# Clearing the road to reform

> An efficient central clearing house will be imperative to realising the proposed pot for life system, but how will it work and what challenges need to be overcome? Jack Gray investigates

> **Summary**
> • The government has proposed a 'pot for life' model for workplace pensions in the UK.
> • Initial industry reaction has been mixed, with many raising concerns over the feasibility of such a large undertaking.
> • A central clearing house is required to ensure people's pension contributions are paid to the correct provider.
> • Its construction will be a mammoth task and could be the deciding factor in whether the proposed system succeeds or fails.

The biggest shake-up to the workplace pensions landscape since pensions freedoms could be on the horizon after the Chancellor, Jeremy Hunt, launched a consultation on a potential 'pot for life' model for occupational pensions in November. Under the proposed model, pension savers would be given the option to ask a new employer to pay their pension contributions into their existing pot, allowing individuals to move towards having one pension pot for life. In theory, this would solve several issues plaguing the pensions market, notably the number of small deferred pots being built up and potentially lost.

However, the road to reform is littered with obstacles. Changes would be needed across the workplace pensions landscape, from employers to administrators, to make pot for life a reality. A key cog in the pot for life machine would be a central clearing house, which would ensure workers' contributions are paid into the correct scheme in the right amounts. This will be no easy task, and the realisation of a pot for life model could hinge on how well the obstacles to its creation are cleared.

## The importance of efficiency

The importance of a robust and effective clearing house for the proposed pot for life model is clear, with Pensions and Lifetime Savings Association deputy director – policy, Joe Dabrowski, describing it as "crucial". "Any clearing house model must prioritise robustness and data protection to instil confidence and safeguard savers' data, and reduce an otherwise very large, anticipated burden for employers who would have to facilitate the model on behalf of their employees," he notes.

This sentiment is shared across the industry. Barnett Waddingham partner, Paul Leandro, says it is "critical", as without it the burden on employers would be insurmountable and the model would fail, while Now Pensions director of public affairs, Lizzy Holliday, calls it "essential" to ensuring auto-enrolment (AE) remains 'automatic'.

"A strong system infrastructure is an absolute necessity for a pot for life model," concurs AJ Bell head of public policy, Rachel Vahey. "Asking employers to pay AE contributions to two or many more providers is going to create an enormous administration headache for them. They will have multiple providers to communicate with each month, enrol members into, and sort out any administration niggles. Getting the right contributions to the right provider for the right person is an absolute minimum."

Getting the clearing house right is also imperative to ensuring people's trust in the system, and any kind of data breach or misallocation of pension contributions would potentially be catastrophic for the industry's reputation.

## Laying the foundations

So, what exactly needs to be created to support the pot for life model? "The idea of a pot for life system is intriguing but requires a great deal of groundwork before it is made a reality," states Standard Life managing director for workplace, Gail Izat. "Before the scheme can be implemented, other infrastructure like pension dashboards and small pots work needs to be in place."

Leandro highlights three 'core characteristics' for a UK clearing house to be successful: It must use a system that directly integrates with company payrolls; be simple to use, and straightforward to learn, install and implement; and be robust and efficient.

Building on the back of other systems, namely pensions dashboards and the default small pots consolidator, could be imperative in the clearing house's construction. However, as Vahey points out, pensions dashboards are only partly built and the clearing house to support small pot consolidation is yet to make it to the design stage. "We have a long way

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to go until we can realistically think about taking this forward," she adds.

The clearing house will also need to have a reliable form of national identity number, says Izat, but she notes that as it is possible to have been issued more than one national insurance number in the UK due to some having emergency national insurance numbers during their careers, this is not a viable option.

The Lang Cat director of public affairs, Tom McPhail, adds: "An interface *[is needed]* to allow employers to make a single bulk payment and data upload to a single counterparty, which could then be responsible for remitting payments and data to multiple pension providers. There is also the question of AE compliance and TPR reporting, which would have to be built into the system.

"The creation of a standard account identifier protocol would not only help

deliver a lifetime provider, it could work with dashboards and pot consolidation and could radically simplify and speed up pension transfers."

However these foundations are built, Dabrowski argues that a great deal more evidence gathering and cost benefit and policy analysis is needed to understand whether pot for life would be beneficial for savers before operational issues or clearing house design are thought about.

## Working in practice

To fully understand how a working clearing house would sit in the pot for life system, it is important to consider how it would operate in practice. While work on hypothesising the potential benefits of pot for life and how a clearing house could be structured are obviously imperative, there also needs to be a long-term vision of how the clearing

house would sit in the regulatory and operational environment.

"The clearing house would be responsible for taking in contributions from multiple employers over an individual's career, via payroll systems, and making sure that they are sent on to the individual's pot for life," Izat explains.

"Without the clearing house, the system would be dependent on individuals informing their employers, both big and small, of the payment details for their pension scheme and on employers making multiple payments via payroll to different to providers and schemes, multiplying the chances of error and potentially the cost."

Dabrowski says that crafting the clearing house would demand a meticulously devised plan, centring on the architecture, which "cannot simply be ported across" from pensions

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dashboards, and data standards for receiving and distributing contributions.

"Any model would also need to work with the final recommendations and regulatory requirements of the Department for Work and Pensions' proposed default consolidator solution for small pots – exploratory work on which is just beginning," he continues. "Moving forward with future changes will rely on resolving these foundational and significant operational changes first, doing anything else would be premature and highly risky." Vahey notes that the government is focused on consolidation

to support increased private equity investment, but questions whether pot for life is the best outcome for members, arguing that it risks creating an environment where there are fewer pension schemes competing against each other, and where the barrier to entry to the market will be high: "To compete against these legacy providers, new companies will need substantial funds to entice in new members," she says. "A market where there are fewer disrupters or new entrants easily moves the power dynamic away from the individual."

### Clearing the obstacles
An undertaking of this size is unsurprisingly fraught with challenges that need to be overcome. The scale of the operation is a challenge in itself, with Izat highlighting the Australian experience as to just how large and complex a project pot for life and required clearing house will be. "The main challenges are around the build of the architecture itself, data cleansing, data security and identity verification," she notes. "A huge degree of data cleansing will be done in getting ready for pensions dashboards."

However, with pensions dashboards, data will not be held centrally and relies on pulling data from providers and schemes when requested by individuals, while the clearing house will need to hold data centrally to identify individual pots for life and pass on contributions, which Izat says makes getting cyber security right even more crucial.

"Any system also needs to be able to work in sync with other parts of the infrastructure, such as dashboards and default consolidators to improve the transfer process for those looking to move their pension pots," McPhail notes.

Holliday adds that practical elements include the need for a unique identifier, given the high degree of certainty that would be needed to match individuals to the correct lifetime provider and pot,

given the employer won't have that direct relationship with the scheme.

Leandro agrees, noting that national insurance numbers will not be sufficient for this. He also highlights tax as a potential issue: "We currently apply tax relief in different ways. The tax system would need to be made consistent. Will this be the catalyst to move from the current Exempt-Exempt-Taxed (EET) model to a Taxed-Exempt-Exempt (TEE) system?"

Meanwhile, Dabrowski states that creating a clearing house throws up several challenges, including addressing the uniqueness of the UK workplace and pension system, as well as keeping up with the ever-shifting standards and rules. "Evidence from other countries indicates it is very costly, for both government and industry," he adds. "The rapidly evolving nature of the market, as well as the unknown impact of policy changes already in train, means designing a 'fit for purpose' system today for tomorrow's world is next to impossible."

Additionally, the governance and relationships of the new entity with providers, schemes and employers all need to be considered, Holliday argues.

"Current legal obligations, liability and compliance models will need to be reviewed," she continues.

"Political consensus would also be needed, given that a vision of this type would take a long time to bring into delivery, and as it constitutes a significant shift from the current system, which will create uncertainty for the market."

If the government pushes ahead with pot for life and clearing house, a lot of work will need to be done across all corners of the industry and government. It appears that the industry needs a lot of convincing that this could be a success, but only time will tell whether this was a short-lived idea or the biggest shake up to the pensions landscape in a decade.

❯ **Written by Jack Gray**