What is the role of engagement in pensions?

PENSIONS POLICY INSTITUTE

PPI

PPI Briefing Note Number 136

Introduction

Spend even a short period of time in the Defined Contribution (DC) pensions industry and you become aware of the numerous discussions about how the world would be different if there was more engagement from members. Past and current discussions about engagement in the pensions industry have focused primarily on how to increase engagement levels, largely ignoring questions about who can become engaged and to what extent, and who can benefit from greater engagement, and/or identifying those who are unlikely to ever become fully engaged and will therefore require alternative solutions in order to achieve positive outcomes.

This is the first output in the PPI's Engagement Research Series. The Series aims to break down what we mean by engagement and for whom engagement is likely to be beneficial, in order to identify what effective engagement strategies might look like for groups with different characteristics.

This Briefing Note provides an overview of the current landscape of pensions engagement. It will be followed by a full report that explores possibilities for more effective engagement strategies and alternative solutions for groups that are unlikely to benefit from engagement.

The first section of the Briefing Note explores the current engagement landscape, setting out:

- What current engagement approaches look like;
- How engagement is measured; and
- Current levels of engagement.

The second section of the Briefing Note explores the definition of engagement and sets out a proposed hierarchy for different levels of engagement.

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Higher levels of engagement are expected to improve retirement outcomes but there are limits to the level of engagement that can be achieved and some people will not be able to achieve positive outcomes through engagement alone

The Department for Work and Pensions (DWP) hypothesise that 'better engagement will lead to better decision making and outcomes for members.'[1] This view is shared by many across the pensions industry. With the pension flexibilities now in place, all DC savers will be required to make complex decisions at, and during, retirement about how to access their savings and achieve an adequate and sustainable retirement income. Engagement strategies are increasingly focused on financial education, helping members to build a greater understanding of the options available to them and the risks associated with any decisions they make.

Theoretically, it makes sense that pension savers who are better informed and more confident in making decisions about their pensions and retirement planning will be able to achieve better outcomes compared to those with lower levels of financial education and engagement. However, some people will find it especially challenging to make these decisions, and greater engagement in isolation will not solve this problem. There are a range of factors that can impact how engaged individuals can feasibly be expected to become, as well as the extent to which they would benefit from greater engagement:

- Demographic characteristics, such as age, gender and ethnic background.
- Financial capability, although savers can be supported to grow their understanding, there may be limits to what can be feasibly expected for some, and over what timescale.
- Current levels of engagement and financial education, including current levels of engagement directly with pensions and whether they have taken any financial advice or guidance.
- Pension scheme membership, including whether they are a member of a pension scheme, the type of scheme of which they are a member and their membership status (active vs. deferred).
- Financial characteristics, such as pot size, income level, wealth and home ownership.
- Employment factors, including the industry or sector they work in, job stability, and employer size.
- Vulnerability, including financial vulnerability and other characteristics which could make it more challenging to effectively engage or put individuals at greater risk of harm.
- Personality traits, including the way that they view their future self and their approach to risk, life priorities and financial planning more broadly.

For some people, engagement could lead to a negative outcome if, for example, they make a poor active decision rather than being defaulted into an option which would deliver better outcomes. There are potential harms associated with engagement, particularly if individuals misunderstand the information communicated to them. Particular areas of concern include:

- Scams, which are reliant on poor active decisions; and
- Tax charges – suboptimal decisions can lead to an increased tax liability with subsequently reduced outcomes.

Considering the broad range of factors that can affect people's capacity for engagement, a one-size-fits all approach is unlikely to deliver optimal outcomes. Effective engagement strategies will not look the same for all, and there may be limits to the extent to which some people can be expected to become engaged. For those who are limited in their capacity to become fully engaged or for whom engagement may not deliver substantial benefits, policy levers other than engagement, such as well-constructed defaults, safety nets or compulsion are likely to be needed in order to achieve positive retirement outcomes.

What do current engagement approaches look like?

This section explores current engagement approaches in order to understand how they affect behaviour.

In recent years, the pensions industry has been particularly focused on increasing engagement levels and the most effective way to do so. New regulations on consumer duty are likely to further increase this focus, with regulators expecting providers to do more to deliver positive outcomes for members and ensure that they understand both their rights and their responsibilities.[2]

When designing an engagement strategy, schemes and providers typically consider:

- What are the member needs? This requires an understanding of the demographics within the scheme and member behaviours.
- What strategies have worked in the past? Drawing on both internal and external evidence.
- What can feasibly be delivered? Practical administration processes and value for money must be considered, as well as regulations.

Digital channels are an increasingly important component of engagement strategies

Many pension providers offer digital tools and platforms to make it easier for members to manage their pensions online. These tools make information about contributions, investment choices and projected retirement income more easily accessible, as well as enabling information formats that some members should find easier to understand and engage with. For example, some providers now offer personalised video content, including animated summaries of information included in members' annual statements. Utilising a range of channels to engage members could help to increase levels of engagement as different people have different learning approaches. As well as being perceived as more accessible for members, digital engagement is easier for providers to accurately measure, and, once established, can also be cheaper to deliver. There is also an increasing focus on helping members to build good habits and engagement behaviours through 'gamification' and some providers are exploring the possibility of loyalty programmes which reward members for engagement.

Further digital engagement is expected through the introduction of the Pensions Dashboard. The Dashboard aims to provide a single point of access for people to be able to see all their pension pots, and their State Pension, in one place. In order to achieve this, schemes and providers are making significant efforts towards digitising their processes and getting their members' data dashboard-ready. Pensions dashboards have the potential to help reduce the number of lost pension pots and increase savers' knowledge of their current position in order to help them to make more informed decisions about planning for later life, but effectiveness will be reliant on individuals choosing to engage with dashboards.

Digital pensions engagement is particularly relevant in the context of young savers who are more digitally engaged in general. Generation Z in particular, but also young millennials to a lesser extent, engage heavily with social media channels, including TikTok and YouTube, rather than traditional media. They are reliant on the information about finances provided by users of these platforms being correct, which is not always the case.

While a shift towards more digital engagement can make it more accessible for many, others who are less digitally capable or have lower levels of access to online services are less likely to benefit and may find themselves excluded from engagement if other channels of communication become less of a focus.

Timing of communications is an important consideration in engagement strategies

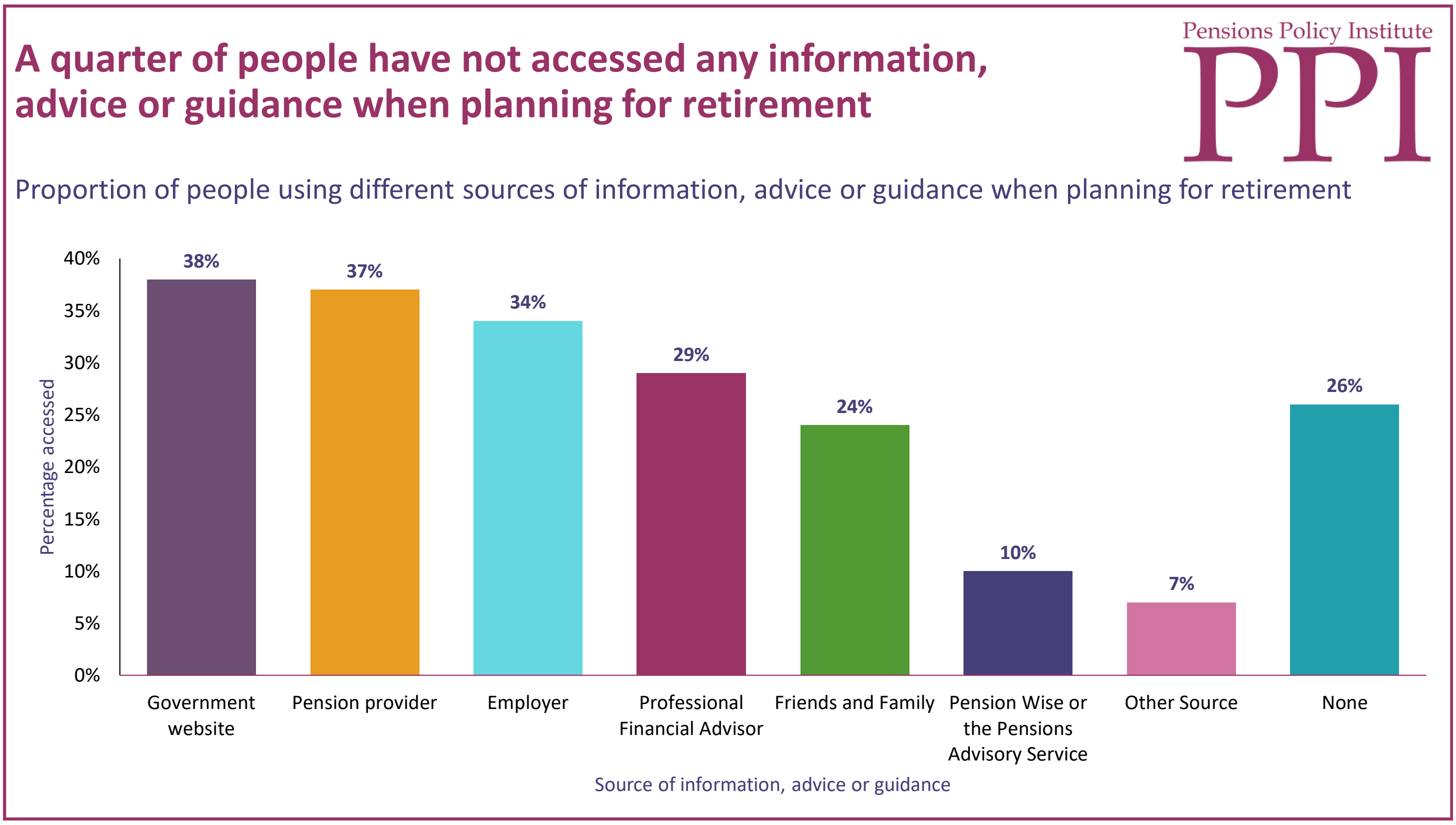
Providers focus on the timing of communications in order to increase how effectively they engage savers, both in terms of regular communications and targeted communications at different stages over the member's pension saving journey. Regular communications, such as annual statements, can be timed to coincide with the end of the tax year, when savers may be more actively assessing their finances, or other times, such as around the member's birthday, although there is limited evidence that this drives up engagement. Ensuring that members receive information relevant to their stage in the pension saving journey is seen as particularly important, and providers often target communications based on members' ages. For new members, initial engagement is the top priority. The proliferation of small, deferred pots increases the importance of ensuring that members are engaged as soon as they join the scheme as they may only be active members for a relatively short period of time, and it is vital that the scheme has correct details to contact the member after they have changed employer. Once engaged digitally, the provider then has the opportunity to further engage and educate members. This becomes increasingly important as they approach retirement, with the introduction of mid-life wake up packs and at-retirement support with decision-making.

Current events can also impact the effectiveness of engagement strategies. Engagement can be particularly challenging in the current economic environment. There is a potential for negative outcomes if communications draw members' attention to economic challenges they may not already be cognisant of, but tailoring content to reflect current economic challenges can help to make communications more relevant and interesting to members.

Engagement strategies are increasingly focused on educating members about their pensions

Once members have been initially engaged by signing up for their scheme's digital portal, the next step is building their understanding and knowledge in order to support more informed decision-making and better member outcomes. Many providers are increasingly offering educational webinars for members to help them to understand the basics about how their pension works and the next steps in their retirement planning journey. However, in many cases, engagement with these offerings is relatively low. Providers are working on making educational content more accessible for members, for example by breaking it down into digestible short videos available through their apps, but further support from employers is likely to be needed to encourage employees to engage with educational offerings. Low levels of take up is a challenge across the pensions landscape, with a quarter of people not having accessed any information, advice or guidance when planning for retirement (Figure 1).

Figure 1[3]



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There have been efforts by various organisations and cross-industry groups to improve financial literacy and educate savers about the importance of pensions and retirement planning, including the Pension Attention campaign, engagement seasons and the stronger nudge towards guidance. A joined-up, cohesive strategy across not just the pensions industry, but also employers and educational institutions, is likely to be needed to meaningfully increase engagement levels.

How is engagement measured?

It is challenging to accurately measure engagement because it does not always result in active choices that can be tracked

Initial engagement can be relatively easily measured. Pension schemes and providers monitor the proportion of members that have registered for digital portals, as well as tracking interaction with email communications, such as open rates and click-through rates. This information demonstrates how involved members are with the scheme, which communications members find interesting and engaging, and can help schemes to tailor future communications and engagement strategies. While engagement with email communications can be a useful measure, it may be primarily indicative of how effective specific communications are rather than broader member engagement or understanding. This means data can be used to influence future communications, but should not necessarily be given too much weight in questions about how informed and engaged members are, although high levels of engagement with communications are a good starting point. The frequency with which members log into digital portals can also be tracked, and may be a more accurate measure of engagement as it demonstrates an active choice by the member.

Measuring the effectiveness of engagement aimed at education or support with decision-making, is more challenging. When engagement results in active choices or action, such as making changes to contribution rates or investments, this can be measured and tracked. Simple actions such as nominating a beneficiary or setting a target retirement age can also be used to measure engagement. Action can be an indication of engagement, but it is not the only one, and in some cases, inaction might be the behaviour that is encouraged, for example the inertia on which automatic enrolment is predicated. Similarly, some members may be engaged with pension decision-making but take an active choice not to change their contribution rate, either because they cannot afford to do so or feel they are already contributing enough, or investments, for example because they think they are best served by the default strategy. This further complicates the usage of active choices as a measure of overall engagement.

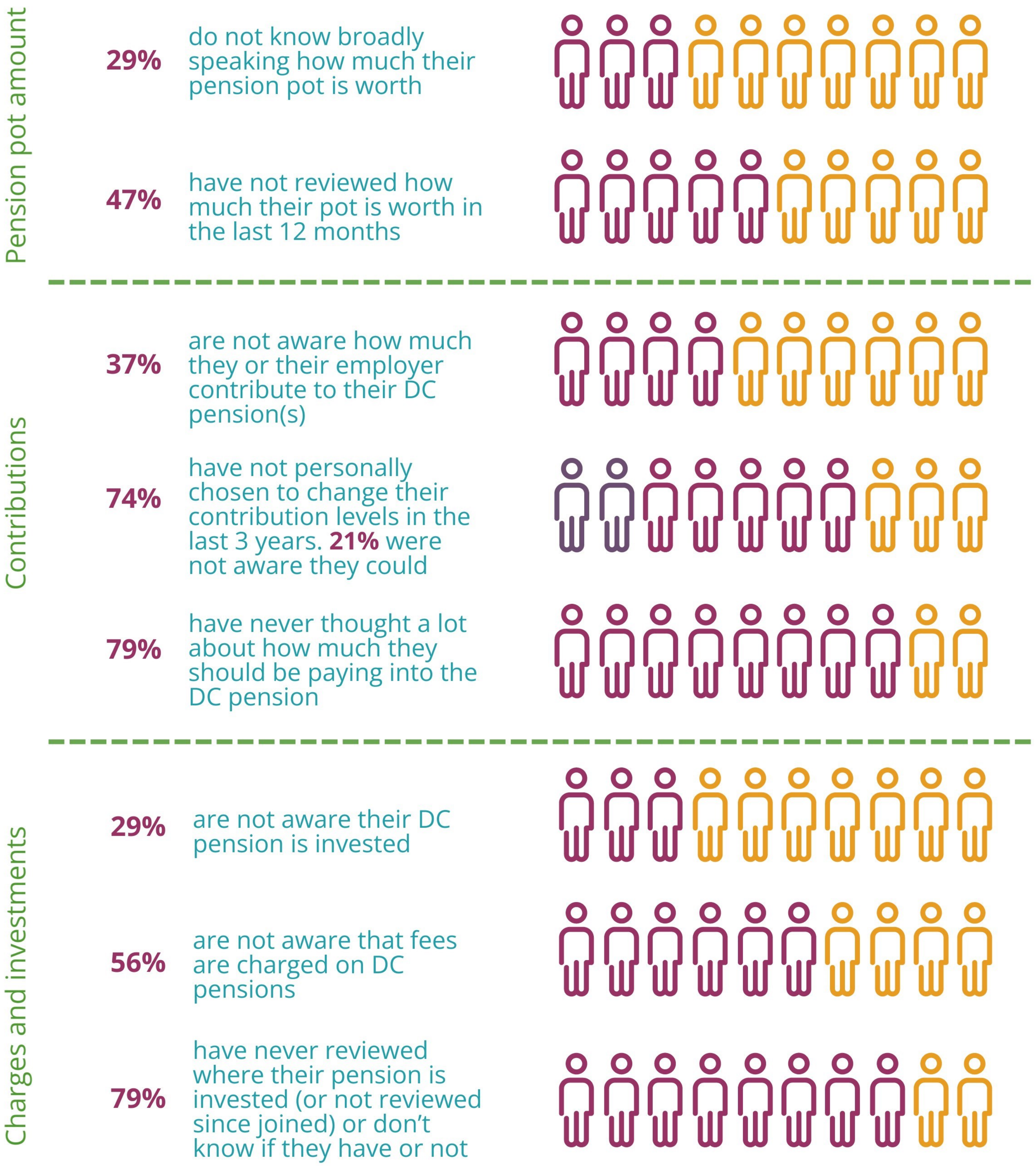
When engagement is aimed at less quantifiable goals, such as better understanding or confidence in decision-making, this is harder to measure. Some providers conduct regular customer panels with members to assess whether they have received and understood their annual statements or other communications. Website visits and webinar attendance can also be indicators of active engagement. National surveys, such as DWP's Planning and Preparing for Later Life (2022) and the FCA's Financial Lives Survey (conducted annually), provide insights into engagement and understanding of pensions, which can be used as an indicative measure of overall engagement levels, rather than the effectiveness of specific engagement strategies. Data that explores understanding and knowledge of pensions, both the landscape and an individual's own pension arrangements, is likely to provide the most accurate picture of how effectively strategies aimed at education and supported decision-making are working overall and how likely savers are to be confident in the decisions they will have to make at, and during, retirement.

What does engagement currently look like?

Average levels of pensions engagement are low

The level of pensions engagement under current definitions among UK savers varies widely. While automatic enrolment has significantly increased workplace pension participation, many pension savers do not actively engage with their pension scheme. Some savers are unaware of the details of their pension arrangements, the rate at which they are contributing and the retirement income this is likely to enable them to have. In 2022, 29% of DC savers did not know the approximate value of their pension savings (Figure 2).[4] Without this knowledge they will be unable to make informed decisions about how best to prepare for later life.

Figure 2: Engagement and understanding of pensions[5]



Savers are more likely to engage with their pensions as they approach retirement. 49% of people aged 18-54 have reviewed their pension pots in the last year, compared to 65% of those aged 55-64.[6] However, savers who do not engage with pensions until later in life are likely to experience poorer retirement outcomes than those who are engaged early in working life when they have a longer horizon over which to prepare.

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Low levels of financial capability, attitudes towards pensions and behavioural biases can negatively impact engagement

Low levels of understanding about pensions, and low levels of financial capability overall, make it more difficult to effectively engage savers. Pensions can be complex, and many savers may find them uninteresting or challenging to understand. This can lead to low levels of engagement, as people may not prioritise learning about their pension options and this confusion deters them from actively engaging. 59% of employers see poor financial literacy as a major financial wellbeing risk in their organisation, and 47% say financial literacy of the workforce is a challenge for improving financial wellbeing for most of the workforce.[7] On pensions specifically, knowledge and understanding is particularly low. For example, 29% of DC savers are unaware that their pension is invested, while 56% are not aware that they are charged fees (Figure 2).[8] Engagement strategies focused on education can help to build financial literacy and pensions understanding for some people. However, for some people, low financial capabilities mean that they are unlikely to build the level of understanding required to confidently make decisions about pensions in order to achieve positive outcomes.

Negative attitudes towards pensions and later life more generally also make engagement more challenging. Savers' concerns about pension fund performance, fees and the sufficiency of their pension savings can influence levels of engagement. Savers might choose not to engage if they feel that their pension is not delivering the returns they expected or if they are worried that they are not saving enough. While engagement campaigns based on fear can work well as a call to action in some instances, for pensions there is a high risk that members will disengage if presented with overly negative information. Some savers may be disengaged because of a perceived lack of control or ownership over the funds or a belief that retirement is too distant to worry about.[9] These negative attitudes towards pensions are particularly prevalent among young savers, with 40% of Gen Z and Young Millennials (aged 18-35) surveyed in 2021 identified as 'pessimistic and disinterested', and a further 33% 'worried and unsure' regarding pensions.[10]

One of the greatest challenges to engagement is inertia. People often avoid making difficult decisions, and this is particularly true where they have low levels of understanding, as with pensions. Pensions engagement strategies are competing with many other, often more immediately pressing, considerations for savers' attention. It can be easy for savers to put off engaging with pensions as many view retirement as a long way off, as well as the commonly held view that having been automatically enrolled, they are already doing what they need to in order to prepare for retirement. Behavioural science has a strong role to play in understanding how to more effectively engage pension savers, by working with their behavioural biases rather than against them, as has been demonstrated by the success of automatic enrolment in harnessing inertia to bring more people into pension saving.

The next section explores the definition of engagement and sets out a proposed hierarchy for different levels of engagement.

What does 'engagement' really mean?

Identifying a single definition of engagement is challenging as it has a number of layers or stages

There is no single agreed upon industry definition of engagement, perhaps because there are many layers to pensions engagement and stakeholders view it from different perspectives. Some stakeholders, particularly those who are actively involved in pension scheme communications, focus on the input side of engagement, by asking whether communications are interesting for members, and if they encourage members to take action. These definitions consider engagement as a tool for connecting with members. Other stakeholders focus on the output side of engagement, which could mean the level of understanding and knowledge people have about pensions, or the end goal of better retirement outcomes. These definitions consider engagement as a goal, with the expectation that more engaged members will achieve better retirement outcomes. These two views of engagement are not necessarily conflicting, but rather reflect the multi-stage nature of pensions engagement. Furthermore, it may be that a single definition of engagement is not optimal, but rather a range of definitions dependent on individual characteristics that impact the way that people engage and the level of engagement that can be expected of them.

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Drawing on current engagement approaches and considering the needs people may have at different points during working life and at retirement, pensions engagement can be broken down into three stages:

- Initial or basic engagement: At its most simple, engagement can mean whether an individual has connected with their pension scheme (assuming they have one) – that they have provided up-to-date contact details and signed up for digital portals so that the scheme can send them communications. This first step creates opportunities for the individual to become further engaged as their scheme communicates with them about their pension and the options available to them. For people who are not members of any pension scheme, initial engagement may be primarily through the government or their employer, for example through media campaigns that inform the public about changes to the State Pension or a financial wellbeing programme that may be offered in their workplace.
- Understanding: The next step is building understanding and knowledge about pensions. This includes whether they know information specific to their own pension, such as how much they are contributing, the current value of their pot, and the level of income they are likely to achieve in retirement if they continue with current saving behaviour, but also basic knowledge about how pensions work, such as investment and taxation. People who are not members of a workplace pension scheme may still benefit from education about pensions, for example about State Pension entitlement or the importance of saving into a private pension if they are able to do so.
- Action: The nature of active decisions varies throughout individuals' lifecourses. Automatic enrolment, coupled with low levels of engagement, means that many pension savers will not make any active choices until they reach the point of accessing their pension savings in later life. However, early engagement could help some people to begin actively planning for their engagement from younger ages and prompt action such as opting into a pension, increasing contribution rates or changing investments. Making sure that savers understand the outcomes they are likely to achieve if they continue with current saving behaviour can help them to make informed decisions, increasing their likelihood of achieving adequate and sustainable retirement outcomes. At, and during retirement, savers will face complex choices about how to access their pension savings. For some people, engagement and financial education will enable them to feel confident in making these decisions, others are likely to need more substantial support.

While some people will transition through each of these three stages, others' engagement journey may stall at the 'initial engagement' or 'understanding' stages, while others still may not even become initially engaged in the most basic sense.

This multi-stage perspective of engagement lends itself to engagement strategies that build progressively from basic engagement with the scheme, to understanding, and finally to active and informed engagement with pensions decisions (Figure 3). Effective engagement strategies need to be clear about who is being targeted and with what objective. Focusing engagement strategies on specific and measurable actions that individuals can take is likely to make them more effective.

Identifying a hierarchy of engagement could help to make engagement strategies more effective for those who would benefit from increased engagement, while also improving outcomes by identifying those who are unlikely to benefit from engagement

While increased levels of engagement do not guarantee better retirement outcomes, many people could benefit from becoming more engaged, even if it is different to what we currently define as engagement. Developing a better understanding of the people strategies are aiming to engage and the characteristics that may impact their ability to become fully engaged could help to make engagement strategies more effective, as well as improving outcomes for those identified as being unlikely to benefit from engagement by ensuring that other mechanisms and support are in place for them. Improving data and understanding of these characteristics and how they interact with engagement levels would be the first step to integrating them. Developing a joined-up, industry wide definition of engagement and the hierarchy of different engagement types would be beneficial in developing more effective engagement strategies that reflect the varying needs and capabilities of individuals (Figure 4). A greater understanding of the way in which people engage and the ways in which they can benefit from becoming more engaged could produce more achievable and measurable targets for engagement.

Figure 3: Levels of engagement

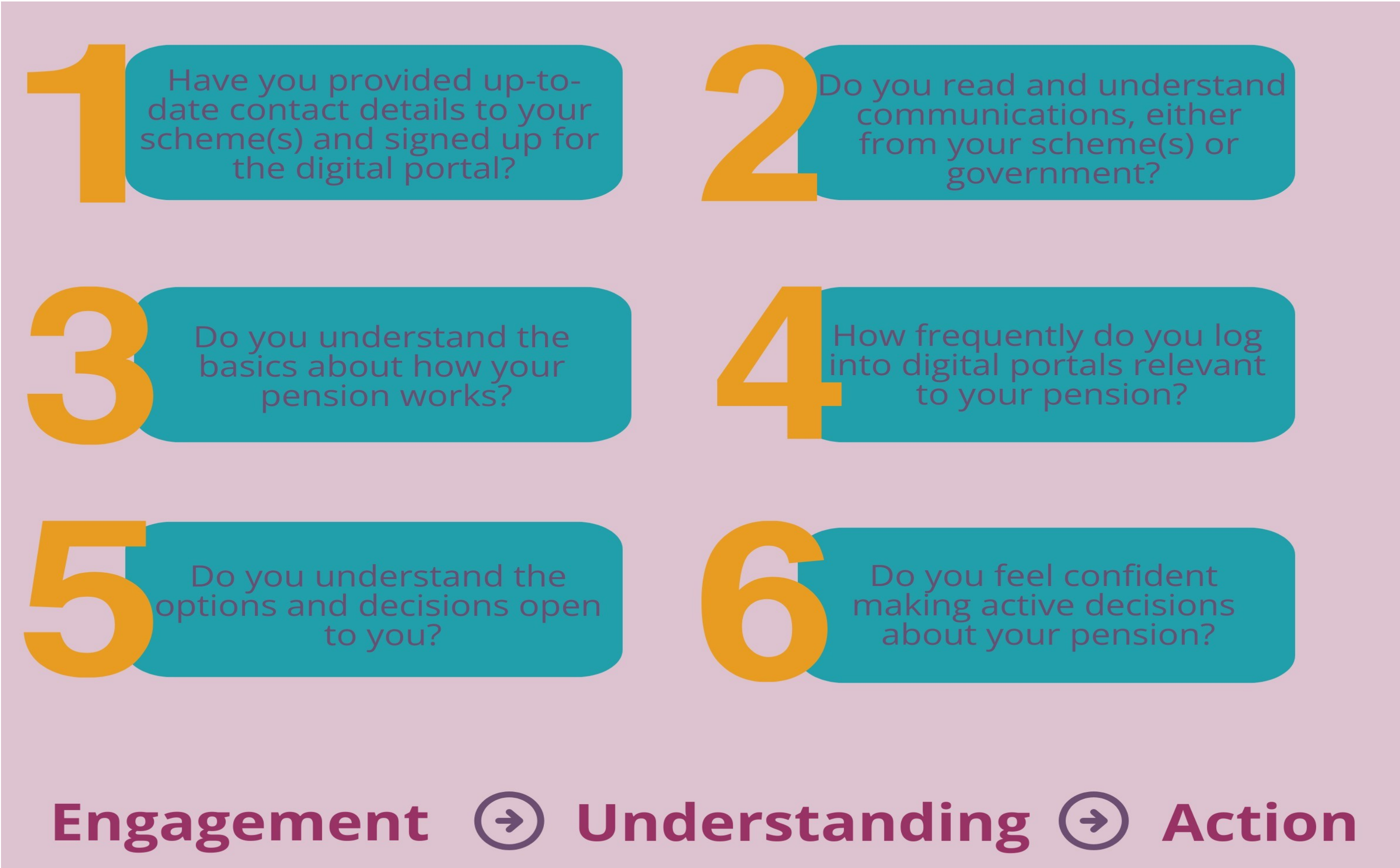
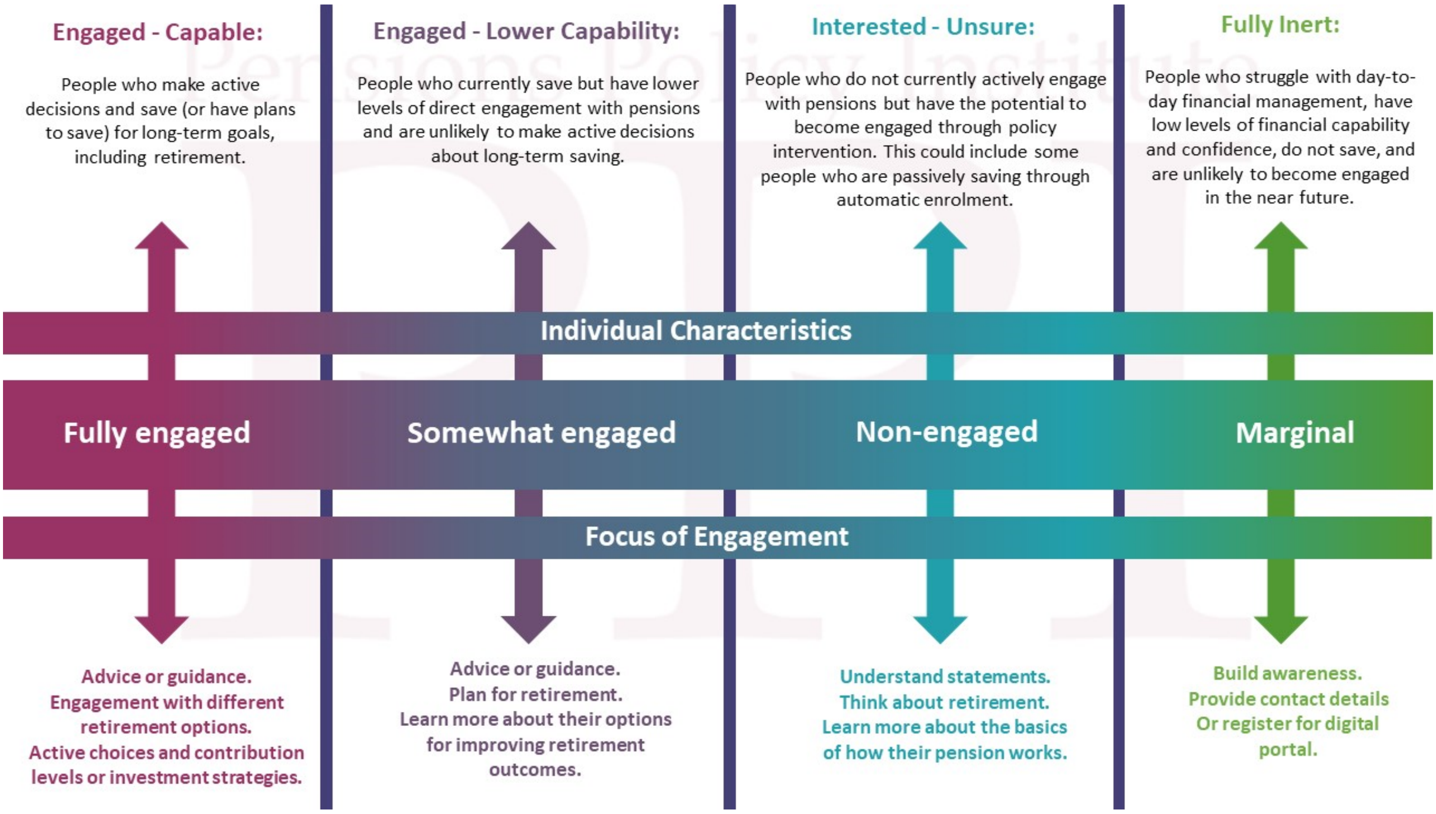


Figure 4



People may transition between these groups throughout their lifetime, but the extent to which they can feasibly be expected to transition will depend on their current level of engagement, as well as the individual characteristics outlined at the beginning of this Briefing Note. Significant, and often unexpected, life events can also cause individuals to transition between levels of engagement on the spectrum.

The stages of engagement identified (basic engagement, understanding and action) do not directly correlate with levels of engagement on the spectrum, but are relevant to the types of engagement that are likely to be most appropriate for people at different levels on the spectrum. For people at the lower end of the spectrum (marginalised or non-engaged), a focus on basic engagement, at least to begin with, is likely to be most important, and later stages would need to be tailored to these individuals' needs and capabilities, with understanding focused on building basic awareness and action focused on support with decision-making at and during retirement. For people at the higher end of the spectrum (fully engaged), basic engagement is unlikely to be a significant issue, but they may still need support to develop a deeper understanding of the options available to them and associated risks in order to feel confident making decisions about their pension and later life planning.

Data may be a challenge in developing this more nuanced approach to engagement, as there may be too much overlap and variation among different segments, due to the large range of possible factors, for this to be feasible for individual providers to investigate and implement. The importance of data in developing effective engagement strategies to benefit individuals will be explored in more detail in the next report in this series.

Conclusions

- Discussions about pensions engagement have primarily focused on how to increase levels of engagement, without asking important questions about who can be effectively engaged and whether everyone would benefit from becoming more engaged. There is a widely-held expectation that higher levels of engagement will improve retirement outcomes. However, there are limits to the level of engagement that can be achieved and not everyone will necessarily benefit from increased engagement.
- Engagement strategies that build progressively from basic engagement with the scheme, to understanding, and finally to active and informed engagement with pensions decisions are likely to be most effective. However, due to differing needs and characteristics, a one-size-fits-all approach to engagement would be detrimental, and some people are unlikely to ever become fully engaged.
- While increased levels of engagement do not guarantee better retirement outcomes, many people could benefit from becoming more engaged, even if it is different to what we currently define as engagement. A greater understanding of the way in which people engage and the ways in which they can benefit from becoming more engaged could produce more achievable and measurable targets for engagement. Identifying a hierarchy of engagement could help to make engagement strategies more effective for those who would benefit from increased engagement, while also improving outcomes by identifying those who are unlikely to benefit from engagement by ensuring that there are other mechanisms and support in place for them.

The next report in this research series will further explore the ways in which people at different levels on the spectrum engage, how they could be better supported and the extent to which they could benefit from engagement.

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This Briefing Note has been informed by interviews with stakeholders across the pensions industry, as well as a PPI Roundtable held in September 2023.

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