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Fixing the problem of multiple pension pots

Time to rethink workplace pensions

A research paper by Cushon
August 2023

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Foreword

Baroness Ros Altmann,
Former UK pensions minister

This timely research highlights reasons for the proliferation of people holding multiple pension pots, as well as potential reforms to help people consolidate past funds. Of course, choosing to have a spread of pension pots across different providers, assuming people have good reasons for doing so and can keep track of them, is not necessarily a concern. Some may think putting all their pension eggs in one basket is too risky. Others may want some small pots to supplement part-time work before full retirement, while retaining better options to build more pensions in the future.

However, if people just lose track of their past pension pots, or do not bother to consider whether their money is being invested in the best way, they could be losing out.

Cushon's research indicates people would like to combine their pensions – but confusing complexity, baffling jargon and off-putting paperwork stop them from taking action. Of course, there are risks in combining all one's pensions, such as giving up past guarantees, moving to a worse-value new scheme, or needing expensive advice. But the results highlight that there is not enough support to help people assess the suitability of amalgamating past pension pots.

Larger pension pots should be more efficient and cost-effective than several small pots, and the more pensions that people accumulate, the more chance there is they will lose track of them over the years. This leaves their money languishing in poor funds, reducing their future income.

Of course, the long-awaited pensions dashboard aims to alleviate this problem, as showing all their pensions in one place will help people keep track of their various funds. However, the dashboard will not address the practical difficulties of combining pension funds or assessing suitable options. There is an urgent need for improving clarity, reducing complexity, junking jargon and simplifying the transfer process to make pensions more user-friendly. Indeed, eventually people may have just one or two lifetime pensions which they take ownership of.

In recent years, multiple pot proliferation has been a growing problem, stemming from the age-old issue of inertia in pensions. Auto-enrolment is predicated on this characteristic and has succeeded because people have pensions arranged for them, rather than by them. Pension products are designed to serve a majority of people who just leave it to others to sort out their pension. This means nothing changes. In October 2021, the Pensions Policy Institute (PPI) estimated that 2.8 million pension pots, worth £26.6 billion, were considered lost. Cushon's research points to potential reforms that could significantly reduce these figures.

It is time for Government and the industry to work together to improve public awareness and capability to plan long-term savings for later life. Perhaps by introducing common data standards that would ensure easy digital access, and helping people understand and take ownership of their pensions themselves, with proper support to take actions that are right for them, including combining pensions where appropriate.

It is a real indictment of past practice that billions of pounds of hard-earned savings are left abandoned. Surely it is incumbent on Government and the industry to work together to solve this problem.

Introduction

Steve Watson,
Director of Policy & Research at Cushon

Although by accident rather than design, when it comes to one of the biggest challenges facing the pensions industry today, pension members and Government are aligned – workplace pensions do not reflect the reality of the modern workforce.

The concept of a 'job for life' has long gone and the reality is that most of us will have multiple jobs throughout our working lives; increased job mobility is here to stay. Retirement is a concept that, for many, is more likely to be a later life transition, rather than a defined event at an exact pre-determined age.

Despite these societal changes, the fundamental design of workplace pensions remains as it was many decades ago and as such no longer fits the brief. They're better aligned with the concept of a job for life and a 'cliff edge' idea of retirement i.e. I reach a certain age and I stop working.

This disconnect between the structure of pensions and the reality of modern working life has created some troubling problems and, unless they are addressed, they are going to get worse.

The first issue is that of multiple pots and abandoned pots. Every time I move jobs, my current pension pot becomes inactive, and my new employer must auto-enrol me into their pension, meaning I now have two pots. I move jobs several times, and suddenly I have several pension pots that become difficult to keep track of and manage. It doesn't take long before I forget about a couple of them, meaning I join the growing number of people who have 'abandoned' or 'lost' pots.

The 'lost' pots issue is becoming so great that the Government has now stepped in, at least for 'small pots', and is proposing to introduce an automated system of pot consolidation. Unless I opt-out or proactively select an alternative, my pot will be consolidated with my other pots. Sounds sensible in practice, but the Government is currently only focused on pots of up to £1,000. So, what about all the others?

We have called on the UK government to widen its brief from just small pots to all inactive pension pots regardless of size and value. This should also come with a requirement for pension providers to make consolidating pensions easier. This can be achieved through digitisation.

The second issue is about the validity of the term 'retirement'. People are working longer and seeing later life as more of a change in their working pattern, maybe moving to part time or changing career, as opposed to 'retiring' at a specified age. This change could be about affordability or just simply the fact that people are now able to work longer. Either way, we need to question whether 'retirement' is still an appropriate term – should we now be talking more about 'later life'?

There's no doubt that the job market has massively changed and so too have people's expectations about later life. It's time to get workplace pensions working for the modern workforce.

Auto-enrolment: a huge success but...

In terms of getting more people to save into a workplace pension, automatic enrolment (AE) legislation has been a resounding success. When the first phase of AE was introduced, in October 2012, less than half (47%) of employees were members of a workplace pension scheme; by 2021, this had surged to four in five (79%) . At the same time, the total amount being saved each year into these pensions has also soared, from £81.7 billion a year in 2012 to £114.6 billion a year in 2021 . UK pensions are now worth nearly £3 trillion.

But behind these positive headlines lies a problem. **Alongside this sharp rise in pension members and contributions, there has been an even sharper growth in the number of inactive or dormant pension pots per employee.** The way the AE regulations are designed means that whenever someone leaves a job and moves to a different organisation, their existing pension pot becomes dormant and their new employer is obliged to open a new pension pot for them.

This would not be a problem if most people still had a 'job for life' as in decades past. But in today's economy, it is not uncommon for people to change jobs multiple times throughout their career. Our own research shows that one in five (21%) of the 18- to 24-year-olds we surveyed are already on to at least their fifth job – while one in ten (10%) 35- to 44-year-olds have had at least ten jobs already.

This rise in job mobility has led to the massive growth in dormant pension pots per employee. Almost half (48%) the employees we surveyed have at least two pension pots; more than a quarter (27%) have three; around one in eight (12%) have four; one in seven (13%) have at least five pension pots; and more than one in four (28%) have so many that they have lost track.

A lack of ownership

Having many dormant pension pots adds a significant administrative burden to savers and increases the likelihood of individuals losing track of some of their pots. More importantly, it appears to exacerbate the age-old problem with pensions: a lack of ownership and engagement.

First, it is difficult to engage with your pension savings if you do not know how much you have put away or where your savings are. This is a big problem when people hold their retirement savings in several different places. More than a quarter (28%) of our respondents do not know how much money they have in all their pension pots; the same proportion (28%) confess that they struggle to remember where all their pension pots are; and a quarter (25%) say they have definitely lost track of at least one of their pension pots.

Second, having multiple pots feeds into another problem with retirement savings: people undervalue their pensions compared to their other finances, such as their bank savings and salary. We asked people how much would have to go missing from their bank account, their wages or their pension savings before they were prompted to track it down. Seven in ten (70%) told us they would contact their bank if less than £50 went missing from their bank account. An even higher percentage (72%) told us they would contact their employer if they were underpaid by £50 or less. Yet, when it comes to pensions, the numbers fall dramatically. Just one in ten (10%) people said they would bother trying to track down less than £50 worth of missing pension savings. And perhaps more concerning, almost one in twenty (4%) said they would not bother trying to track down a missing pension pot no matter how much it was worth. Clearly, there is a major disconnect here which illustrates the UK's apathy towards pensions.

So, while a retirement fund of £10,000 is worth the same whether it is saved in one single £10,000 pot or 20 pots of £500, psychologically people may place a much lower value on several £500 pots.

Figure 1.1: If money went missing from your bank account, what amount would prompt you to contact your bank to retrieve it? + If your employer underpaid you one month by mistake, how much would you need to be underpaid to prompt you to ask for the difference to be paid to you? + If you lost track of a pension pot completely, how much would it need to be worth to prompt you to track it down?

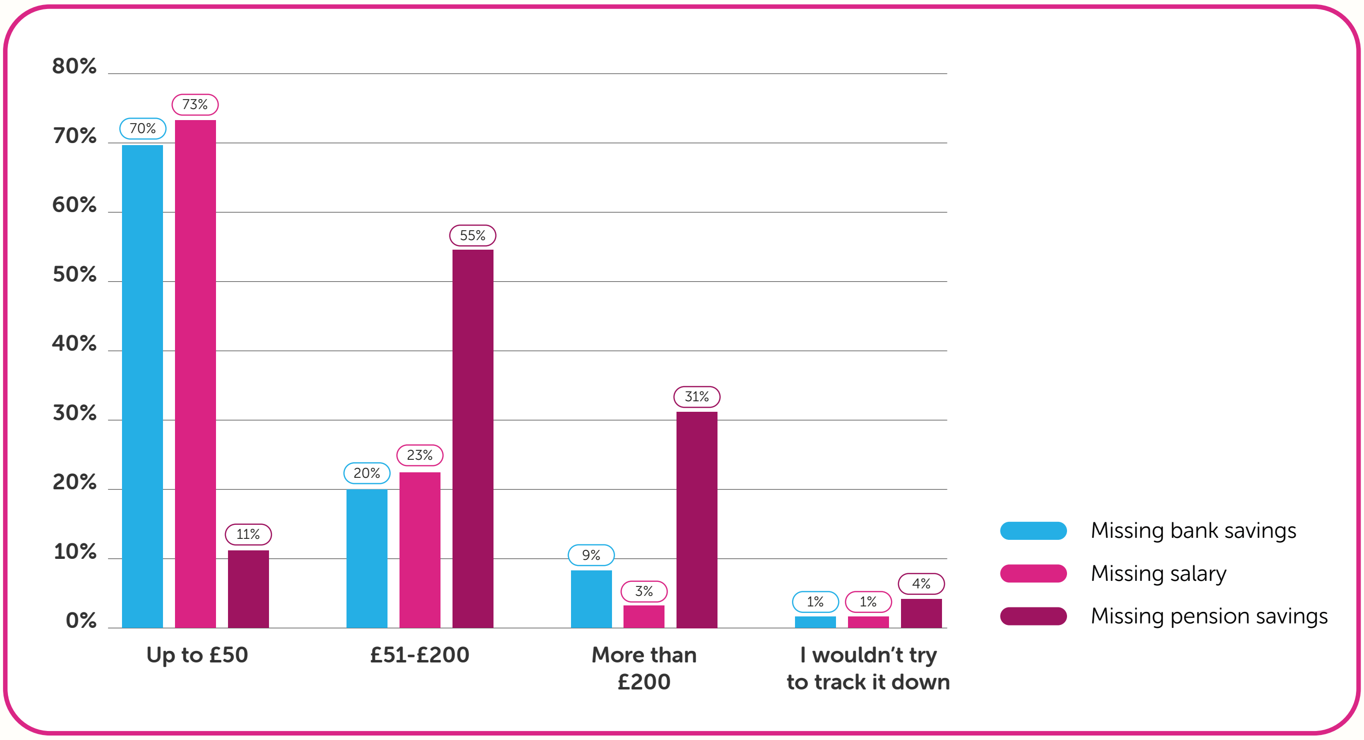
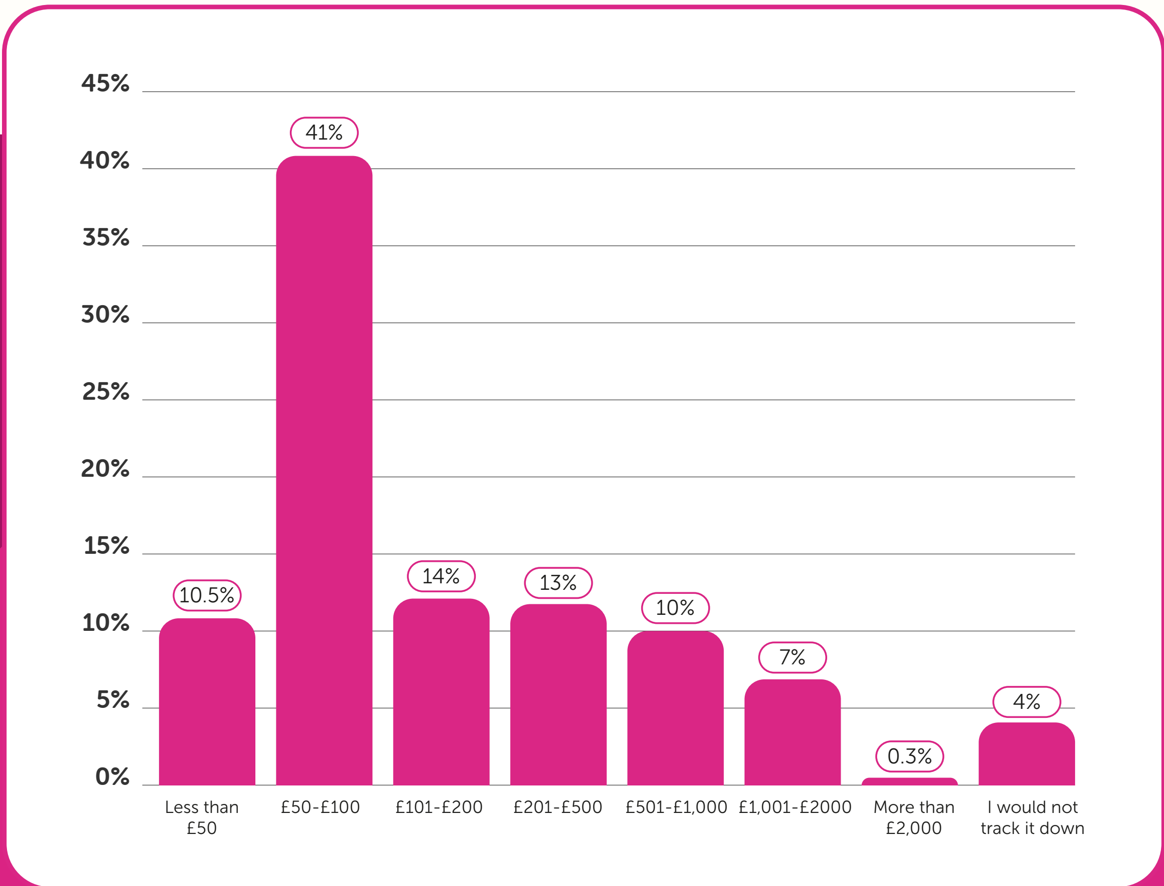


Figure 1.2: If you lost track of a pension pot completely, how much would it need to be worth to prompt you to track it down?



Fixing the problem of accidental multiple pots

Again, having multiple pots is in itself not a problem if this is what people actually want and if they keep on top of them. The problem is when people accumulate multiple pots simply due to job mobility – this is when people are more likely to lose touch with some of their pots and not know how much money they have saved.

Of course, the answer would be for people to combine all their pots. However, in reality, very few people choose to do this; among our sample, less than one in five (19%) employees say they have ever transferred one pension into another. There are several reasons why.

Less than one in five employees say they have ever transferred one pension into another.

The first issue is a lack of understanding. A third (33%) of employees told us they do not know how to combine their pension pots – while almost a quarter (23%) said they did not know that combining them is even possible.

Second, people view the process as too difficult:

Almost one in five (18%) believe it's too time-consuming to combine them; and around one in seven (15%) said there is too much paperwork involved.

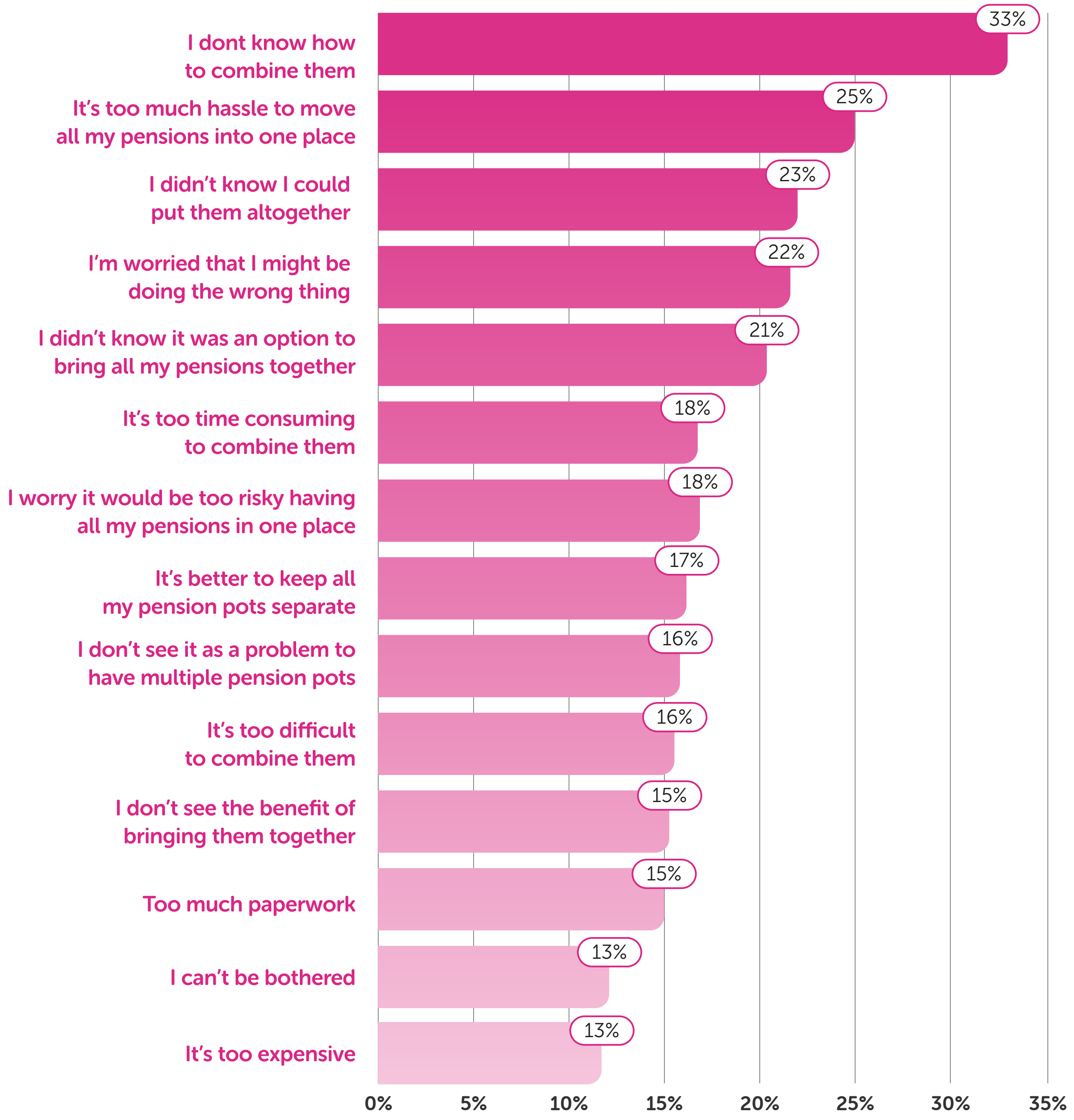
Third, people lack the confidence to make these kinds of financial decisions. One in five (22%) employees said they have not combined their pension pots as they are worried they might be doing the wrong thing, with a similar proportion (18%) worried that it would be too risky to have all their pensions in one place.

Fourth, the issue of perceived cost: one in eight (13%) employees think it's too expensive to move their pensions into one place.

And finally, there is a sizeable group of employees who would rather keep their pension savings in different places: one in six (16%) believe it's better to keep all their pension pots separate; a similar proportion (16%) do not see having multiple pots as a problem; and around one in seven (15%) do not see what the benefit would be of bringing all their pensions together.

Of course some of these concerns could be valid for instance guard rails, which can cause delays, do need to be in place to protect savers from potential scams and losing out by transferring to a bad scheme. But that's about communication and education rather than unnecessary complexity.

Figure 2: Why aren't your pension pots in one place? + Thinking about the process of transferring your pension, which of the following statements apply?

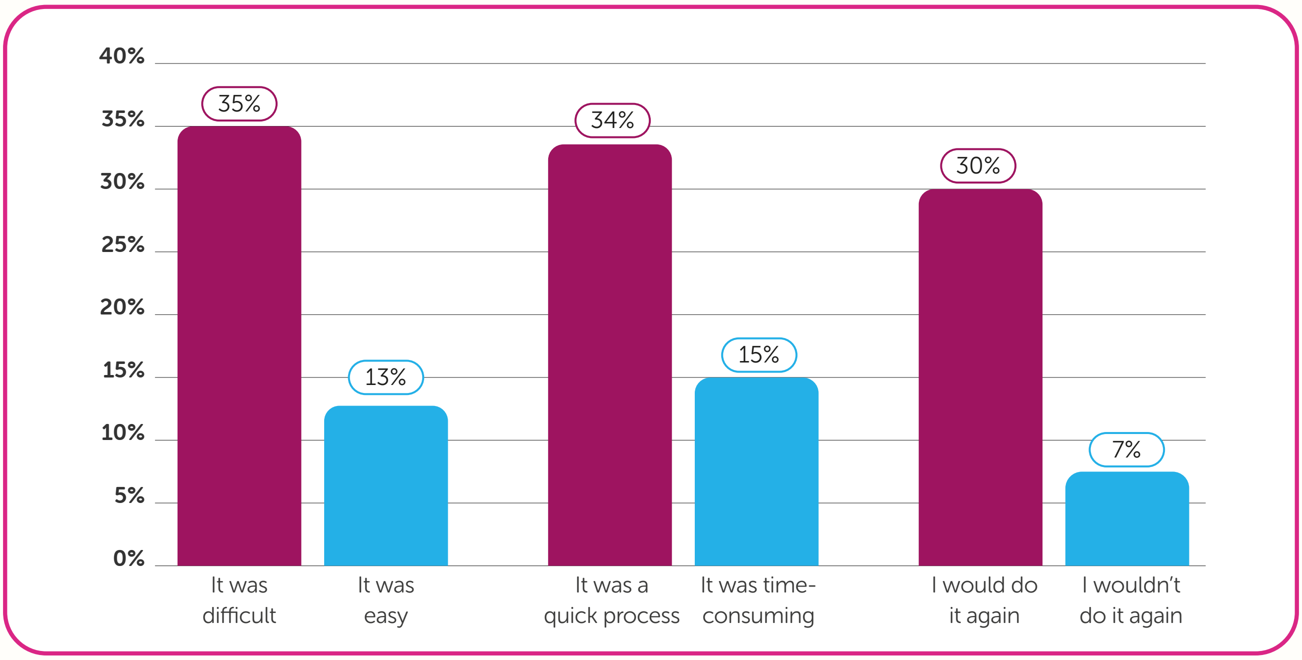


Educating employees about consolidation

This data makes it clear that the pensions industry needs to do more to educate people about how pension consolidation works. If they could get more people to combine their pensions, the process may become normalised. More and more people are now more comfortable with switching their bank account, for example. And our data also suggests that people who have consolidated two or more of their pension pots are generally quite positive about the experience.

> **Just over a third (35%) of this group said it was easy; a similar percentage (34%) said it was quick; and three in ten (30%) said they would do it again.**

Figure 3: Thinking about the process of transferring your pension, which of the following statements apply?



Simplifying the consolidation process

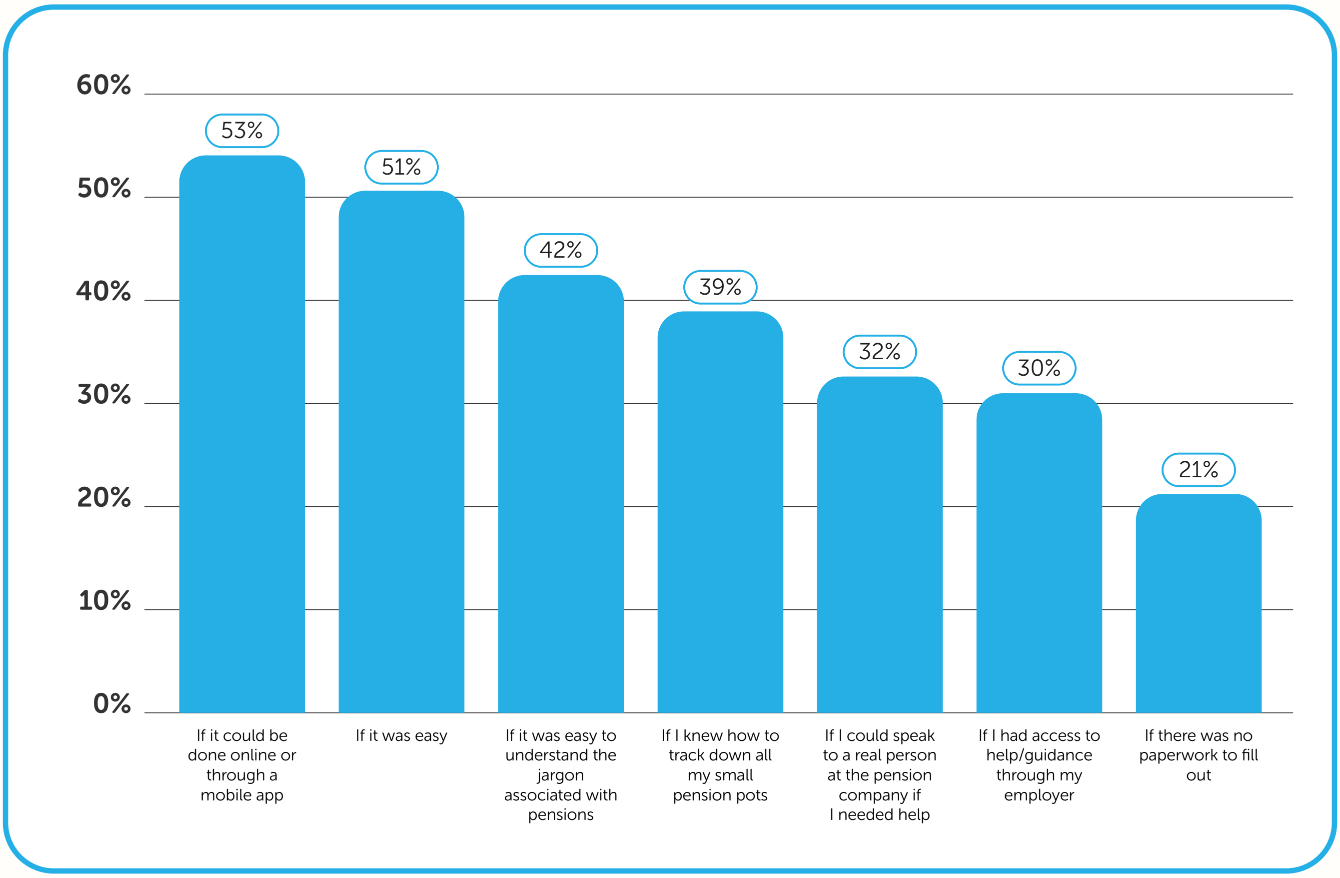
As well as educating people about the fact that they can combine their pension pots, providers also need to make the process easier.

First, providers need to make good use of technology: more than half (53%) of our respondents said it would be helpful if they could consolidate their pensions online or through a mobile app.

They also need to use plain English: more than two-fifths (42%) of employees would find it helpful if it was easy to understand the jargon associated with pensions.

Finally, employees also need support: a third (32%) would like to be able to speak to a real person at the pension company if they need help, and a similar percentage (30%) would like access to help or guidance through their employer.

Figure 4: What, if anything, would help you to get all your pensions in one place?



Pensions Dashboard

A stepping stone to getting more people to combine their pension pots is to create an easier way of managing multiple savings. The UK Government is currently rolling out a digital scheme that aims to do just that.

When it does finally launch, the 'Pensions Dashboard' programme will allow people to view all their various pensions, including their State Pension, in one place. And employees are positive about this prospect: almost nine in ten (88%) of our respondents believe the pension industry should work together to provide a single dashboard where they could see all their pension pots.

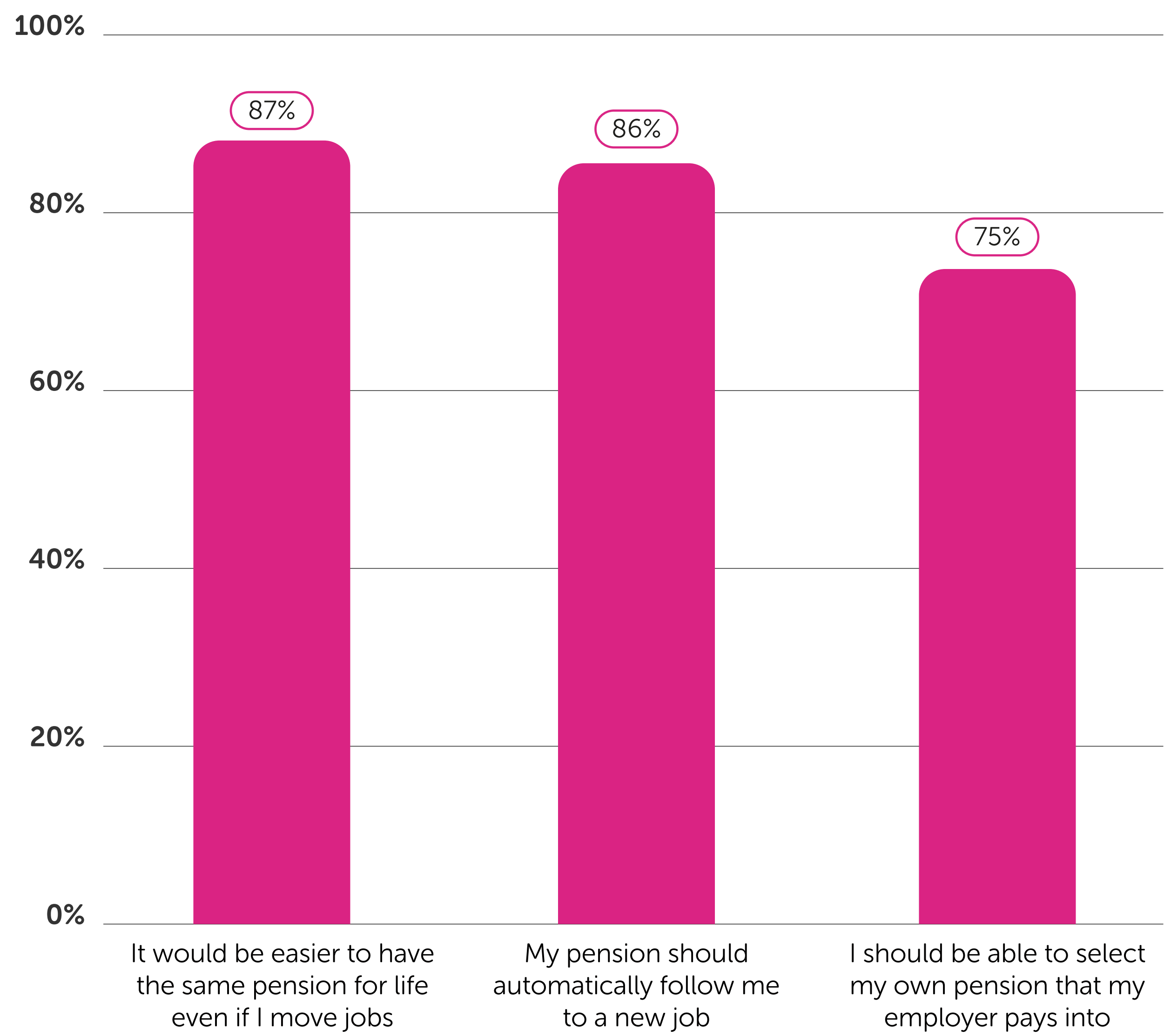
However, this platform is still some way off and doesn't provide a consolidation mechanism, only a look/see function.

A single pension pot for life

Of course, it would be helpful if employees did not have to accumulate new pension pots whenever they change jobs. We believe it would be helpful to overhaul the current system so that employees have a single pension pot that belongs to them and which they 'take with them' whenever they move employers. Their new employer then contributes to this pot, rather than enrolling them into a new scheme.

There is a great deal of support for this kind of approach among our sample. Almost nine in ten (86%) respondents believe their pension should automatically follow them to a new job, and a similar proportion (87%) think it would be easier to have the same pension for life, even if they move jobs.

Figure 5: To what extent do you agree or disagree with each of the following statements?



87%

of respondents think it would be easier to have the same pension for life

Rethinking retirement savings

However promising, all of these routes – encouraging people to consolidate their multiple pension pots; providing an online platform for managing savings across multiple providers; and implementing a single 'pension for life' – miss the real problem.

In effect, they are just sticking plasters, when what we need is a cure. **To really address the problem with the lack of ownership and engagement with pensions, we need to rethink the entire system.**

It is a problem that can be traced back to the gradual phasing out of defined benefit pension schemes and their replacement with defined contribution schemes.

Defined benefit schemes were pensions as originally intended: that is, they were designed to replace part of an employee's salary when they retired.

Employers are responsible for funding these schemes and making sure they hold enough assets to cover their liabilities. However, most of these schemes have closed as they became too expensive for employers to fund and the concept of a 'job for life' disappeared.

They have been replaced by defined contribution schemes, which are designed to take much of the financial burden of pensions off the shoulders of employers and provide more flexibility to employees in how they use their savings.

These schemes are not designed to replace part of an employee's salary at retirement. Instead, they are investment vehicles, where employees take on the risk of making sure they save enough on top of their basic state pension to fund a comfortable retirement.

The term 'pension' is possibly a misleading term for these types of schemes – they are 'retirement' or better still 'later life' savings plans. In fact, these kinds of schemes are not referred to as pensions in other countries. In the US, for example, a distinction is made between defined benefit schemes – known as 'pensions' – and defined contribution schemes, such as IRAs or 401k plans.

'Later Life Funds'

Pension providers need to be more transparent with employees about these differences.

They need to make it clearer that defined contribution schemes are not 'pensions', as such – really, they are long-term savings vehicles. Unless people engage with them, monitor their value and review their contributions, they are unlikely to be able to replace an appropriate part of their salary on retirement. That is if they retire at all – like the idea of having a 'job for life', retirement as we understand it is also a dying concept. For a lot of people, it's no longer a 'cliff edge' but more of a transition.

Instead, these schemes should be looked at as a way of supplementing income; as a fund that enables you to make changes to your life in your later years. So, rather than thinking about saving into a 'pension' for 'retirement', we should be talking about contributing to a 'Later Life Fund' that will allow you to change your working patterns as you get older.

Maybe you want to change career? Or move to a three-day week? The 'Later Life Fund' is a pot of money that can help you do that. Of course, for some, it will allow them to stop working altogether. But for many, the income they receive from their retirement savings will actually be used to top up their salary as they continue to earn an income.

Repositioning defined contribution pension schemes as 'Later Life Funds' would recognise this new reality – and might help encourage employees to think about their 'retirement savings' in a different way.

Conclusion

Combining pensions has to be easier

Across the pensions industry and from Government, there is a lot of expectation of – and reliance on – the pensions dashboard to raise awareness which will help with the issue of lost pots. And while it is an important part of the answer, when it finally becomes a reality it will only be the first step.

Our research shows that people might not just want to see their pensions in one place, they might want to be able to combine them and that means being able to easily transfer from one pension provider to another. There are still too many manual processes involved, which in our digitally connected world is bizarre. The issue of multiple pots is not just about small pots, it's across the board.

The Government's proposals in its recent consultation on pots of up to £1,000 will go some way to solving the issue, excluding the many lost pots housing more than this. But regardless of pot size, providers still need to make the transfer process a lot easier and they can do this through digitisation. Otherwise, the multiple pots issue and the problem with people losing track of them will persist.

While this is no panacea, there are a number of collective actions that the Government, pensions industry and employers can take to improve things:

Government

Increase industry uptake of digitisation via regulatory requirements

In the 21st Century, pensions are still dominated by 20th Century legacy systems and paper-based documents. Innovative technology – such as mobile phone apps – will not only make the transfer process a lot quicker for members, it will also reduce friction as they'll know how much they have in their pots, meaning they'd have more impetus to transfer.

This doesn't mean removing guard rails that protect people from scams or losing out on underlying guarantees. It's about removing unnecessary complexity and making the process more user-friendly.

We believe the Government has a role to play in pushing providers to make it easier for members to transfer pensions. This would be best achieved through digitisation, which would avoid wet signatures, manual processes and paperwork.

Pushing the industry to digitisation requires providers to adopt common data standards and formats

When employers change pension providers, the original existing pension pot, in some cases, can't be automatically transferred. This means the existing pot remains with the previous pension provider, which just adds to the problem. A solution would be for Government to allow automatic transfers in the case of a provider change (where it's assessed that the new scheme is indeed better or no worse than the existing scheme), ensuring that pension savers don't need to do anything for their current employer's pension to move.

Industry

Reduce friction in the customer journey

Our research shows that people perceive the transfer process as complex and lengthy. Providers need to really look at their processes to eradicate all paper-based actions and replace with a seamless digital customer experience.

Knowledge

There are a lot of misconceptions around combining pensions and a relatively large cohort of people who don't even know that combining pensions is possible. Providers need to do more around giving people enough information to make informed decisions.

Employers

Recognise that bigger pots drive greater appreciation

Although previous pension pots have nothing to do with a new employer's workplace pension, engagement levels with the newer scheme can increase when people transfer previous pots in. Similarly, raising awareness through education and communication can drive engagement levels up.

Changing pension providers should include existing pot

Although in most cases the decision to move existing pension pots to a new provider chosen by the employer is down to individual employees, employees generally expect that this is automatic. Even without automation, the employer can play a really important role together with the new pension provider in making this a much simpler process – facilitating education, communication, individual guidance sessions and digitisation.

About Cushon

Cushon is a fintech using its world-leading financial technology to engage savers and empower them to build a better financial future.

Cushon offers a range of investment & savings products via an intuitive mobile app that provides a highly personalised experience and environmentally focussed investments, making it easy for customers to manage their money and invest in a way that aligns with their personal goals and beliefs.

With a solution that fully integrates with payroll and benefit platforms, Cushon's products are delivered via the workplace to reach as many savers as possible. Employers use Cushon to enhance the financial wellbeing of their workforce by providing employees with a simple and convenient way to save into ISAs and General Investments products direct from pay from as little as £10 a month.

Cushon Group currently has over 550,000 customers with £2bn of assets under management. Its corporate clients include 250 well known blue-chip companies including many of the FTSE 100, plus over 22,000 smaller employers across the UK.

To find out more about workplace savings, get in touch or visit our website:

hello@cushon.co.uk | www.cushon.co.uk