# Small pots, big problems


**Summary**

• Small pots are inconvenient for savers, because they can be rapidly eroded by charges, and for providers, as the costs of administration outweigh the size of the investment.

• Auto-enrolment has caused an acceleration in the number of small pots, while the Covid-19 pandemic could exacerbate the problem.

• There are a number of proposed solutions, most of which involve either forcible consolidation or increasing savers' control and awareness of their pensions.


**Small pots are a hot issue in the ever-evolving pensions universe. Duncan Ferris delves into the world of small pots to find out why they are such a problem, what caused them and what can be done to resolve their issues**

The fact that something is small does not mean it cannot cause trouble. A cut in the roof of your mouth. A crack in a Boeing 747's windshield. A toddler throwing a wobbly in the supermarket. All of these examples can of course lead to unimaginable levels of chaos and the issue of small pension pots might have that same potential.

The Pensions Policy Institute (PPI) warned in July that there could be as many as 27 million small deferred pots in the UK by 2035, up from eight million in 2020, adding that this would

dwarf the nine million active pots in 15 years' time. This has thrust the issue into the limelight as it demonstrated that, although they may be little on their own, small pots could soon cast a large shadow in the pensions landscape.

**Why the fuss?**

The first port of call is to establish why it would even be a problem for both savers and providers that there are a great deal of small pots floating around.

Starting with savers, Aegon head of pensions, Kate Smith, says: "Small pension pots can be difficult for people to keep track of, especially at the start of someone's career. If people have had numerous jobs, they might have numerous small pots scattered with different pension providers and different pension schemes."

Aon partner and head of UK retirement policy, Matthew Arends, points out that there is also the risk that small pots can be of "eroded over time", particularly in situations where "the costs and charges levied by the provider are measured in pounds and pence (as opposed to a percentage of the pot)".

Pensions and Lifetime Savings Association head of defined contribution, master trusts and lifetime saving, Lizzy Holliday, agrees, stating: "The key risks from small pots are the erosion of a pot due to fees, that people may lose track of small pots over time and that having multiple pots at retirement may cause confusion or drive certain economically inefficient behaviours."

She adds: "Similarly, engaging with, or receiving communications from, numerous schemes potentially adds to the feeling of complexity or lack of control for the individual regarding pensions savings."

Mercer partner and director of consulting, Brian Henderson, explains that this complexity can be further exacerbated in situations where "different providers have different charging structures", noting that this would be an especially "inefficient" way of managing retirement savings.

For providers the issue creates problems as well, as Arends explains: "From a provider perspective there are financial challenges associated with administering small, deferred pots as the costs are disproportionate to the amounts of money invested."

PensionBee head of corporate development, Clare Reilly, concurs, adding: "PPI data shows the average pension pot size in master trust schemes in 2020 is £1,000. PPI modelling also shows that for a provider to break even on a pot and charge 0.5 per cent annual management charges, the pot only becomes financially sustainable at £4,000."

**Cause**

Once some of the problems caused by small pots have been examined, it is key to understand what factors have catalysed their proliferation. In this case, there is a clear prime suspect.

Arends explains: "Auto-enrolment has been the biggest contributor to the rate of increase in small, deferred pots. This most often arises when individuals opt out but do so shortly after the window for a refund and so end up with a small residual pot."

He adds that this is particularly problematic as it both "brings into question whether the original policy aims of auto-enrolment are being fully realised in practice" and could "lead to distrust of the pensions industry" because of savers receiving poor results from many small pots.

Reilly points out that auto-enrolment also gives workers a new pension pot each time they start a new job, meaning that "people can end up with many tiny pots that they lose track of or become an administrative burden to maintain".

She adds: "Another feature of the system is that even if an employer enrols an employee with a provider they already have a pot with, it won't necessarily be consolidated together. That means one person can have many abandoned small pots with the same provider. This occurs with some of the big auto-enrolment providers and needs to be urgently resolved as it is exacerbating the problem."

Reilly marks out job switching as a further issue, commenting that "the labour market looked very different when the auto-enrolment system was being designed".

She explains: "Millions of people are in insecure work due to temporary or casual work contracts, agency work or the gig economy. People are moving in and out of the labour market in a way that wasn't anticipated. It adds to the issue of small pots as people temporarily working for an employer for limited periods of time, even a few months, will each time be enrolled in a new pension scheme."

Unfortunately, this could become even more pronounced as Covid-19 continues to ravage the economy.

Smith explains: "The job retention scheme originally protected auto-enrolment by covering employers' auto-enrolment minimum contributions up to a capped salary. This meant furlough workers were earning less and potentially saving less in a pension.

"As the job retention schemes come to an end, it's expected there will be a rise in unemployment, which has the potential to exacerbate the small pots issue."

**Action**

As small pots are creating a problem, some steps are already being taken towards dealing with the problem and some others can be taken by providers and organisations at an individual level.

Smith states: "The Department for Work and Pensions has set up a working group, with expert panels, to look at possible solutions to help deal with the proliferation of small pension pots. It's likely that a range of solutions will be needed including the greater use of guidance, making transfers simpler, consolidation pension schemes and refund of micro small pots."

Henderson comments: "The anticipated arrival of pensions dashboards will help individuals see all their pensions in one place and potentially drive consolidation. The ability to consolidate and sweep up small deferred pots should be one of the by-products of the dashboard and the industry should be ready to support such activity."

Holliday acknowledges that industry members and employers can "seek to communicate with savers on the importance of considering moving their pot when they come to change jobs", but concedes that past attempts at this kind of project "have not had transformative impacts, and we think the focus for the solution needs to shift".

Smith agrees, stating that "providers need to engage with pension savers to highlight the benefits of consolidation" but says it "needs to be easier to consolidate small pension pots".

**Future steps**

In terms of future steps that can be taken, there is a limited amount that the industry can do in the current climate, as Arends states that it is "incumbent on the government to facilitate consolidation and identify the best way that this can be achieved from the feasible options" as "law limits refunds and requires savers consent for transfers".

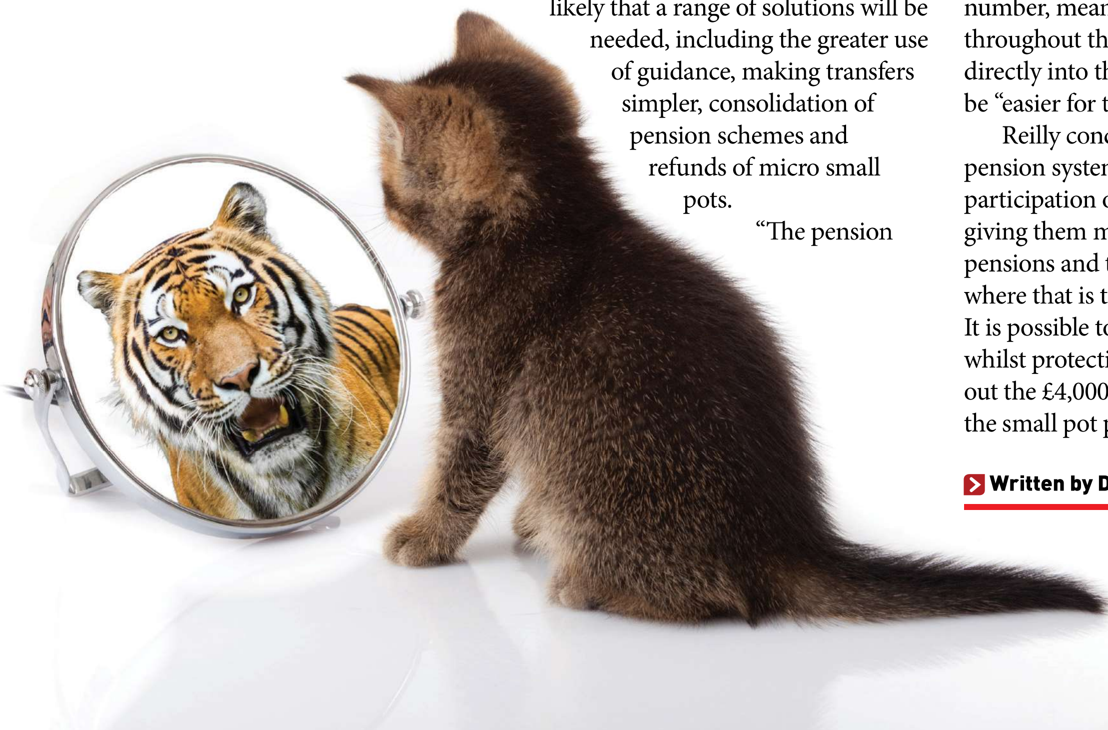
He seems to consider consolidating without saver consent to be a viable option, commenting that it could be considered where "better value is delivered for the saver" and that there could be a "robust way to assess this".

Arends states: "Our view is that a non-consent individual transfer would require assessment criteria to be established to test whether consolidation would provide better value for the saver, allowing in particular for transition costs, a comparison of the suitability and quality of funds and respective member borne charges.

"Particular care needs to be given to any arrangements carrying underpins or guarantees to ensure that consolidation does not have unintended consequences. Alongside this, we would expect the government to provide any necessary protections required by providers so that transfers without saver-consent cannot lead to claims against the providers."

Smith is pragmatic in the search for an answer and also highlights the need for legislative assistance, stating: "It's likely that a range of solutions will be needed, including the greater use of guidance, making transfers simpler, consolidation of pension schemes and refunds of micro small pots.

"The pension dashboards will help people reconnect to all their pension pots, but as this will be implemented later than anticipated, in 2023, so other solutions will need to be considered. It's unlikely that one solution will be enough to address this problem, and the government may have to legislate to help address this growing issue."



Reilly also endorses developments in the way in which small pots could be consolidated, backing the creation of a "small pot switching guarantee", which would give any pot with a value of under £4,000 "free and rapid movement around the system to enable savers to consolidate all their old small pots to the provider of their choice".

She continues: "Currently, the Pensions Schemes Act 1993 gives providers six months to release funds. To simplify the process for consumers, requests for transfers under the small pot pension switch guarantee should be completed in 14 days. Modern technology enables this. Savers are still poorly served by the fact that it can take up to two months to move a small pot out of major master trusts."

In addition, Reilly stated that savers could have a single pot registered against their National Insurance number, meaning that "every employer throughout their working life should pay directly into the same pot" and it would be "easier for the saver to manage".

Reilly concludes: "An effective pension system requires the active participation of savers, which means giving them more ownership of their pensions and the ability to consolidate, where that is the sound financial option. It is possible to consolidate pensions whilst protecting consumers by carving out the £4,000 limit for transfers under the small pot pension switch guarantee."

**Written by Duncan Ferris**