

PENSIONS POLICY INSTITUTE

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Consumer engagement:
barriers and biases

Executive summary

Consumer Engagement: barriers and biases is sponsored by Pinsent Masons. This report is the first in a series of reports exploring consumer engagement with pensions and financial products. Further reports will explore policies designed to promote engagement internationally and draw out lessons for promoting better engagement in the UK, including the ways in which people engage currently and how behavioural interventions might work alongside other policy levers (defaults, compulsion, consumer protection and safety nets) to help people to achieve better outcomes from pensions.



Pinsent Masons

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Executive Summary

There are many behavioural factors which explain why people do not always make rational decisions. Carefully designed behavioural interventions have been suggested as a way to improve decision-making in order to produce better outcomes as a result. But other policy levers remain important in ensuring positive outcomes in pensions.

Experience, family, social structures and other influences lead to attitudes and behaviours that can affect decision-making, and in some cases lead to less optimal outcomes.

Policy-makers are increasingly seeing behavioural techniques as a means to help people to make more rational decisions and achieve better outcomes.

Behavioural interventions have been successful in reducing harmful behaviour:

- **Choice architecture** redesigns have increased organ donor registration.
- Creating new **anchoring heuristics** has been used to decrease alcohol consumption.
- Decreasing **availability and salience** has also been used to decrease alcohol consumption.
- Financial incentives have been used to counteract **present-bias** among smokers.
- Refocusing risk in terms of others, rather than personal risk, has been used to increase use of safety precautions by reducing **overconfidence**.
- Influence of **social norms** has been used in order to encourage behaviour that reduces risk.

Using behavioural techniques in a pensions environment brings complications due to the myriad of factors affecting pension outcomes. Some of these techniques are now being used to promote saving and have the potential to help people make better decisions about retirement saving:

- **Choice architecture** redesigns have been used in automatic enrolment in order to harness people's tendency towards **procrastination and inertia** to increase the number of people saving for retirement.
- Automatic enrolment does not solve the problem of low levels of engagement with contribution rate decisions, as those who are defaulted into saving are by definition less engaged than those who opt-in.
- A behavioural technique that works with people's **inertia**, like automatic enrolment, could be used to increase contribution rates and deliver better outcomes for many people. For example, the Save More Tomorrow (SMarT) programme which schedules increases in contribution rates to coincide with pay rises.
- There are many behavioural factors which can influence people's investment decision-making, including:
 - Ø **Inertia or status quo bias**: People often avoid making difficult decisions.

- **∅ Representativeness and availability heuristics:** People may rely heavily on past fund performance, ignoring expected future returns and risk factors.
- **∅ Choice and information overload:** Investment decisions often involve a large number of options and vast amounts of complex financial information.
- **∅ Risk aversion:** Some people may feel that the risk of making a loss is lesser if they invest in the default fund, rather than relying on their own knowledge.
- As decumulation decisions become more complex, behavioural techniques are unlikely to be able to make up for shortfalls in financial capability that may lead people to make less rational decisions about how to access their retirement savings.

The complexity of both behavioural techniques and the pensions environment mean that it is not always most effective to attempt to eliminate behavioural factors. Automatic Enrolment, for example, uses behavioural factors in order to produce better outcomes, rather than trying to eliminate those factors. As well as identifying behavioural barriers and biases and ways in which these could be counter-acted, part of the difficulty lies in determining what level of engagement is most appropriate for different individuals in order to produce the best outcomes.

A range of policy levers remain important in ensuring positive outcomes in pensions:

- **Compulsion:** Options that people must take whether they wish to make an active choice or not.
- **Defaults:** An option given to people who do not make an active choice.
- **Safety nets:** Policy mechanisms designed to help those who find it difficult to support themselves financially and are in danger of falling into poverty as a result.
- **Consumer protection:** Legal and regulatory measures put in place to protect people from fraud or poor governance.
- **Behavioural intervention:** Policies aimed at encouraging people to make a decision (or not make a decision) which results in better financial outcomes for that individual.
- **Freedom:** Policies which allow greater freedom to individuals such as removal of tax regulations which prevent people from taking all of their DC savings in cash.