net worth, more stable, workers, and this may have influenced the DWP's analysis. The revised model, and its results, should be put into the public domain.

Proposal 5: The DWP should initiate another round of modelling, without a transfer limit, with aggregations ability to immediately consolidate dormant pots appropriately recognised. In addition, employees' *live* pots should be modelled as if held within third party aggregators, thereby eliminating a bias in today's modelling.

6.3 Harnessing inertia *with* engagement?

Ordinarily, a consumer service would be designed around answering one simple question: *what do consumers want?* But given the widespread disengagement with all matters pensions, this question is difficult to answer. Given the industry's lack of collaborative instinct, this invites a state-inspired initiative.

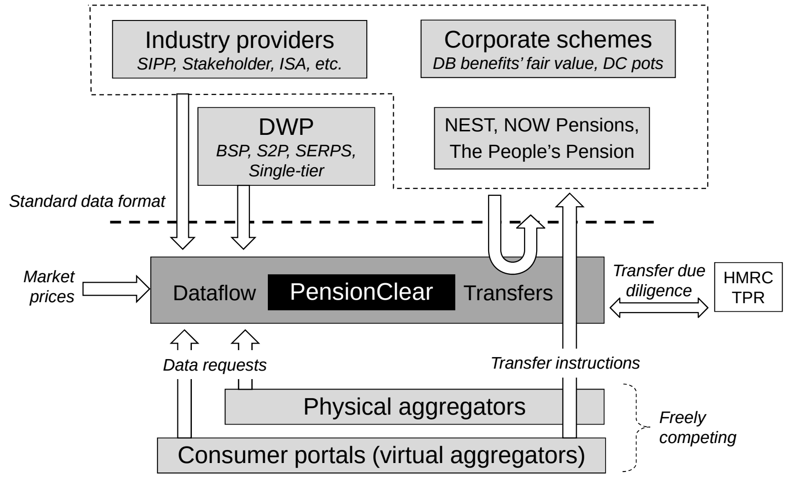
If there is one area of unanimity – both political and across the industry – it is the desire to encourage consumer engagement with retirement saving. But this is unlikely to be promoted by a mechanism that solely harnesses inertia (such as PFM). A framework is required which both engages consumers *and* harnesses inertia.

6.4 PensionClear: a central clearing house

The state could make a major contribution to encouraging consumer engagement *and* the scaling up of retirement assets by *facilitating* (not necessarily delivering) a national clearing house ("PensionClear"). It would handle data inquiries and execute pot transfer requests. This idea has been mooted before, but not in combination with proposals concerning aggregation.

Clearing houses are well-established in a number of markets (not just financial), and include the biggest custodians, clearers and settlers of the Eurobond market: Euroclear (user-owned) and Clearstream (Deutsche Börse). CREST (user-owned) is another major clearing house, providing real-time electronic settlement system for UK and international shares, and also UK government bonds (Gilts). Figure 1 provides an overview of PensionClear and allied aggregators.

Figure 1: Aggregation and clearing house architecture



PensionClear would have four primary roles:

(i) respond to data demands from (freely competing) consumer portals (i.e. virtual aggregators) and physical aggregators, by harvesting data from both the DWP and industry participants. This would have to be presented to PensionClear using standard digital formats (no paper);[28]

(ii) field pot transfer instructions from aggregators, other industry participants and occupational pension schemes, perform authentication and identification due diligence prior to transfer (concerning both the receiving party and the beneficiary, requiring liaison with HM Revenue & Customs (HMRC) and TPR), and then issue transfer instructions, as appropriate;

28 It is acknowledged that this would not be possible with some "bespoke" assets, including directly held commercial properties, holdings of gold bullion and unregulated investments.

(iii) provide a clearing and settlements service for transfers of retirement savings assets (which could include ISAs) and pension pots; and

(iv) provide "corporate services" to occupational schemes, including the safe custody of pension assets. PensionClear Corporate Services (PCCS) could also facilitate employers transferring their schemes into any qualifying aggregator that offered a default fund. Employers and employees would then simply pay their contributions to the aggregator, either directly or via PCCS.

With consumers, the DWP and the industry all communicating with the same entity, PensionClear would considerably simplify, and accelerate, the data gathering and pot transfer processes.

> **Proposal 6:** A national clearing house ("PensionClear") should be established to handle retirement savings and pension pot data inquiries, perform pre-transfer authentication and identification due diligence, provide a clearing and settlements service for savings and pot transfers, and provide "corporate services" to occupational schemes, including the safe custody of pension scheme assets.

PensionClear's responsibility for receiving schemes' status authentication would include transfers from both DC and DB schemes. Consequently, HMRC's registration system would have to be made more robust, to eliminate the risk of pot theft. Perhaps HMRC/TPR should be held liable for losses to bogus receivers approved by them (the aggregators should not be held accountable)?[29]

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[29] Note the current problems with pensions liberation.

In addition, if trustees were exempted from any responsibility for authentication, this would provide an (overall) efficiency gain, but it would have TPR licencing implications for pension schemes.

6.5 PensionData: a central database (or register)

(a) Not uncharted territory

A central database of transferable retirement benefits is conceptually simple, and therefore attractive. The concept is not new; some countries, including the Netherlands, already have a pensions register which *requires* pension schemes to send details of members' pots to it. Its data is accessible by consumers and provides a consolidated view of all of their pension pots.

PensionClear could include such a database, and it would make sense for it to reside "alongside" PensionClear's authentication and transfer services. In addition, it could be linked to HMRC to facilitate the payment of tax relief on pension contributions.

(b) Access driven by consumer inquiry

Such a database should be capable of being interrogated by (eligible, i.e. licenced) industry providers (including aggregators) and third party scheme administrators (TPAs), but only in response to a consumer inquiry concerning virtual aggregation or a physical transfer. The licencing criteria would have to address data protection and cross selling risks.

(c) A database: under consideration

A central database is clearly on the pension minister's mind. The Pensions Bill 2013 contains an enabling power which could be used to establish it, to assist in the automatic transfer process. Significant governance issues would have to be addressed, including who should "own" the database and assume responsibility for it. Given that neither the industry nor the state are fully trusted, this could be a not-for-profit (mutual) organisation, perhaps initially funded by a loan from the state, repaid by user charges (which would ultimately reach the consumer).

Proposal 7: PensionClear could incorporate a central database (PensionData) of transferable retirement benefits, perhaps linked to HMRC to facilitate the payment of tax relief on pension contributions. Licenced industry providers and third party administrators (TPAs) should be able to interrogate it, but only in response to a consumer inquiry concerning virtual aggregation or a physical transfer.

(d) Substantial benefits for all... eventually

While a fully populated database would produce huge benefits for both consumers *and* the industry, getting there would be a time-consuming, arduous process (uploading data, often from paper-based records). But once operative, industry participants could abandon their legacy computer systems (today, they have little incentive to invest in upgrading them) and the need for many of the (expensive) manual interventions. In addition, with PensionClear performing due diligence prior to effecting a transfer, its database could include the authentication status of all potential receiving schemes, as well as the contact details of each individual. This would cut down on data duplication, saving time and money when transferring schemes.

Armed with a database, PensionClear could also help the industry cut costs by assisting in issues such as finding lost members, and reuniting orphaned (i.e. lost) pots with their owners (ideally prior to annuitisation). It would also make sense to connect it to the Pension Tracing Service: the nation's pool of unclaimed pension pots already totals some £3 billion,[30] a figure that is expected to grow substantially over the next decade.

6.6 A cursory road map

Stage 1

- Preparation of standards, including for data transmission between PensionClear, aggregators and providers; consistent measurement (to establish (cash) transfer values); authentication and individual identification procedures. Pan-industry adoption of a standard pension statement for individuals, and industry charging methodology (e.g. for AMCs).
- Establish quality criteria for TPR licencing, for all parties that would want to make use of PensionClear's services and/or interrogate its database, including virtual and physical aggregators, other industry providers and TPAs.

Stage 2

- DWP invites parties to bid to design and construct PensionClear and PensionData. The scope should clearly indicate the potential of future role expansion (including the range of assets to be handled).

Stage 3

- Launch of PensionClear, initially including only DC workplace pots active and dormant (i.e. the legacy pots, which is where much of the consumer detriment lies), and State Pension accruals. DB schemes should be included later.

Stage 4

- Launch of central database (PensionData), with a schedule for progressively populating it with data.

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30 J Shury and C Koerbitz, *The Pension Tracing Service: A quantitative research study to establish who is using the service, and their outcomes*, DWP, 2010.

Stage 5

- PensionClear expands capabilities to include other asset classes (Stakeholder products, annuities, ISAs….) and PensionClear Corporate Services (PCCS), offering safe custody of DC pension pots.

7. TECHNICAL CONSIDERATIONS

7.1 Three principal challenges

Irrespective of the transfer mechanism (virtual or physical, or indeed PFM), it must be trusted and reliable (i.e. 99.9%+ of transfers should work seamlessly), and free of counterparty risk. This raises three key technical challenges, which are common to all transfer mechanisms:

(i) the quality of the data has to be near perfect;

(ii) there has to be a simple process for receiver authentication, in respect of transfers; and

(iii) the identification process, linking pots to their true owners, should, ideally, function without involving the individual.

(a) Data quality

Poor data quality is a well-known industry problem, exacerbated by some providers still relying upon inefficient paper-based administration.[31] Dormant pots, in particular, suffer from data

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[31] 2.3 million members are in schemes with poor common data, with a further 2.9 million in schemes where the common data score is not known; *TPR's annual scheme record keeping survey,* July 2013.

issues, which makes for an arduous (i.e. expensive and slow) transfer process. In addition, some of these pots are stuck in high charging (and profitable) legacy businesses: their providers have little incentive to improve transferability. Assertive prompts from the DWP may be required to make such pots "transfer ready", in a standardised electronic format. The quality of all the data entering PensionClear would have to be the responsibility of the sender.

(b) Receiver authentication

Prior to authorising a transfer, PensionClear should consult a TPR-maintained register of "qualifying" receivers (pension schemes and aggregators), not least to limit the activities of pension liberation companies. It would be helpful if the definition of "qualifying" incorporated TPR's guidance and checklist, issued to help trustees assess the validity of transfer applications. This would also help protect individuals, who cannot be expected to assume any authentication responsibilities.

Proposal 8: The Pensions Regulator should assume responsibility for establishing an authentication process in respect of asset and pension pot transfers. It should maintain an on-line register of "qualifying" receivers (pension schemes and aggregators).

(c) Individual identification

Unlike those countries which have, or are building, virtual aggregation (including the Belgians, Danes, Dutch and Swedes), the UK does not have a digital identification capability. This is a major short-coming: the UK cannot digitally authenticate pot data back to its rightful owner. Consequently, ceding and receiving parties often have to wade through paper-based records to confirm that the pot being transferred belongs to the correct individual.

Solutions could involve National Insurance numbers, HMRC records (via an upgraded Government Gateway?) or variations on whatever solutions the banks adopt to deliver bank account portability. Alternatively, why not take advantage of recent developments in technology, such as biometric capabilities embedded in mobile phones (a key feature of engagement with consumers)? There is also IdenTrust, which is well known amongst government agencies and corporations for managing risks associated with identity authentication. It is used by contract-based DC workplace schemes (including a few master trusts, platforms and SIPPs), but less so by trust-based schemes (many are not registered, so there is no mechanism to facilitate authentication) and third party administrators (TPAs).

In addition, SWIFT, the probable nominated message carrier, provides a network that enables financial institutions worldwide to send and receive information about financial transactions. It is experienced in network security, including authentication and identification issues, but it does not hold accounts for its members, nor perform any form of clearing or settlement.

Whichever identification solutions are developed, they should assume a disengaged individual. Given TPR's role of protecting scheme members' benefits, it is a candidate for assuming responsibility for overseeing data security in respect of PensionClear and its counterparties.

Proposal 9: The Government should commission the establishment of a standard digital identification capability, one purpose being to assist in the process of asset and pension pot transfers.

7.2 Cash transfer or asset re-registration?

Should pot transfers be effected via cash transfer or asset re-registration? Behind this question is another: in the context of pot consolidation, what does "transfer" mean? Perhaps more fundamentally, which mechanism is best for consumers?

Today, most transfers between pension schemes are made via cash, the common denominator for embedded rights. This is essential when consolidating DB pots, DC pots accompanied by ancillary benefits (including guarantees) and default funds (none precisely replicates any other). Conversely, transfers of complex or diverse investment funds, and transfers between SSASs and/or SIPPs, are sometimes conducted *in specie*, i.e. without the need to first convert the asset to cash.

The industry is divided between cash transfer and asset re-registration. Broadly, the life insurance community favours cash transfer, marshalled by Origo (owned by its members, predominately life companies), using an extension of its Options Transfer Service. Conversely, other industry participants ("the rest") support the Altus/TISA[32] preference for re-registration, using an ISO/SWIFT standard.

Altus provides standardised contracts, so that platforms, for example, would not need to renegotiate contracts before transfers could occur between them. But, to date, it has no experience with pensions, while Origo's experience is limited: only recently, for example, has it shown an interest in SIPP and

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32 TISA, the Tax Incentivised Savings Association. It operates TISA Exchange Limited (TeX), which facilitates the electronic transfer of wrappers and assets between any firm which holds assets on behalf of investors. It uses common standards and associated Service Level Agreements (SLA).

SSAS re-registration transfers.[33] It does offer Unipass Identity, a digital authentication service that may lend itself to pot transfers, but perhaps the main issue with Origo is that it only offers a closed system, which it may not be willing to share with non-members. This is hardly conducive to fostering a collaborative environment, necessary for a pan-industry clearing house.

Given this, the preliminary conclusion is that re-registration is preferred, not least because transferring an asset from one administrator to another really should not incur market transactions costs (including needlessly crossing the bid-offer spread).

7.3 Standardisation

(a) Essential

The industry appears to have a love-hate relationship with standardisation. Today, over 650 different file formats are in use by pension providers, interfacing with multiple HR and payroll systems. Given the expected huge increase in the volume of data flowing between providers, employers and their employees, a set of standards is desperately needed. There would be obvious benefits (simplification and cost reduction), but standardisation would expose industry participants to greater competition.

Standards are required to:

- guide (but not micro-manage) processes, such as the physical transfer of assets and pots;

[33] Origo joined the Association of Member Directed Pension Schemes (AMPS), the SIPP and SSAS trade body, in early-2013.

- provide consistent measurement, for example when establishing (cash) transfer values ("fair value");
- provide consistent data formats between all parties; and
- facilitate authentication (ceding and receiving schemes, and aggregators), and individual identification in respect of transfers.

(b) Lessons from the Dutch

(i) A standard annual pensions statement

Prior to launching their Pensions Register, the Dutch created a standard annual pension statement (a Uniform Pension Overview, UPO). This format is now used by *all* Dutch pension funds and insurers. The UPO shows an individual's accrued pension rights, and the income that could be expected from each occupational pension pot, over a range of circumstances: at retirement, in the event of disability or what a partner or children would receive in the event of death. Being standardised, the user's UPOs are readily fungible for (virtual aggregator) presentational purposes.

Proposal 10: The industry should create a standard pension statement, along the lines of the Dutch Uniform Pension Overview (UPO) and adopt it nationwide. If the industry were to fail to do this within a year, say, then the DWP should develop its own and, after consultation, impose it upon the industry.

(ii) Information sharing

The Dutch system allows changes of information to be rapidly shared with the pension providers, because Dutch residents are obliged swiftly to provide such information to regional authorities. The British have always resisted this: HMRC, for example, does not help schemes by sharing information (aided and abetted by the Data Protection Act). Given the prevalence of NI numbers, it should not be difficult for HMRC to exchange information with a small number of accredited aggregators.

(c) Establishing the standards

But who should set, and control, the standards, and ensure that, once established, they are stable? There are a number of candidates, including the Pensions Administration Standards Association (PASA), Origo Standards and TISA (advocating ISO 20022, the ISO Standard for financial services messaging, developed by the UK Funds Market Practice Group, UKFMPG).[34]

Origo and TISA represent different interest groups within the financial services arena but neither offers a comprehensive, tried and tested, set of transfer standards that spans the whole gamut of retirement savings products. Consequently, the DWP should avoid becoming caught up in intra-industry territorialism, and itself establish a comprehensive set of standards. In so doing, it should consult with PASA, Origo and TISA, amongst others, ideally working with TPR, which is likely to end up with an oversight role.

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[34] UKFMPG is the investment funds' National Market Practice Group (NMPG) for the UK. It is part of the Investment Funds Working Group of the (not-for-profit) global Securities Market Practice Group (SMPG). The latter's mission includes creating globally harmonised market practices, with the objective of enhancing "straight through" processing at an industry level, and the consistent implementation of ISO messaging standards by securities industry participants for processing within, and across, all markets.

Proposal 11: The DWP and TPR should jointly establish a set of standards to support the virtual aggregation and physical transfer of assets and pension pots. This should include standards for consistent measurement (transfer "fair value"), data formats, counterparty authentication and individual identification.

Subsequently, any software vendor (including Altus, Calastone, ENX, Euroclear and Origo) should be allowed to compete to build software incorporating these standards, perhaps subject to meeting TPR-managed software licensing requirements. Ideally, a market practice for applying the standards would then evolve, as they are used.

7.4 The Holy Grail: straight-through processing (STP)

In a perfect world, PensionClear would operate on a STP basis, with the entire transfer process embracing technology, perhaps even powering the industry towards a more prosperous future. Imagine pot transfers being reliably settled on a T + 3 basis (i.e. three business days after instruction, as per equities transactions). But STP is only feasible if *all* parties were operating digitally, so PensionClear could function without any re-keying or manual intervention. We are a long way from realising such an ideal, not least because of the absence of digital identification in the UK. Indeed, today, some parts of the industry are the operational antithesis, enmeshed in a complex labyrinth of manual processes that can take many weeks.

7.5 Currently, more questions than answers

There are lots of challenges to be addressed prior to an effective pension savings consolidation service becoming a reality, concerning IT, security, standardisation and systems connectivity between the many different parties, including TPR; see Appendix II.

8. DELIVERY

8.1 Can the industry be trusted to deliver?

Ideally, the private sector should assume responsibility for delivering an efficient, nationwide, pension pots consolidation service, connected to a number of competing aggregators, both physical and virtual. But today's situation is akin to a tragedy of the commons. By pursuing individual advantage, the necessary pan-industry collaboration is unlikely to materialise.

That said, if collaboration were to be forthcoming, control of the delivery process would, effectively, be being ceded to the industry, which includes some who are distinctly nervous about the competitive pressures that PensionClear and virtual aggregators, in particular, could spawn. To be effective (i.e. useful to consumers), virtual aggregators require substantially improved transparency (in respect of costs, for example). This, combined with functionality that enables users to move assets (including pension pots) between providers could, finally, provide consumers with an ability to counter the dysfunctional nature of some parts of the industry.

Consequently, there is a risk that the industry may claim an eagerness to please, and then drag its feet, perhaps hoping that the political momentum behind pot consolidation will wane ahead of the next election. The DWP should retain a healthy scepticism with regard to the industry's willingness to deliver an effective PensionClear/aggregation framework.

In the meantime, the OFT (motivated by the on-going auto-enrolment) is conducting a study of the DC workplace pension market, to examine whether it is working well for consumers. A PensionClear-centred framework would help address many of the concerns that the OFT identified in its July 2013 Progress Update.

8.2 Driving change: lessons from the telecoms industry[35]

Over the last 20 years the UK telecoms market, once dominated by BT, has been revolutionised, by a combination of regulator imperative, technical innovation and relentless consumer pressure.[36]

Regulation has been characterised by Ofcom's strong authority, transparency and willingness to act, its remit being to regulate in both the national and consumer's interest. This, for example, catalysed BT's investment in an Internet Protocol (IP) network, prompting all host computers on the network to use the same communication protocols. This standardisation accelerated the roll out of broadband and, combined with a storm of technical innovation, led to a market convergence between data, voice and media, fuelling consumer demand for integrated access and number portability.

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35 With thanks to Baroness Drake.

36 That said, in some quarters the industry remains "clubby" (e.g. mobile phone pricing), and price transparency and complexity continue to be issues concerning consumers.

Ease of number switching between providers is essential to consumer empowerment. The historic lack of portability supported client inertia (note the life company parallel; hence their preference for PFM rather than aggregation), but industry incumbents' resistance to change was overcome by a combination of an assertive regulator and technical innovation. The latter spawned multiple forms of access (including mobile/wireless), so the commercial significance of the portability issue diminished. The emergence of B2B, B2C and C2C relationships were also huge drivers of change, supported by a regulator that works hard to stay in pace with the technology and the market.

The third driver of change has been lots of interested and knowledgeable consumers, with an insatiable appetite for innovative new products. Changing technology, the global nature of the market place and the paramount importance of reliability means suppliers have to be more responsive to the consumer. This makes consumers powerful: the contrast with the UK's pensions arena could not be more stark.

8.3 PensionClear

(a) Construction

PensionClear, with its back office focus, would be operating in an arena where, today, competitive advantage amongst providers is perceived, by consumers at least, to be slight. The prospect of delivering significant cost savings to the industry should encourage mutually beneficial industry collaboration to establish it.

Consequently, the Government should "invite" the industry, via its representative trade bodies, to build PensionClear to a consumer-centric specification. The industry should then operate it as a not-for-profit, mutual, organisation, adhering to the principles of a public service.

However if, within a given timeframe, the industry were to fail to commit to deliver PensionClear then, such is the strategic importance of savings (to fund investment and provide retirement incomes), the state should commission it. Development and subsequent operation should then be performed by private sector contractors, not least because the state has hardly covered itself in glory when it comes to delivering IT projects, albeit that PensionClear would not require the development of any innovative technology. The project should therefore be considered low risk.

Proposal 12: The DWP should “invite” the industry to build PensionClear to a consumer-centric specification. It should then be operated, by the industry, on a not-for-profit basis, as a mutual organisation adhering to the principles of a public service. If, within a given timeframe, the industry were to fail to commit to deliver PensionClear then the DWP should commission it.

(b) Who pays?

Ultimately it will be consumers who bear the cost of building and operating PensionClear. Exactly how the initial construction costs would be recouped depends upon who builds it. Ideally, it would be the industry (perhaps encouraged by the prospect of retaining some control): its costs would then be recouped from income received from the users of PensionClear’s services. If, however, DWP had to step in, its costs should be recouped through a levy on the industry: either way, PensionClear’s construction should not be considered a public spending commitment.

(c) On-going pricing

State-guided pricing to use PensionClear may be appropriate, and this could include a flat rate membership fee, so that the more customers an aggregator has, for example, the lower the per capita cost.

A mechanism for apportioning costs would have to be worked out, but this should take into account that PensionClear should create costs savings for both the industry (fewer dormant pension pots to administer) and employers. The costs of authentication and identification, governance and regulation would have to be quantified and apportioned. Crucially, DWP in particular, should not lose sight of the benefit that PensionClear would bring to society: larger pensions (care of economies of scale and lower costs).

PensionClear's income and costs would have to be fully disclosed, not least to ensure the preservation of its not-for-profit status.

Proposal 13: The cost of building PensionClear, and its subsequently operation, would inevitably fall upon those who use it: the consumer. If the DWP were to finance PensionClear's construction, it should recover its costs through an industry levy.

(d) Governance

PensionClear, incorporating PensionData (the central database), should be overseen by a Board of public interest directors, the majority of whom (including the Chair) should be independent of both the industry and politics.

(e) Encouraging industry participation

The industry (including the aggregators) may be persuaded to build PensionClear, but would it be used? If participation were slow, the "first movers" could consider following a strategy of being Nice, Retaliatory, Forgiving and Clear: see Appendix III.

If this were to fail, participation in PensionClear could, for example, be made a pre-condition for providers' pension products being eligible to receive tax relief on contributions (a major lubricant of the industry). More simply, the Government could demand mandatory participation, to an agenda set by the DWP. This would ensure that no industry provider could deny any consumer the opportunity to make use of PensionClear.

Proposal 14: No consumer should be denied the opportunity to make use of PensionClear. If the industry were to fail to facilitate this, then participation, by all industry providers, should be mandatory.

8.4 Physical and virtual aggregators

(a) A licenced (i.e. regulated) market

Ideally, a range of competing commercial interests would develop their own aggregation vehicles to transact with PensionClear. They should be licenced (by TPR) to ensure that they adhere to the DWP/TPR quality standards, not least to engender consumer trust. If an aggregator were to fail to perform appropriately (perhaps by reference to some Key Performance Indicators), it should lose its licence.

Proposal 15: All physical and virtual aggregators making use of PensionClear's services should be licenced by The Pensions Regulator, to ensure that they adhere to DWP/TPR quality standards.

(b) Pricing

Each aggregator should be free to determine its own pricing architecture, albeit that it would probably be influenced by PensionClear's pricing policy. Pricing should be absolutely transparent but, as is the case for auto-enrolment schemes generally, regulation could provide for the capping of administration charges, with exit charges (i.e. in respect of a user moving to another aggregator), for example, prohibited.

(c) Aggregator design: simplicity is essential

To be effective, an aggregator has to be simple to use, albeit that it could house considerable complexity "under the bonnet", provided that this is not at the price of reliability.[37] It would need to communicate with PensionClear, harvesting and delivering data using standard templates, incorporate operational flexibility (to add and remove pots, and other assets) and issue transfer instructions. Designers of virtual aggregators, in particular, should not lose sight of the core objective: to encourage consumer engagement.

Virtual and physical aggregators could, of course, be one vehicle performing both services.

(d) Off-the-shelf or new build?

Individual and corporate wraps, or platforms, already act as virtual aggregators, but their product range is limited. Other products could be added, but these may not benefit from live data feeds (fund values, unit prices etc.). IFA back office systems providers (notably Avelo and Intelliflo), serving

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[37] Apple's Ipod is a good example of offering a simple user interface, with the underlying operational sophistication hidden from view.

platforms and others, offer a more comprehensive virtual aggregation service, and already execute transactions using straight-through processing (STP). But these too are limited to whatever data feeds the providers make available to them.

Data feeds aside, technology solutions are constantly evolving: enhancing existing back office systems to serve consumers, via virtual aggregation portals, should not be an insurmountable challenge. This could include a broader product range (to include pension products) and an ability to communicate with PensionClear (including transfer instructions), and perhaps even the automated rebalancing of portfolios via live links to trading platforms (which would, admittedly, make life difficult for individual wrap platforms).

(e) Aggregation: delivery prioritisation

Virtual aggregators would be easier to deliver than physical ones. In addition, physical aggregation (to ensure funds are maximised) is most important at the time of decumulation, i.e. *later*. Given this, it may make sense for the DWP to encourage the industry to build its virtual aggregation capabilities first. In the meantime, small pots would stay where they are, but people would have visibility of their savings so engagement would rise, leading to additional retirement saving. Thereafter, the focus could move to physical aggregation, which would take more time to deliver, and change the industry in a more fundamental way.

8.5 Does delay risk Balkanisation?

Whilst a phased introduction of aggregation may be appealing, auto-enrolment is up and running, spawning millions of small pots over the next few years, and with short service refunds abolished from 2014, the risk of small pot gridlock is rising. In addition, the more time that passes without an operational pot consolidation service, the greater the risk that there could be a proliferation of different transfer approaches, based upon incompatible standards. These could emerge from within the industry, or from outsiders, perhaps utilising innovative, disruptive technology. A single, nationwide, transfer service, embraced by the whole industry, is more likely to be in the consumer's interest.

8.6 Proof of concept: the state could lead

The private sector will take years to establish PensionClear and its arena of aggregators. In the interim, the state could demonstrate a "proof of concept" by enrolling all local government employees into their own virtual aggregator, followed by a gradual expansion of its capabilities. Phase One could enable them to view their occupational pension entitlement[38] combined with their state pension accruals. In Phase Two any private pension provision could be added to the portal, and in Phase Three employees (past and present) could be empowered to move their pots to other aggregators, once PensionClear were operative.

[38] The funded Local Government Pension Scheme (LGPS).

CONCLUSION

Pension pot consolidation is on the agenda partly because the industry does not share a common purpose with consumers. It rarely takes *voluntary* steps that show that it is actively considering the question “what is best for our customers, rather than ourselves?”

Realising the vision of a central clearing house for pension pots and other retirement savings products, residing within an arena of competing aggregators, would deliver significant bargaining power to consumers. Physical aggregators would facilitate scaling up, and consumer portals (i.e. virtual aggregators) would inform, encouraging consumer engagement.

Together, aggregators and a clearing house could dramatically improve the consumer’s experience of dealing with the industry. The allied simplification and standardisation runs contrary to the industry’s natural instincts, but not necessarily its long-term interests. The subsequent rebuilding of consumer trust could result in improved business volumes and, ultimately, larger retirement incomes.

In the meantime, the DWP's pursuit of PFM is a sideshow relative to the requirement for aggregation. That said, PFM could operate alongside aggregators, with people running two pots; PFM when it is a better buy, alongside an aggregator when it is not (the two being merged prior to annuitisation). This approach would spread risk, as well as acting as an incentive for the PFM-providers to match the aggregators' pricing.

APPENDIX I

Pension pot consolidation via PFM

The DWP's key proposals for creating a system to consolidate small DC pots are as follows:

- automatic transfers to apply to all members moving between workplace money purchase (DC) schemes;
- a pot will be eligible for automatic transfer either once all contributions have ceased and the individual has left employment or once all contributions have ceased for a prescribed period;
- a pot will be eligible for automatic transfer as long as it was created after a certain date;
- the pot size limit will be £10,000 with a requirement on the Secretary of State for Work and Pensions to review the limit and revise it, if appropriate;
- there will be an option for members to opt out and leave their pension pots in their previous employer's scheme,

retaining the right to initiate a transfer to an alternative pension arrangement;

- the DWP may prescribe standards for automatic transfer schemes;
- the DWP will work with interested parties to develop a transfer process based on either a pot-matching solution involving an IT system or a member-driven approach using a "Pensions Transfer Information Document (PTID)";
- regulation will specify what information should be given to the member, and by whom, so that the member is properly informed about the nature of the transfer process, and the effects it may have on their benefits;
- TPR will be the main enforcement body for the automatic transfer process; and
- the approach to regulation would be aligned with the overall regulatory approach for DC pensions schemes (currently under consultation). Details of the requirements and penalties for breaches would be set out in regulation.

As an aside, the DWP has proposed, alongside PFM, that short service refunds be withdrawn for those in money purchase schemes from 2014, thereby ensuring that the pot is preserved when a worker leaves an employer.

APPENDIX II

Technical issues to be addressed (not exhaustive)[39]

Systems/Processes/Controls

- Who owns/is responsible for maintaining PensionClear
- Software requirements, including licences
- Access rights
- Business continuity
- Who is responsible for reconciliations/financial controls
- Approval/collection/allocation of charges
- Timescales and responsibility for monitoring
- Standard file format requirements
- Unique identifiers required – fields incorporating individual/employer/provider identifiers

[39] With thanks to Philip Briggs and Mark Taylor of Baker Tilly.

- Complex logistical aspects of interfaces
- Data security and integrity checks
- Eligibility checks
- Error rectification procedures

Individual

- Lost documentation
- Indecision
- Enquiries/dispute communication and resolution procedures

Employer

- Lost documentation
- Errors in information uploaded
- Software interface costs
- Responsibility for operation
- Administrative burden
- Enquiries/dispute communication procedures

Products

- Consistency
- Compatibility

Providers

- "Know Your Client" Anti Money Laundering procedures
- Service Level Agreements

APPENDIX III

Encouraging collaboration: be Nice, Retaliatory, Forgiving and Clear[40]

Achieving behavioural transformation across the industry is an exercise to be played out over an extended period; it cannot be shoehorned into a one-off, "big bang" initiative.

An alternative strategy, as described by the political scientist Robert Axelrod, is for one or a small group of companies to take the lead by being "Nice, Retaliatory, Forgiving and Clear". In the retirement savings context, the approach could be as follows.

(i) Individual industry participants start by setting an example, by changing the way they themselves do business. This could include establishing a set of guiding principles, ideally endorsed by consumer groups (but not by industry

[40] After Robert Axelrod; *The Evolution of Cooperation,* 1984. This approach was developed by Michael Liebreich (CEO of Bloomberg New Energy Finance), in the context of climate change*; How to Save the Planet: Be Nice, Retaliatory, Forgiving & Clear,* September 2007.

representative bodies, politicians or regulators). The leaders subsequently encourage other industry participants to make similar unilateral commitments.

(ii) The leaders should be publicly scathing of those who refuse to take action ("free riders").

(iii) If others subsequently change course, the leaders should publicly acknowledge that they have done so and build bridges with them (by, for example, inviting them to adopt standardised documentation or sharing technology).

(iv) The leaders should be absolutely clear, up-front, about their direction of travel and how they are going to behave (there is no advantage to be gained through obfuscation).

Industry participants should be concerned that the longer they continue to prevaricate, the less time, credibility and energy they will have to devote to alternative approaches, such as Axelrod's. Furthermore, the longer they ignore consumers' clamour for genuine transparency, for example, the more they will look quixotic, self-indulgent or cynical… and risk the wrath of those politicians who want to establish a savings culture.

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The DWP is right to be taking steps to facilitate pension pot consolidation, thereby delivering economies of scale to the individual (leading to higher retirement incomes and lower welfare costs).

But the DWP's "pot follows member" (PFM) approach lacks ambition. This paper argues instead for a central clearing house for pension pots. This would deliver significant bargaining power to consumers and enhanced control over their own assets. Physical aggregators would facilitate scaling up, while secure access to easy-to-use websites would let consumers see and control their sources of retirement income (including their state pensions).

These reforms would help to rebuild consumers' trust in the industry, and catalyse consumer engagement with retirement saving. The industry would also benefit, through lower costs and, ultimately, improved business volumes.

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