Small Pots Policy Team
Department for Work and Pensions
Caxton House
Tothill Street
London SW1H 9NA

By email to: smallpots.policyteam@dwp.gov.uk

5 September 2023

Dear Small Pots Policy Team

**Ending the proliferation of deferred small pension pots: USS response**

The Universities Superannuation Scheme (USS) welcomes the opportunity to respond to this consultation. We are mindful that USS is very different to most UK pension schemes, given its size, resources and hybrid nature. However, proposals that might be appropriate in relation to pure defined benefit (DB) or defined contribution (DC) schemes may not be appropriate for (or perhaps even potentially detrimental to) members of schemes like USS, where members will only have DC benefits in addition to their DB benefits. Thus we hope our response is both useful and taken forward when considering the final policy approach.

**About USS**

By way of introduction, Universities Superannuation Scheme (USS) was established in 1974 as the principal pension scheme for universities and higher education institutions in the UK. We work with around 330 employers to help build a secure financial future for 528,000 members and their families. USS is primarily a DB pension scheme, we are one of the largest pension schemes in the UK, with total assets of around £75.5bn (at 31 March 2023); this includes £27.7bn (at 31 March 2023) of private market assets (the default fund in our defined contribution or DC section also includes a significant allocation (c.20%) to private market assets). The scheme remains open to future DB accrual for both new and existing members, with members also able to build up DC benefits. As a non-associated multi-employer scheme offering DC benefits USS is an authorised Master Trust.

The trustee of USS is Universities Superannuation Scheme Limited (USSL), a corporate trustee which provides scheme management and administration from its offices based in Liverpool and London. The trustee is regulated by The Pensions Regulator and has a primary responsibility to ensure that benefits promised to members are paid in full on a timely basis.

USSL delegates implementation of its investment strategy to a wholly-owned subsidiary – USS Investment Management Limited (USSIM) – which provides in-house investment management and advisory services. USSIM is authorised and regulated by the Financial Conduct Authority.

USSIM manages between 60% and 70% of the investments in-house and appoints and oversees external investment managers to manage the rest. This allows the investment approach to be tailored to the scheme's requirements and provides us with a unique perspective compared to many other institutional investors. USS aims to be an active, engaged, long-term and responsible owner of the companies and assets in which it invests.

Most of the annual costs and charges on defined contribution pots are subsidised by sponsoring employers and not paid by members.

**Response**

We recognise that the proliferation of small pots is an issue that has grown since the introduction of automatic enrolment, and that within the mass AE market this is a drag on value for money.

USS is not affected in the same way as many providers, because our members build a combination of DB and DC benefits as set out above. Many of our members have small DC pots (around 21,000 (83%) of our deferred pots are under £10,000 and around 9,000 (37%) are under £1,000) , but all members accrue DB benefits also and so any DC pot is attached to a more significant DB entitlement.

We recognise the consultation is mainly focused on the challenging practical issues of facilitating small pot transfers. In principle, we agree that a central clearing house to ensure effective communication will be less burdensome to schemes, and is proven to operate well in other countries.

However, we believe there is a more fundamental issue around the inclusion of members with true hybrid benefits within the scope of this policy (we recognise there may be hybrid schemes where members may accrue only DC benefits) and have therefore sought to address this issue alone in our response in order to reflect its importance to us. Below we set out the key reasons why we believe members with hybrid benefits should be excluded, with reference to the situation at USS:

1. First, the marginal administrative burden these pots place on USS overall is low. Most administration activities, including data management, and communications would still be required after any DC transfer out and therefore savings would be limited.

2. Second, automatic or mandatory transfers out of these DC pots would almost certainly not be in our members' best interests. They would still have a USS benefit, and therefore any mandatory transfer would potentially increase the number of pensions they would need to manage. There are also a number of benefits that members have as part of our hybrid structure that would be lost on transferring out. These include:

    - Employer subsidy of both administrative and investment costs and charges - this means that, by the time they retire, a member's benefits could be significantly higher than if transferred out[1];
    - The ability to use DB and DC benefits together at retirement in ways not possible when they are held separately. When planning for retirement there is a material benefit from having the DB and DC parts within the same trust, for example when considering how much, and from where, any tax free lump sum is to be taken. At this point in time, the DB and DC benefits interact with each other in a way that benefits outside the trust cannot; and
    - Due to the hybrid nature of the scheme, with a variable salary threshold above which

[1] Over a 30 year timespan and assuming investment returns of CPI+3% annually, a 0.5 percentage point increase in charges could result in a deferred pension that is around 16% lower. It is unclear to us how any central consolidator if it were subject to the FCA's consumer duty could therefore accept such a transfer from USS.

members start building up DC benefits, members frequently start and stop making DC contributions to the DC section, whilst continuously contributing to the DB section. In addition, many of our deferred members rejoin – around a quarter of our joiners each year.

3. Third, we understand that part of the reason for consolidating small pots is to drive better outcomes for pension savers, as outlined in the wider package set out by the Chancellor in his Mansion House speech. The DC part of the scheme already allocates 20% to alternative assets, as part of a balanced portfolio, which can increase overall returns for pension savers. Transferring members out of a DC arrangement that already meets many of the objectives outlined in the Mansion House speech would seem counterintuitive and potentially reduce our members' ability to invest in illiquid assets.

As a result, we believe it would be detrimental for our members with small pots to be included in the proposed consolidator or 'pot follows member' approaches. Whilst we are aware that these considerations are not typical of the pensions market, we strongly believe that the simplest and most appropriate solution will be to exclude schemes offering true hybrid benefits from any requirements to cede (or receive) transfers under these automatic solutions.

We would be very happy to discuss this further and look forward to further developments.

Sincerely yours

**Richard Williams**
**Head of Corporate Communications and External Affairs**