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Consumer engagement: the role of policy through the lifecourse

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Executive Summary

Behavioural nudges are increasingly being viewed as a means of helping people to achieve better outcomes from long-term saving. While effective if used appropriately, nudges are not alone sufficient to help everyone realise their full potential benefit from long-term saving.

This report explores the role that behavioural techniques play alongside other policy levers to help people achieve better long-term saving outcomes throughout the lifecourse (Box EX1).

Box EX1: Policy levers involved in promoting good pension outcomes

This report explores pension outcomes within the framework of six policy levers:

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 wish to or are unable to make an active choice.

Safety nets - policy mechanisms designed to help those in financial hardship.

Consumer protection - legal and regulatory measures which protect people from fraud or poor governance (including high charges).

Behavioural interventions – policies aimed at encouraging people to make decisions (or not make decisions) which result in better financial outcomes.

Freedoms - policies which extend freedom to individuals, such as the removal of tax regulations which previously prevented people from taking all of their Defined Contribution savings in cash.

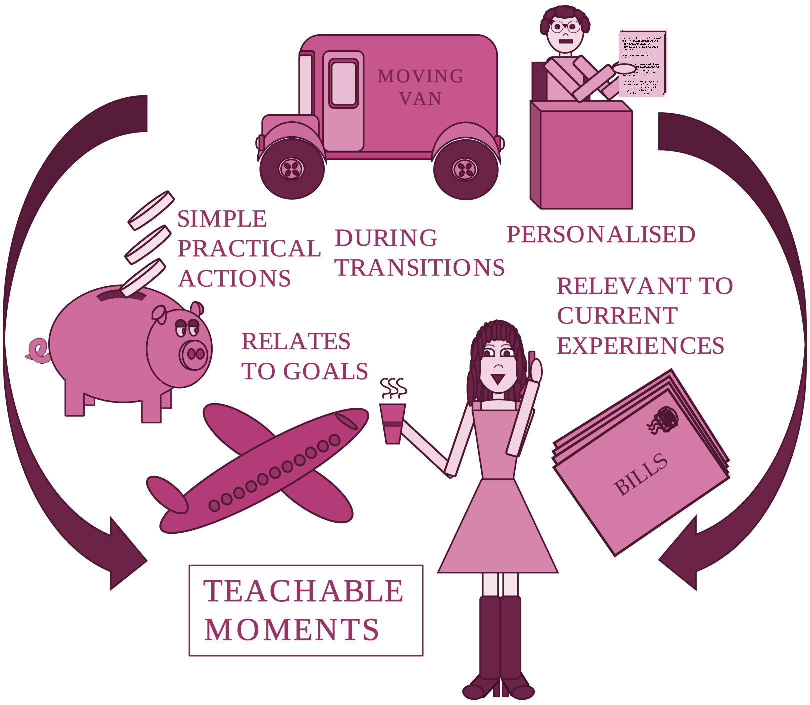
Government and industry alone will not be able to ensure better pension outcomes. Many poor outcomes arise from socio-economic inequalities. Tackling the barriers outlined in this report (such as low levels of financial capability), will require a joint effort from Government, industry, employers, education providers and consumer support organisations.

The rest of this executive summary looks at when the policies outlined above could best be used to help people to achieve positive outcomes from long-term saving.

When are behavioural interventions most effective?

The efficacy of behavioural interventions varies between people depending on the time that they are applied, the way that they are framed and the individual characteristics of the target group.

- Behavioural interventions are most effective when they are applied during teachable moments. For a moment to be "teachable", it must be a time when the intervention is relevant to people's current circumstances, relates specifically to their goals and allows for people to follow on with simple, practical actions. Teachable moments vary between people by age and circumstances but generally occur during key transitions, such as moving house, getting a job or starting a family, or during other times when people are making financial decisions such as buying other financial products.
- Behavioural interventions are most effective when they take into account:
  - Prior levels of knowledge and understanding
  - Personal circumstances
  - Cultural attitudes
  - Income levels
  - Gender
  - Age



What is the most effective format?

As with timing, the format or channel of the most effective behavioural interventions varies between people.

- Personalised interventions where people feel that their own needs, circumstances and goals are understood and addressed are most effective. Generally theses interventions require some human contact through face-to-face, telephone, web-chat or group education.
- Younger people, those with low capability and those on lower incomes respond better to peer-led interventions.

- Younger people are most likely to turn to digital methods for advice, information and guidance, though may find these confusing and difficult to act on.
- Older adults, particularly those over age 75, generally have lower financial capability and will be less likely to have access to or understand how to use digital methods. For older adults, face-to-face interventions (group or individual) are more effective. Peer-led interventions can greatly assist communication with older, isolated people.
- As current generations age, it is expected that the levels of digital ability, financial capability and confidence will grow amongst older cohorts.
- Letters, posters and advertising can help build awareness, but are less effective than interactive, personalised interventions through face-to-face, via phone, web-chat or group education.
- People of all age groups are highly susceptible to media campaigns, particularly via TV and, for younger people, social media. However, media campaigns can motivate people to take actions without having sufficient financial capability to make the optimal decisions. This is because media campaigns offer the least opportunity for queries and clarification, of all intervention types.
- Older adults, those with higher capability and those with higher incomes respond better to individualised, high level or complex information from a finance professional.

When are behaviour interventions least effective?

There are times during people's lives in which their circumstances render them less able to respond well to financial interventions. During these times, other policy levers may be the most effective way of ensuring that people have good financial outcomes. It is less effective to attempt to motivate people who are suffering severe deprivation or are unable to make active decisions. Those with low levels of capability may experience negative outcomes from interventions aimed at promoting active decision-making unless educational support for the decisions are included in the intervention.

- Those who are experiencing periods of social exclusion are more likely to be struggling with immediate issues such as homelessness, domestic illness, and drug or alcohol addiction and therefore pension saving is unlikely to be an important, or even feasible, priority. Because of prevalent lack of income among these groups, and general lack of access to social support, even those who are inclined to save are likely to be constrained from doing so. For the majority of marginalised people, a lack of income or employment will provide the main barriers to financial engagement and long-term saving.
- For many marginalised people, safety nets such as means-tested benefits and disability benefits will be their main sources of income during working life and retirement. While pension compulsion or defaults could help, these tend to be accessed through traditional employment and those in marginalised groups are less likely to be traditionally employed.

- It can be risky to attempt to motivate people with low levels of financial capability to make active decisions before building up capability. In particular, media-led engagement campaigns can motivate those with low capability to make sub-optimal financial decisions.
  - Because of the importance of saving into a pension early and consistently in order to accrue sufficient pension savings, it is not generally in the best interests of non-engaged people to defer saving in a pension until they have achieved a higher level of financial capability.
  - Therefore, defaults or compulsion to contribute a certain amount to a pension will particularly benefit the non-engaged.
  - Alongside work around raising financial capability (and defaults or compulsion to save in a pension), it is vital for non-engaged people to have safety nets they can fall back on. Those who are non-engaged are more likely than engaged people to be unprepared for financial difficulties and are therefore more dependent on social safety nets such as means-tested benefits.
- Engaged people are the main consumers of financial products, and therefore benefit from regulation and consumer protection which governs overcharging, misconduct and fraud by financial services. The highly engaged benefit more from these policy levers than from defaults, compulsion or safety nets.
- However, all people who use financial services benefit from consumer protection and people on low incomes are most likely to fall prey to high rate services such as payday lenders.

While behavioural interventions can be used to help people to achieve positive outcomes, people are also exposed to behavioural cues which can lead to making poor decisions. Reducing negative behavioural cues plays an important role, alongside positive cues, in helping to reduce harm and promote positive outcomes from long-term saving.

People in different age groups vary in:
- Financial capability level,
- What they might need to know in order to engage with long-term saving, and
- Which messages they will respond to.

Table EX1 sets out the differences between the age groups.

Table EX1: Differences in financial capability, financial confidence, aptitude for learning, needs and optimal engagement styles

Life stage	Financial capability, confidence and aptitude	Support needs	Optimal engagement
Childhood - ages 18 and younger	Capability – low Confidence – low Aptitude - high	Education laying groundwork for future capability, confidence and behaviour.	Financial education provided by family and / or school.
Young adulthood – ages 18 to 25	Capability – low, varying Confidence – low, varying Aptitude – med to high	Managing debt, competing financial priorities, whether / how much to save.	Personalised, simple, practical education, peer or organisation led (face-to-face, phone, web-chat) implemented during key transitions.
Adulthood – ages 25 to 55	Capability – low to high Confidence – low to high Aptitude - decreasing with age	Managing debt, competing financial priorities, financial planning for the future.	Personalised, support, advice or education, peer or organisation led (face-to-face, phone, web-chat) which takes into account differences in culture, income, gender and financial capability.
Pre-retirement – ages 55 to SPa	Capability – higher on average Confidence – highest of any age group (73% -very confident) Aptitude - decreasing with age	Ensuring saving goals are being met, decisions around leaving work, accessing and using savings, planning for uncertainties (e.g. future needs such as care etc.).	Personalised, specific, practical advice, support and information which takes into account varying capability, explains the implications of options and makes clear that people do not have to access pension savings at age 55.
Older age – ages SPa and over	Capability – decreasing with age, particularly over age 75 Confidence – high on average Aptitude - decreasing with age particularly low over age 75	Sustaining income through retirement, preparing for changes in need, avoiding scams and fraudsters.	Organisation or peer-led (face-to-face, phone, web-chat or group education) support, advice or guidance which assumes lower than average levels of financial capability and numeracy and potential cognitive decline, especially for those over age 75.

Introduction

The pensions landscape is evolving, and although much of the future direction is unpredictable, what is certain is that many of tomorrow's retirees will bear more risk at and during retirement than previous cohorts. Many people do not have the necessary capability or support to make optimal decisions about long-term saving. Therefore it is important that support and safety nets exist for those who find navigating such decisions challenging.

This is the third PPI report in a series exploring consumer engagement and how behavioural economics can be used alongside a range of other policy levers to help people achieve better pension outcomes. The first report explored the barriers and biases which prevent people behaving in economically rational ways in relation to long-term saving. The second report explored international examples of policies designed to promote engagement and drew out relevant lessons for the UK

This report builds on the first two research reports to segment people by life stage, current level of engagement (and other characteristics) and set out how behavioural interventions and other policy levers might be most helpful in helping people to achieve good pension outcomes.

Chapter one explores current engagement levels and how six policy levers (compulsion, defaults, safety nets, consumer protection, behavioural interventions and freedoms) could best be used to further peoples' interests.

Chapter two looks at the ways children engage with financial concepts.

Chapter three looks at the ways young adults engage, the different triggers which might affect changes in saving throughout the lifecourse and explores the concept of teachable moments.

Chapter four looks at the ways adults engage with long-term saving and where teachable moments for adults might occur.

Chapter five looks at the ways people approaching retirement might engage and how people's particular needs for guidance and support pre-retirement might be met.

Chapter six explores the needs of people at and over State Pension age and how a range of policy measures, including behavioural interventions, could help them to achieve better pension outcomes.

Chapter one: what do engagement levels tell us about people?

This chapter explores current engagement levels and how six policy levers (compulsion, defaults, safety nets, consumer protection, behavioural interventions and freedoms) could best be used to further peoples' interests.

Engaging people does not always lead to positive outcomes

This report explores the role of engagement in achieving positive pension outcomes. However, engagement is not the only method of helping people achieve good outcomes. For some people, engagement could lead to a negative outcome if, for example, they make a poor decision rather than being defaulted into an option which would deliver better outcomes. All of the transitions, decisions and required knowledge discussed in this report could be aided by other policy mechanisms. The appropriate mechanism varies in each case between people, though in some cases one mechanism might be appropriate for almost all people (Box 1).

There is currently a lack of consensus on what a "good" pension outcome might look like though some suggestions such as replicating working life living standards in retirement or avoiding regret are commonly used. There is an inherent difficulty in helping people to achieve positive outcomes when there is no agreed-upon definition.

Box 1: Policy levers involved in promoting good pension outcomes

This report explores pension outcomes within the framework of six potential policy levers:

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 wish to or are unable to make an active choice.

Safety nets - policy mechanisms designed to help those in financial hardship.

Consumer protection - legal and regulatory measures which protect people from fraud or poor governance (including high charges).

Behavioural interventions – policies aimed at encouraging people to make decisions (or not make decisions) which result in better financial outcomes.

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Engagement in long-term saving is becoming more important

Several economic and social trends have conflated recently in order to increase focus on the need for pension engagement. These are summarised below.

Historically low levels of saving and current low contribution levels - which can result in lower pension incomes than desired (see appendix one for more details). Higher levels of engagement could potentially help more people to think about:

- The level of income they might need or want in retirement.
- How much of that will need to come from private pensions.
- How much they might need to contribute in order to achieve that.[1]

An increase in the number of people saving in Defined Contribution (DC) pension schemes - which involve higher levels of risk for savers than Defined Benefit (DB) schemes and the introduction of flexible access to pension saving - which requires DC savers to make informed decisions at and during retirement (see appendix one for more details). Higher levels of engagement during working life and at and after retirement could assist people to:

- Have the time to build up sufficient levels of knowledge and understanding to make complicated financial decisions.
- Build enough personal financial capability to use advice and guidance as part of a host of tools underlying decision-making rather than the sole tool.
- Plan ahead to avoid to avoid financial problems or make decisions during a financial crisis.

A lack of interest and involvement in saving – for example, a lack of retirement planning during working life (see appendix one for more details). Higher levels of engagement could assist people to:

- Understand the importance of saving from a young age.
- Calculate a desired level of income for retirement and the level of contributions required to meet that income.

An “advice gap” - where around 43 million people are not accessing the advice, support or information that they need to make informed financial decisions (see appendix one for more details).[2] Higher levels of engagement might ensure that:

- More people are aware of the advice, guidance and support that is available to them.
- People understand when they need help and seek support before significant financial problems develop.

[1] This particularly applies to members of Defined Contribution pension schemes (which provide less certainty about benefits), though Defined Benefit scheme members may also wish to assess whether their state and private pension combined would provide sufficient retirement income or whether income will need to be topped up from other sources.
[2] CAB (2015a) page 3

The rest of this chapter explores the characteristics of people by engagement level.

There are four main degrees of financial engagement. People may transition between these groups throughout their lifetime.

- Marginalised: people who struggle with day-to-day financial management, have low levels of financial capability and confidence, do not save, and are unlikely to become engaged in the near future.
- Non-engaged: people who struggle with day-to-day financial management, have low levels of financial capability and confidence, do not save, but have the potential to become engaged through policy intervention.
- Somewhat engaged: people who are able to manage their day-to-day finances and make some short term financial decisions but are unlikely to make active decisions about long-term saving.
- Engaged: people who make active decisions and save (or have plans to save)[3] for long-term goals, including retirement.

Box 2: What is financial capability?

This report considers how financial capability interacts with the way people engage with long-term saving. Those with high financial capability:

- Have higher levels of knowledge and understanding about financial services and products,
- Have attitudes and motivations that are in keeping with making rational financial decisions,
- Have the opportunity to enact decisions, and
- Are more likely to feel that they have control over their lives.[4]

Financial capability is not the same as financial confidence. People may have a certain amount of capability without confidence and some of those with high levels of confidence have little understanding of finances. However, there are correlations between the two and generally, the greater experience people have with making financial decisions the higher their confidence and capability.

Lower levels of financial capability are associated with difficulty managing finances and increased psychological stress. This stress can lead to lower levels of financial confidence and poorer decision-making.[5]

The rest of this chapter considers how policy levers could be used to help people of different engagement levels achieve the most positive outcomes from pensions.

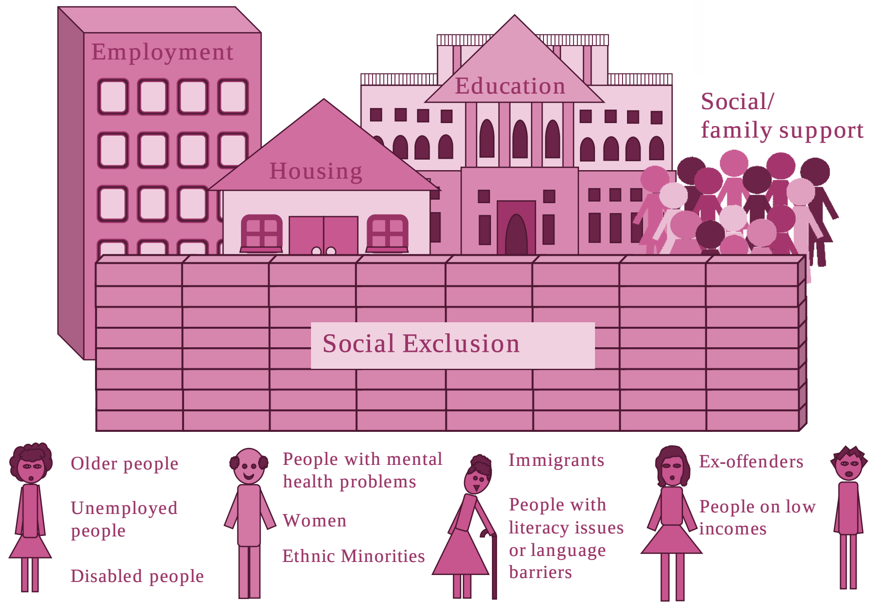
[3] People may be engaged but lack the funds to put plans into action yet, for example, students.
[4] MAS (2014) page 19 & 21
[5] Taylor ***et al.*** (2011)

Marginalised people are unengaged with finances and are therefore unlikely to be engaged with pension saving

Many marginalised people (Box 3) are "socially excluded": ***Social exclusion is a complex and multi-dimensional process. It involves the lack or denial of resources, rights, goods and services, and the inability to participate in the normal relationships and activities available to the majority of people in a society, whether in economic, social, cultural or political arenas.***[6]

Box 3: Marginalised people

Those who are marginalised and/or socially excluded often have reduced access to employment, housing, education and social/family support and are more likely to fit in to one of the following categories:



Social and structural barriers prevent marginalised people from becoming engaged

Marginalised people are more likely to be struggling with immediate issues such as homelessness, domestic illness, and drug or alcohol addiction and therefore pension saving is unlikely to be an important, or even feasible, priority. Because of prevalent lack of income among these groups, and general lack of access to social support, even those who are inclined to save are likely to be constrained from doing so. For the majority of marginalised people, a lack of income or employment will provide the main barriers to financial engagement and long-term saving.[7]

[6] Levitas ***et. al.*** (2007) page 9
[7] MAS (2014) pages 28 & 36-38

Marginalised people are more dependent on safety nets and other interventionist policies

For many marginalised people, safety nets such as means-tested benefits and disability benefits will be their main sources of income during working life and retirement. While pension compulsion or defaults could help, these tend to be accessed through traditional employment and those in marginalised groups are less likely to be traditionally employed. Some people who are marginalised or socially excluded will transition to (or from) a more stable position during their lives.

Box 4: Non-engaged people

Non-engaged people struggle to manage their own finances, do not actively budget or save, avoid making short or long-term financial decisions, but have the potential to become more engaged.[8]

Non-engaged people:

- Are more likely to fall in to debt.[9]
- Do not save for short or long-term goals.[10]
- Generally feel that their financial management approach is "working".[11]
- Have low general knowledge about personal finance, available financial products and support options.[12]
- Generally have low levels of financial capability and confidence.
- Are less likely to demonstrate the behavioural attributes associated with managing finances well: preparedness, adaptability, taking responsibility and an ability to deal with their own emotions.[13]
- Generally are not saving due to a lack of perceived affordability.[14]
- Are motivated to delay saving because of the need to pay off existing debts.[15]
- Tend to be on low to average incomes, (but those on high incomes can also be non-engaged).

Lower levels of financial capability can reinforce non-engagement

Low levels of financial capability makes simple financial choices more difficult, which can reinforce non-engagement.[16] Difficult or confusing choices often result in people abdicating decision-making to someone else or choosing the path of least resistance (the default or most available option).

[8] MAS (2014) page 31
[9] TNS BRMB (2015) page 13
[10] TNS BRMB (2015) page 13
[11] TNS BRMB (2015) page 17
[12] TNS BRMB (2015) page 13
[13] TNS BRMB (2015) page 27
[14] TNS BRMB (2015) page 13
[15] TNS BRMB (2015) page 13
[16] MAS (2014) page 31

For non-engaged people to become engaged, initial barriers such as low-levels of financial capability must be tackled

Financial capability should be tackled prior to focussing on engagement as low capability can lead to poor decision-making. There are several ways to increase financial capability:

- Financial education
- Peer mentoring
- Experience: trial and error

Financial education improves both capability and behaviour, with some effect on pension saving behaviour

Financial education courses improve capability by 27% on average, and increase financial activity by 9%, on average. The most significant impact is on budgeting/planning behaviours (21%) and saving/asset accumulation behaviours (including pension saving) (10%).[17] The positive effects improve when courses are longer[18] and voluntary.[19]

Peer-mentoring is particularly helpful for young, non-engaged people

While young people are more susceptible to the effects of financial education,[20] they are wary of advice and guidance offered by people older than they are who they perceive as not understanding their particular needs and challenges. Peer-to-peer mentoring from a trusted source (such as a line manager) who has had financial experience is an effective way to develop understanding of how financial products work and managing day-to-day finances.[21]

Non-engaged people are likely to respond well to initiatives that address social norms

Non-engaged people are more likely to make financial decisions based on emotions, beliefs, biases, and social cues about what constitutes "acceptable behaviour". The herding effect (where people are prone to choose the course they feel others are choosing) also strongly effects non-engaged people's behaviour.[22] Tackling perceptions of social norms, which affect emotion and attitude, can be powerful drivers for behavioural change.

Some commonly held beliefs among non-engaged people are:

- ***My approach to managing my financial affairs is working.***
- ***I can keep a mental track of where my money goes.***
- ***Saving small amounts is a waste of time.***
- ***Saving is difficult.***

[17] Kaiser and Menkhoff (2016) pages 9-11; Page 40, figure 6 – averages derived from 115 evaluations of financial education programmes.
[18] Actual hours taught and/or duration of course.
[19] Kaiser and Menkhoff (2016) pages 15 & 20, financial education offered voluntarily in the workplace is more effective than mandatory courses at work or in schools.
[20] Because of a lack of experience-related biases and higher cognitive functioning.
[21] Harrison ***et. al.*** (2016) page 26
[22] TNS BRMB (2015) page 5

- ***Being good with money requires complicated financial knowledge.***
- ***Using credit means I have more to spend***.[23]

Social norms can be repositioned by framing responsible financial management as the right thing to do for one's family.[24] For example:

- ***Responsible borrowing is the right thing to do.***
- ***It is right for my children that I am careful with money.***
- ***Being careful with money provides security for my family.***
- ***Going bankrupt would be a negative situation for myself and my family***.[25]

In a pensions context, this could be framed as "saving in a pension could help both myself and my family to avoid poverty in retirement".

Messages such as these can be delivered through multimedia, using pictures and narrative to reinforce themes. For example, Smart Life Insurance is currently running an advertising campaign using social norms and family responsibility based messages to motivate people to take out life insurance. The campaign involves television and internet ads using pictures of men with their children to invoke a sense of duty and responsibility among men for the financial future of their dependents.[26]

Experiments within the Guatemalan tax system show that incremental changes in positioning can substantially affect the proportion of people who pay their taxes.

[23] TNS BRMB (2015) page 5
[24] TNS BRMB (2015) page 5
[25] TNS BRMB (2015) page 5
[26] www.smartinsurance.co.uk/family-life-insurance/

Box 5: Case study: framing social norms, duty and nationalism to encourage compliance

The Guatemalan Government sent out several different version of tax demand letters and discovered that in particular, those which highlighted that others paid their taxes, and invoked a sense of national pride were the most effective motivators for paying tax, for example:

- ***According to our records, 64.5 per cent of Guatemalans declared their income tax for the year 2013 on time. You are part of the minority of Guatemalans who are yet to declare for this tax year.***
- ***You are a Guatemalan citizen and Guatemala needs you. Be a good citizen and submit the 2013 annual return of income tax … Are you going to support your country?***[27]

Indicators that the State was "watching" people, and would take action against non-compliance also provoked a response, though this tactic may be less relevant in a private pensions context.[28]

Non-engaged people respond more favourably to simple messages about financial management than to complex economic lessons

Complex lessons on financial products are confusing for those with low levels of financial capability and reinforce the belief that managing finances requires unattainable levels of knowledge.[29] Simple steps that help people prepare for future financial shocks and build up a stable level of saving over time are more digestible and appear more relevant.[30] Examples of these types of steps are:

- Adopting simple savings habits, such as saving 20p pieces in smarties tubes.[31]
- Illustrating how small levels of saving can prepare for financial shocks and reinforcing personal responsibility for managing shocks.
- Illustrating the amount lost through using credit and calculating what that money could be spent on, for example, £250 paid as interest or fees on credit in a year could be used for a holiday.[32]
- In a pensions context, framing pension contributions as the equivalent of everyday purchases (such as a cup of coffee) can help people to see that low levels of contributions are not unaffordable, and that there are potential ways of budgeting to compensate for the reduction income.

Non-engaged people respond better to financial education from peers with the opportunity for following up with questions

Non-engaged people, particularly those from minority communities (such as people with disabilities, older people and ethnic minorities) are more likely to

[27] SciDevNet (2014)
[28] SciDevNet (2014)
[29] TNS BRMB (2015) page 5
[30] TNS BRMB (2015) page 9
[31] This will equal £13 when full
[32] TNS BRMB (2015) page 9

trust messages from their peers than from a professional whom they do not know personally. An effective method of reaching the entire population is by cascading information through organisations that engage with people. Though this is a resource heavy method, working with organisations, training staff and ensuring messages are filtered through people known to consumers, is an effective way of prompting behavioural change.

Box 6: Case study: peer-to-peer communication promotes active decision-making among hard-to-reach members of the community

Between October 2007 and October 2012, the UK underwent a process of switching from analogue television broadcast signals to digital television signals (the Digital Switchover).

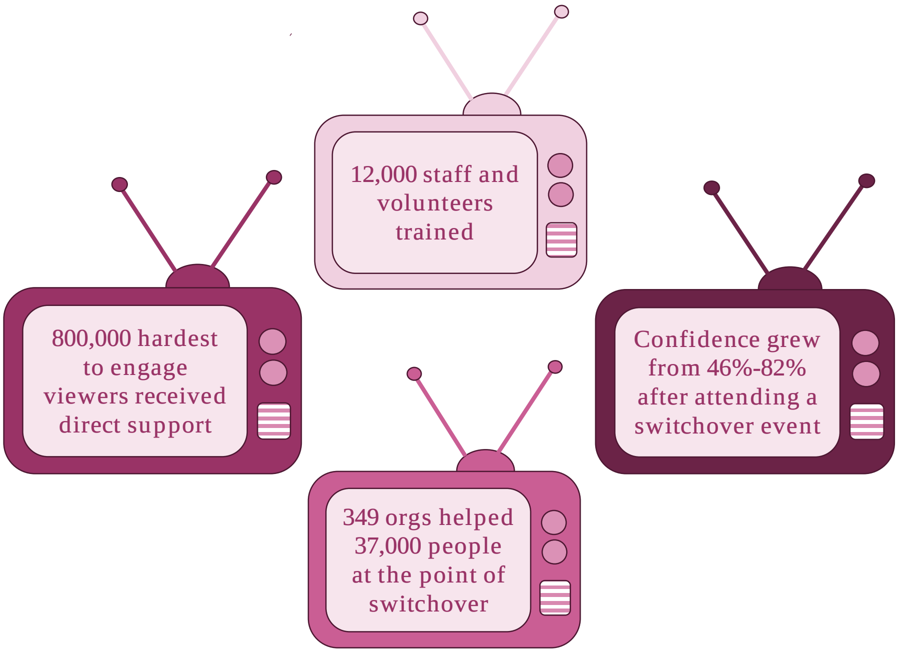
The Digital Switchover required those with analogue TV sets to convert their sets (using electronic equipment) to be able to receive digital broadcast signals. Therefore, the Digital Switchover required many people with TV sets to make active decisions in order to continue being able to receive TV broadcasts. There was widespread concern that vulnerable or hard-to-reach community members such as older people, who might rely heavily on their TVs, might be difficult to access and motivate.

The Government and its subsidiaries used the help of several outside organisations to engage with hard-to-reach people. One organisation, Outreach Solutions,[33] was key in designing the engagement campaign. The campaign consisted of cascading information and messages through community organisations which engage with hard-to-reach people. Through training people in how to train others within and without their own local community organisations, the campaign allowed for a high number of key people within communities to engage with their clients (and to use outreach methods to pass messages and information on to people not engaged with their organisation).[34]

A corollary effect of this type of campaign is that community members pass information between each other. When many people within a community are taking a specific action, it becomes easier for others to find someone to turn to for guidance. The herding effect also dictates that people are more likely to take an action if the majority of their peers are also taking that action.

The Switchover Campaign resulted in:[35]

[33] www.outreachsolutions.org.uk/about-us/
[34] Digital Outreach (2014)
[35] Digital Outreach (2014)



Defaults and compulsion help non-engaged people with very difficult decisions such as the decision to save in the first place

Because early and consistent saving significantly assists the accrual of sufficient retirement income, it is not in the best interests of non-engaged people to defer saving until they have attained higher levels of financial capability. Therefore, defaults or compulsions to contribute to a pension will particularly benefit people in this group.

At the moment, automatic enrolment fulfils this role for people who are eligible through their employer, but some non-engaged people do not benefit from this policy because of a low level of earnings, casual / part-time / multiple-job work, self-employment or unemployment which means they are ineligible.

Safety nets and protection-based policies play an important role for the non-engaged

Alongside work around financial capability and defaults or compulsion to save in a pension, it is vital for non-engaged people to have safety nets they can fall back on. Safety nets are any support offered by Government, such as means-tested benefits, to help those in financial difficulties. Safety nets can also be provided “in kind” through guidance, support, legal assistance, or care and support for those with health problems or struggling families. Those who are non-engaged are more likely than engaged people to be unprepared for financial difficulties and are therefore more dependent on social safety nets than more fully engaged people.

Box 7: Somewhat engaged people

Somewhat engaged people are comfortable with manging their day-to-day finances and may be saving for short-term purchases (within the next few years) or save at a low level for emergencies.[36]

Somewhat engaged people:
- Have higher levels of financial capability and financial confidence than the non-engaged.
- Generally save for the short term but are not engaged in long-term saving.[37]
- Generally feel that they are "making ends meet".[38]
- Tend to manage their finances through short cuts (influenced by anchoring and rules of thumb) such as sporadic balance checks and "mental accounting" which can lead to inaccuracies.[39]
- Generally have a greater understanding of available guidance, information and support services but may not be aware of all of them.[40]
- Are more aware of financial options than the non-engaged.
- Are more likely to be "over confident" beyond their level of capability than the non-engaged. Over-confidence can lead to poor decision-making.[41]

The somewhat engaged are more likely than the non-engaged to be over-confident in their ability to manage money, though some may be under-confident

The somewhat engaged have varying levels of confidence. Some may be over-confident about their ability to manage money, especially those who have some financial capability, are saving, and feel they are successfully "making ends meet".[42] Though some have low levels of confidence which impinge decision-making.[43]

Somewhat engaged people in debt often feel that they are managing well and are less likely to seek help from free services which they view as being for people unable to manage.[44] The somewhat engaged are more likely to make active decisions than the non-engaged but are more at risk of making poor decisions than the fully engaged.

[36] TNS BRMB (2015) page 15
[37] TNS BRMB (2015) page 15
[38] TNS BRMB (2015) page 15
[39] MAS (2014) page 30
[40] TNS BRMB (2015) page 25
[41] TNS BRMB (2015) page 22
[42] TNS BRMB (2015) page 25
[43] Evidence from scheme administrators
[44] TNS BRMB (2015) page 25

Financial education could help raise capability levels among the somewhat engaged

The positive effects of financial education courses are conversely correlated with financial capability; those with high levels of financial capability benefit less than those with low levels.[45] However, those with some financial capability are more able to understand and act on complex information due to higher levels of understanding of how the economy works, higher confidence and higher levels of numeracy.[46] Correctly targeted financial education could help raise financial capability among the somewhat engaged.

The somewhat engaged are aware of media campaigns

The somewhat engaged tend to be aware of pay-day loan companies, and campaigns such as automatic enrolment, that are widely advertised on television, but many are unaware of less publicised, free information and guidance services such as the Money Advice Service.[47] While media can be an effective channel for motivating active decision-making, it is a channel which should be used with caution. The following example illustrates that a high level of engagement can be prompted through a media campaign but may not provide people with sufficient support and guidance to make the best decisions.

[45] Kaiser & Menkhoff (2016) page 19
[46] MAS (2016) page 17
[47] TNS BRMB (2015) page 25

Box 8: Case study in media-led engagement

In 2000, Sweden introduced a new range of tax-advantaged private pension schemes alongside a large-scale advertising campaign encouraging people to make active pension investment decisions. There was a strong response from the public: 67% of whom actively chose to invest their pension contributions in funds other than the default fund.

After the initial enrolment period, the Government reduced spending on the advertising campaign, and active decision-making dropped dramatically, to 8% by 2003.

Unfortunately, many of the active choosers invested in funds that performed less well than the default funds in their schemes. This occurred for a variety of reasons:

- The recent high performance of some of these funds was based on returns in a high-performing "bull" market, but at the point that the schemes were rolled out to pension investors, the economy declined and returns reduced.
- Many choices were not based on sound economic theory but a preference for funds invested locally in Sweden. This strategy resulted in less hedging through diversification in internationally based funds and, overall, lower returns on portfolios.

A lot of the active-choosers, who disengaged as the media campaign was rolled back, remained in their poorly performing funds.[48]

While the media campaign resulted in higher engagement through active decision-making, the overall result was lower returns in pension saving which may continue into the future for those who remain in poorly performing funds. Television is an excellent medium for sending a message to a wide group of people and is associated with prompting action, though it does not necessarily help raise capability.

The somewhat engaged can benefit from free guidance and advice

While there are prejudices among the somewhat engaged regarding money advice and support services, those who do seek help with money management report that these services improved their financial behaviour.[49]

Choice architecture could help those with medium levels of financial capability

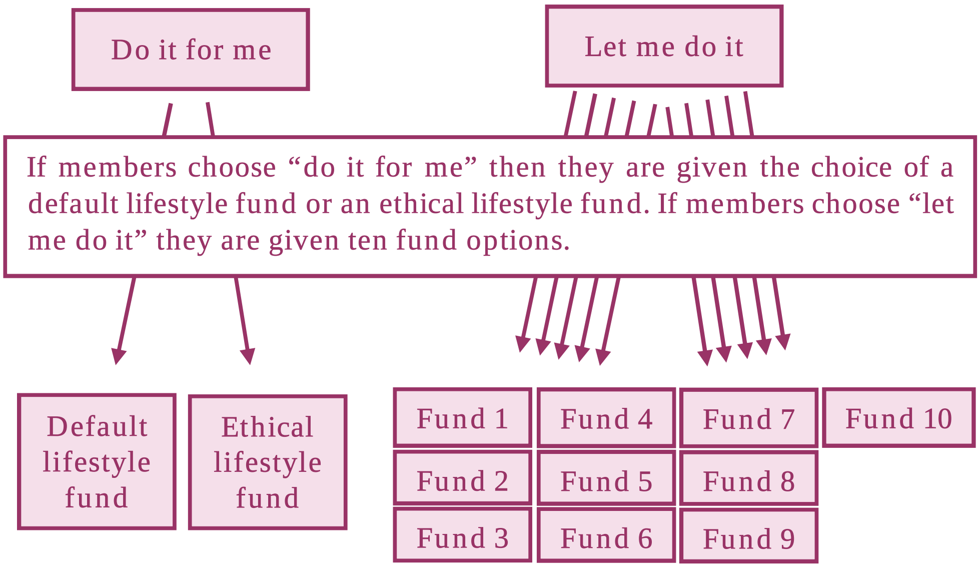
The somewhat engaged are generally more comfortable making simple financial decisions than the non-engaged, but may struggle with complex decisions.

[48] Cronqvist & Thaler (2004)
[49] MAS (2016) page 65

Options can be streamlined through choice architecture so that decision journeys start with the option to make a choice or have the choice made automatically. Box 9 provides an example of using choice architecture in this way.

Box 9: The Universities Superannuation Scheme: an example of using choice architecture

The Universities Superannuation Scheme (USS) has recently rolled out a DC section to form part of its Occupational DB/DC hybrid scheme. The DC section is supported by a web portal that members can use to manage their pension savings and contribution levels. When members log in to the investment section of the portal they are presented with two options:



In presenting two simple and straightforward options up front, people are motivated to choose one. This approach avoids eliciting inertia and disengagement through choice overload. The simplicity of the options avoids alienating those with lower levels of financial capability.

However, those who wish to make a complex choice are able to choose an avenue which gives them ten fund options, an array which might confuse others.

The less active option is more popular: two thirds of people accessing the portal choose "do it for me" and one third choose "let me do it". Those who choose "let me do it" are more likely to choose higher-risk options.[50]

While the above example demonstrates how providers can use choice architecture digitally to allow people to decide their level of options, not all

[50] Data provided by USS

people have access to the internet and not all schemes have an online facility for people to manage their funds.[51]

Box 10: Engaged people

Engaged people generally have average to higher incomes, though a minority of engaged people have low incomes. Engaged people are more likely to come from wealthy families though some people from low income backgrounds have high levels of financial capability.[52]

Engaged people:

- Have higher levels of financial capability than the non-engaged and somewhat engaged.
- Are more likely to be financially comfortable.[53]
- Are more likely to have a "professional" job.[54]
- Tend to have more automated systems of managing finances, for example, involving the use of spreadsheets.[55]
- Are likely to be saving both for short-term needs and for retirement.[56]

Engaged people are least likely to respond well to financial education

Financial education courses are less profitable for fully engaged people (as higher levels of financial capability reduce the impact of financial education).[57] However, the fully engaged generally have a higher capacity and willingness to learn new things because of high levels of confidence and capability in other areas and a stronger sense of financial autonomy.[58] These qualities are often associated with higher incomes and more positive experiences with financial decision-making. Those with higher financial capability are more likely to be able to understand and act on discrete information provided about new schemes or products.

Engaged people are attracted to policies which allow greater financial freedom

Engaged people value their autonomy and feel a strong emotional attachment to managing their own finances.[59] They generally do not respond well to compulsion, which takes the power for managing their own finances away from them.

This creates a tension for policy makers as compulsion may benefit the less engaged but takes decision-making power away from people with higher levels

[51] The data covers information from ABI data providers for 2016. The information is from an ad hoc data collection and not from the ABI's regular data collection series.
[52] ONS (2015c) page 18
[53] MAS (2014) pages 25 - 27
[54] TNS BRMB (2015) page 15
[55] MAS (2014) page 30
[56] TNS BRMB (2015) page 15
[57] Kaiser & Menkhoff (2016) page 19
[58] MAS (2014) pages 25 – 27, USS data
[59] MAS (2014) pages 25 - 27

of financial capability. Soft defaults which provide an option for the less engaged but do not compel active decision-makers down a particular route can provide a helpful middle ground, but risk missing some of those who would benefit from compulsion.

Engaged people benefit from protection against overcharging and fraud

Engaged people are the main consumers of financial products, and therefore benefit from regulation and consumer protection which governs overcharging, misconduct and fraud by financial services. The highly engaged benefit more from these policy levers than from defaults, compulsion or safety nets.

While behavioural economics are used to help people to achieve positive outcomes, people are also exposed to behavioural cues which can lead to making poor decisions. Reducing negative behavioural cues plays an important role, alongside positive cues, in helping to reduce harm and promote positive outcomes from long-term saving.

People might interact with financial services and pensions throughout their lifetimes without becoming engaged, though some interactions may prompt engagement

Whether and how people engage with pension savings varies as a result of age and personal circumstances. Some saving transitions (such as automatic enrolment) do not necessitate much, if any, engagement from individuals while others require individuals to take an active decision in order for any transition to take place. There are specific "triggers" that could prompt people to learn more about long-term saving or to make active decisions during their lives.

At any point in time, people's ability to actively engage is affected by:

- Age
- Demographics (household makeup, job, location, education, ethnicity, ability)
- Sources of income
- Sources of credit / debt
- Assets
- Expenditure needs
- Protection (insurance products)
- Financial confidence and capability[60]

The rest of this report explores how people engage throughout the lifecourse:

- Chapter two: how do children engage?
- Chapter three: how do young adults engage?
- Chapter four: how do adults engage?
- Chapter five: how do people approaching retirement engage?
- Chapter six: how do people at and over State Pension age engage?

[60] MAS (2016) page 6

Chapter two: how do children engage?

This chapter looks at the ways children engage with financial concepts.

Childhood – under age 18

While children do not need to make decisions around pensions and savings, childhood represents an opportunity to lay the groundwork for future financial capability, confidence and positive behaviour.

Children have low financial capability, high cognitive ability and fewer behavioural biases

Children are less likely to make active financial decisions (because of financial constraints and the lack of financial responsibility) and they possess low levels of financial capability on average. However, some children are forced by circumstances to become financially responsible for themselves and their families and can, in these cases, assume a level of autonomy and skill generally associated only with adults.

Children are uniquely capable of learning

While children have lower levels of financial capability, they have a higher cognitive ability than adults and are more able to learn.[61] Children are also less likely than adults to have strong behavioural biases, due to their lack of experience, and are more susceptible to messages regarding optimal financial behaviour.[62] Childhood presents a key opportunity to lay the groundwork for financial capability and decision-making in the future.

There are gender differences in children's financial interest, behaviour and confidence

Financial interest among girls[63] is 10% lower on average than for boys, and girls are 10% less likely to save their pocket money. Some of this difference is attributable to gender differences in financial confidence which lead girls to self-assess as having lower capability, though there is no detectable gender difference in financial knowledge among children.[64] As children move into adulthood, gender differences in capability and confidence become more pronounced. Efforts at tackling gender differences in financial confidence and behaviour may need to begin in childhood in order to lay the groundwork for reducing gender differences among adults.

Children display trust-related biases towards financial institutions

While children have fewer biases that might prevent positive financial behaviour, there is evidence of developing mistrust towards banks and other financial institutions among children, especially teenagers.[65]

[61] Lührmann ***et al*** (2014) page 160
[62] Kaiser & Menkhoff (2016) page 15
[63] Observed from age 13
[64] Lührmann ***et al*** (2014) page 14
[65] Harrison ***et. al.*** (2016) page 24

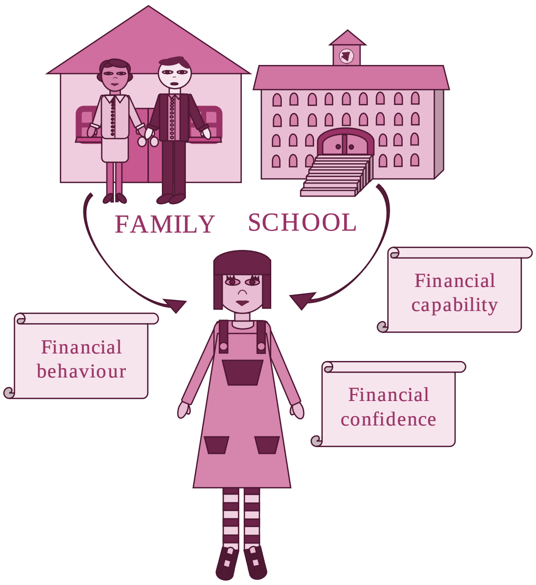
Children receive the majority of financial information from family and school

Children are unlikely to be responsible for making household level financial decisions but there are a few avenues through which they engage with financial concepts, attitudes and behaviour.

- Family: families teach children about finances through encouraging saving (pocket money) and demonstrating money management behaviour
- Children inherit attitudes and behaviour from their family:
  - Children from struggling families learn different approaches to money management than those from wealthier families.
  - Children whose parents have low levels of financial capability generally have lower levels themselves and vice versa.
  - Children whose parents teach them about budgeting and economics generally have higher financial confidence and capability than children whose parents do not.[66]

Family based financial interventions could be useful for those whose parents have limited levels of financial capability, however this could be resource heavy and difficult to roll out.[67]

- School: Other than from family, children receive the majority of their information from school. The school environment allows for teaching different economic skills over a protracted period of time:
  - Lessons in economics both on an individual and society-wide level.
  - Financial education, budgeting lessons.



[66] Harrison ***et. al.*** (2016) page 27
[67] Harrison ***et. al.*** (2016) page 27

Educational interventions in childhood can increase financial capability and engagement

Financial education courses increase interest and knowledge among teenagers, and improve ability to determine product risk.[68] Financial education with teenagers can modify hyperbolic discounting and a lack of self-control; observed through reductions in impulse buying.[69]

Follow-up work is necessary to determine the extent to which educational interventions in childhood impact decision-making in later life, but increases in financial capability generally impact future behaviour positively.[70] School based interventions are an effective way of targeting a cross section of the population. However, many young adults feel that they didn't receive the practical financial education they required at school to help them make decisions in adult life.[71]

Voluntary financial education is more effective than mandatory lessons

One potential drawback of school interventions is that mandatory lessons are less effective influences on capability and behaviour than voluntary lessons.[72] Further work may be necessary to find ways of encouraging children and teenagers to buy in to the need for financial education and attend voluntary lessons offered through their schools or elsewhere.

Box 11: Most and least effective behavioural interventions with children

<table>
<tr><th>Children</th><th>Male</th><th>Female
· Focus on enhancing confidence</th><th>High income</th><th>Low to medium income</th></tr>
<tr><td>Marginalised</td><td colspan="4" rowspan="4">Most effective
· Aimed at increasing capability and confidence
· Family, (face-to-face, individual), demonstrating behaviour, educational, ongoing, long-term
· School, (face-to-face, group) educational, ongoing, long-term or short-term
Least effective
· Complex or high level education</td></tr>
<tr><td>Non-engaged</td></tr>
<tr><td>Somewhat engaged</td></tr>
<tr><td>Engaged</td></tr>
</table>

[68] Lührmann ***et al*** (2014) page 161
[69] Lührmann ***et al*** (2014) page 172; Lührmann ***et al*** (2015)
[70] Lührmann ***et al*** (2014); Lührmann ***et al*** (2015)
[71] Harrison ***et. al.*** (2016) page 27
[72] Kaiser and Menkhoff (2016) pages 15 & 20

Chapter three: how do young adults engage?

This chapter looks at the ways young adults engage, the different triggers which might affect changes in saving throughout the lifecourse and explores the concept of teachable moments.

Young adulthood – ages 18 to 25

Box 12: What types of financial decision-making (relevant to long-term saving) might young adults need to make?

- How can I juggle my competing financial priorities?
- How do I deal with debt?
- What is a pension? What is it for? How do I save in one?
- Should I opt out of my pension or stay in?
- Should I opt in or find some other form of provision?
- What can I expect from my employer?
- How much should I contribute? What can I expect to get back?

Young adults have varying levels of financial capability

Financial confidence and capability is low among young adults on average, due to a lack of decision-making experience,[73] though there is variation:

- Young adults who live at home and/or are financially dependent on their parents tend to have lower levels of financial confidence and capability.
- Young adults in employment and/or who live away from the parental home and have assumed financial responsibility tend to have higher levels of confidence and capability.[74]
- 24% of young women are very confident in managing financial decisions compared to 48% of young men. However, young women are more likely to discuss their finances and seek advice from their family than young men.[75]

While few young adults are actively engaged with financial products,[76] there are correlations between capability, confidence and engagement among those who are:

- 63% of young adults with a mortgage have plans for how to meet financial goals compared to 37%-40% of young people living in rented accommodation.[77]
- Young adults with a savings account or credit cards tend to be more financially confident than those without.[78]

[73] Harrison ***et. al.*** (2016) page 11
[74] Harrison ***et. al.*** (2016) pages 13 & 14
[75] Harrison ***et. al.*** (2016) pages 16 & 18
[76] Harrison ***et. al.*** (2016) page 12
[77] Harrison ***et. al.*** (2016) page 5
[78] Harrison ***et. al.*** (2016) page 12

Young adults from wealthier backgrounds are more likely to use financial products or to have a mortgage.[79]

The majority of young adults have short-term financial goals

69% of young adults have financial goals for the next five years, compared to 53% of all adults. However, young adults are more likely to struggle with making concrete plans for meeting their goals due to having less financial experience to draw on than other adults.[80] The majority of young adults' financial goals are short-term (related to buying a house or a car).[81] To some degree this reflects the propensity toward present-bias among younger people, however, young adults are more likely to struggle with competing priorities and have a lower income than older adults.

Young adults struggle with social pressures to focus on the short-term

While most adults are influenced to some degree by social expectations, young adults are subject to specific and competing social pressures regarding financial-management. There is social pressure for young adults to live an "enjoyable life" and a perception that to enjoy life one must sacrifice financial stability in favour of travel and socialising. Some young adults report that they often succumb to these pressures and spend money that they are attempting to save.[82]

Young adults struggle with competing goal sets which can generate confusion and poor decision-making

Many young adults also aspire to get married, buy a house and start a career. The dissonance between goals (settling down vs. travel and freedom) generates confusion when it comes to making financial decisions, and can reduce confidence and result in impulsive choices.[83] The immediate financial struggles that young adults face: dealing with social pressures, and juggling competing goals, can reduce the apparent relevance of long-term financial needs.

Young adults are more likely to be in significant debt

Young adults are more likely to have significant debts than people in other age groups but are less likely to seek debt advice, especially if living in the parental home. Young men are more likely to feel overconfident in their ability to sort out debt problems while young women generally acknowledge when they need help but don't know what support is available.[84] Poor financial experiences, such as debt, are associated with lower confidence though the causal relationship is uncertain. Those with low confidence are three times as likely to be in debt as those who are very confident.[85] As lower levels of confidence can make it harder

[79] Harrison ***et. al.*** (2016) page 12
[80] Harrison ***et. al.*** (2016) pages 5, 10 & 13
[81] Harrison ***et. al.*** (2016) pages 5, 10 & 13
[82] MAS (2014) pages 34 & 37
[83] Harrison ***et. al.*** (2016) page 12
[84] Harrison ***et. al.*** (2016) page 16
[85] Harrison ***et. al.*** (2016) page 12

to manage finances and cope with difficulties, debt can become self-perpetuating for some young adults.[86]

Young adults have low levels of trust in financial institutions

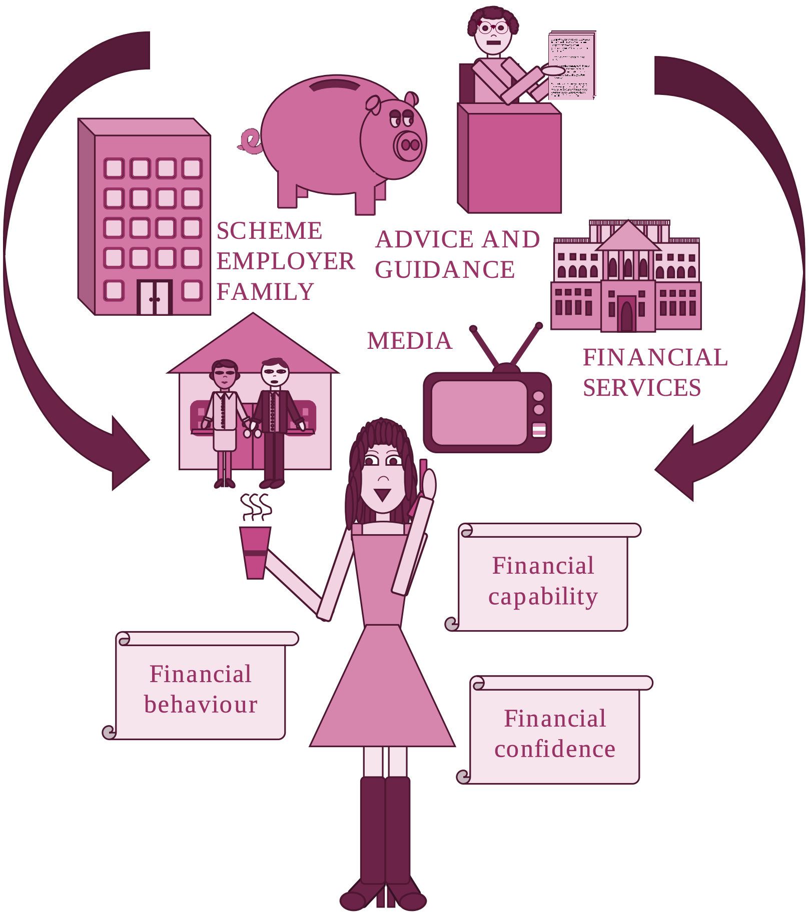
Young adults generally have limited experience of financial institutions, though most have dealt with banks. Levels of trust in banks are low and advice is perceived to be impersonal, computer-led and generally focused on the banks interest rather than the customers.[87] Low levels of trust in banks and financial services motivate many young adults to turn to family and friends as more personal and trusted sources of information.[88]

Young adults receive financial information, guidance and advice from a variety of sources:

- Family: 40% of young adults turn to family and 26% turn to friends as their main sources of financial advice and guidance.[89]
- When automatically enrolled, re-enrolled or voluntarily joining a pension scheme: Pension schemes are required to communicate with members at certain times such as joining or when annual statements are due.
- Internet: 29% of young adults use the internet to find information about financial products but often find the vast array of conflicting information confusing.[90]
- Employer: Most employed young adults receive statutory communications from their employer regarding their automatic enrolment pension scheme. Some employers provide further information about pension options at their discretion. Young adults feel a higher level of trust for their employer than for providers of financial services. Many of the young adults enrolled in a pension scheme have little knowledge of their arrangements and assume that their employer is making informed choices on their behalf.[91]
- Free support and guidance: While free support and guidance is available to all adults, many young adults are unaware of it or do not think they are eligible for help.[92]
- Financial services: Young adults are unlikely to have contact with a range of financial services, though many have had contact with banks. Overall levels of trust in banks is low, though 18% of young adults used them for financial advice in 2016.[93]
- Financial adviser: A few young adults, around 4% in 2016,[94] use financial advisers. They are generally seen as expensive and out of reach.[95]

[86] Harrison ***et. al.*** (2016) page 12
[87] Harrison ***et. al.*** (2016) page 29
[88] Harrison ***et. al.*** (2016) pages 23 & 24
[89] Harrison ***et. al.*** (2016) pages 2 & 19, table 2, 2015/2016 data
[90] Harrison ***et. al.*** (2016) pages 2 & 19, table 2, 2015/2016 data
[91] Harrison ***et. al.*** (2016) page 10
[92] Harrison ***et. al.*** (2016) pages 2 & 19, table 2, 2015/2016 data
[93] Harrison ***et. al.*** (2016) page 19, table 2, 2015/2016 date
[94] Harrison ***et. al.*** (2016) page 19, table 2, 2015/2016 date
[95] Harrison ***et. al.*** (2016) pages 2 & 19, table 2, 2015/2016 data

- Media: Young adults absorb media through many different channels and are more likely to use digital channels to access advice and support than people from other adult age groups.



Box 13: Teachable moments occur when information can be acted upon in order to achieve a goal that is of importance to an individual at that time.

It is important to engage with people at a "teachable moment" when they are willing and able to take decisive action. To some extent, the timing of an intervention is as, if not more, critical than the nature of the intervention. Interventions conducted when people are incapable of absorbing and acting on information (due to behavioural or structural factors) may be extremely ineffective. These can occur during life transitions or during other times when people are making financial decisions such as buying other financial products.

The Behavioural Insight Team concludes that if interventions are Easy, Attractive, Social and Timely (EAST) then they are more likely to motivate action. This aligns with the theory of teachable moments in that:

- Any follow up action must be straightforward (easy).
- People are more likely to take action if they feel others would approve and/or are doing the same thing (social).
- Messages must be personalised and relate to achievement of current goals (attractive and timely).[96]

Young adults are most likely of all age groups to be experiencing transitions which give rise to "teachable moments"

Financial interventions of any kind will have minimal effectiveness if they are not personalised, relevant to people's current goals, and people are not able to take immediate practical action. Young adults experience many of the transitions which give rise to teachable moments:

- Starting university
- Moving away from parental home (and setting up own home)
- Starting employment
- Buying a house
- Moving in with a partner
- Starting a family

Financial interventions provided at these points are more likely to lead to long-term behavioural and attitudinal change.

Family is the most common source of financial advice and information for young adults

While family is the most common source of financial advice and information, the capability of parents varies and in some cases advice is incorrect or not forthcoming.[97] Therefore, family will not be the best source of support for some young adults. Family-wide interventions may be helpful for families with low

[96] Service ***et. al.*** (2014)
[97] Harrison ***et. al.*** (2016) page 27

financial capability,[98] alongside ensuring that young adults are made more aware of other sources of advice and information available.

Young adults prefer using digital methods to access advice and guidance

Young adults are more likely to use digital methods for financial help; around 29% of young adults use the internet in order to gain information about financial products. However, the varying sources and types of information are often perceived as confusing and can lead to indecision. This is a result of the effects of choice and information overload.[99]

Peers are often seen as more trustworthy and approachable than financial professionals

Young adults generally have low levels of trust for financial service professionals but feel that people in their age group and / or local or professional community are trusted sources of information.[100] Circumstances affect intervention opportunities, for example, older students might be appropriate key agents for people just starting university whereas younger managers might in the best position to talk with those starting work for the first time.[101]

Financial interventions with young adults should focus on simplicity

45% of young adults are "very confident" compared to 58% for all adults. Simple approaches are easier for those with low levels of confidence to practically act on as they are unlikely to generate confusion or require high-level decision-making.[102]

Workplace education could help to raise financial capability and change behaviour among young adults

Voluntary education is more effective than mandatory education. However, mandatory education in the workplace is more effective than mandatory education at school.[103] Young adults are in a key position to benefit from workplace-provided financial education due to low levels of capability and confidence coupled with undeveloped behavioural barriers and biases. However, 87% of workplaces did not offer financial education to their workforce in 2011. Appetite among employers who don't offer education is low; only a quarter of those who don't offer it believe that there would be a benefit to doing so.[104]

Visualising one's "future self" can help people prioritise long-term saving

Some providers use multimedia (television, radio, and internet) to encourage people to think about their future selves, write letters to them or use makeup as

[98] Harrison ***et. al.*** (2016) page 27
[99] Harrison ***et. al.*** (2016) pages 2 & 19, table 2, 2015/2016 date
[100] Harrison ***et. al.*** (2016) page 27
[101] Harrison ***et. al.*** (2016) page 26
[102] Harrison ***et. al.*** (2016) page 1
[103] Kaiser and Menkhoff (2016) pages 15 & 20
[104] IFF Research (2011) page 5

a way of seeing what people might look like when they are older. These activities help people to relate to their future selves and act as an impetus for retirement planning.[105]

Young adults on lower incomes are likely to have lower levels of confidence and capability

Financial capability is correlated with income to some degree. Lower capability among those on low incomes relates to factors including (but not limited to) negative financial experiences, lower familial capability, and fewer educational opportunities.[106]

Financial education interventions could be tailored to prevent class–related learning barriers by focussing on helping those with low capability to build up capability and behaviour related to positive financial behaviour.[107]

Box 14: Most and least effective behavioural interventions with young adults

Young adults	Male	Female	High income	Low to medium income
		· Focus on enhancing confidence		
Marginalised	· ***Compulsion, defaults, safety nets***			
Non-engaged Somewhat engaged Engaged	Most effective · Implemented during teachable moments · Simple and practical, aimed at increasing confidence and capability · Family-led (if high capability) (face-to-face, individual) demonstrating behaviour, educational, long-term · Peer-led (face-to-face, individual) demonstrating behaviour, educational, long-term · University or work-led, voluntary (face-to-face, group) educational, long-term – focus on increasing capability · Multimedia (TV, internet or individual / group		Most effective · Organisation led (employer or adviser) (face-to-face, phone, web-chat), personalised, · Focussed on loss aversion · ***Consumer protection, freedoms***	Most effective · Peer or organisation led (face-to-face, phone, web-chat, group or individual) personalised · Focused on social norms · ***Compulsion, defaults, safety nets***

[105] www.aviva.co.uk / retirement / shape-my-future / unlock-my-future / article / getting-know-future-self / ; Merril Lynch
[106] TNS BRMB (2015) page 7
[107] Kaiser & Menkhoff (2016) page 25

	work) visualising or engaging with future self, (group or individual), short-term		
	Least effective · Not implemented during a transition · Complex and high level · Family, (if low-capability) · Financial institution-led (bank or other financial service) · Internet searches		

Box 15: Case study: opting in, staying in and opting out.

Alan is a median earning man who works in every year from age 18 (in 2017) to his SPa. In each year he earns at median earnings for his age and gender. He takes part in a peer-led educational programme on long and short-term financial health at his work. As a result he decides to either opt out, remain in or opt in early (at age 18) to pension saving. This case study is designed to show the potential financial impact of behavioural changes in relation to automatic enrolment.

1. Baseline scenario: Alan is auto-enrolled at age 22 and contributes at 8% of band earnings with his employer every year until SPa.
2. Alternative scenario 1: Opting out – Alan opts out at age 22 and again at ages 25 and 28 (after he is re-enrolled). At age 31 he is re-enrolled and does not opt out. He contributes at 8% of band earnings with his employer every year between age 31 and SPa.
3. Alternative scenario 2: Opting in – Alan opts in to his employer's scheme at age 18 and contributes at 8% of band earnings with his employer every year from age 18 until his SPa.

The below table shows the likelihood that Alan will receive an income which allows him to replicate working life living standards in retirement (£15,100) through a combination of state and private pension income.

Scenario	Baseline saving from age 22	Opting out until age 31	Opting in at age 18
Chance of replicating working life living standards	67%	45%	71%

If Alan saves earlier as a result of behavioural interventions, he increases his chance of replicating working life living standards in retirement by 4%. However if he decides to delay saving until age 31 (which he may do as a result of engaging more, but may also do because of a lack of engagement) he reduces his chance of replicating working life living standards by 22%.

Chapter four: how do adults engage?

This chapter looks at the ways adults engage with long-term saving and where teachable moments for adults might occur.

Adulthood – aged 25 to 55

Box 16: What types of financial decision-making (relevant to long-term saving) might adults need to make?

- How do I deal with debt?
- What is a pension? What is it for? How do I save in one?
- Should I opt out of my pension or stay in?
- Should I opt in or find some other form of savings?
- What can I expect from my employer?
- How much should I contribute? What should I expect to get back?
- How many pensions do I have and where are they?
- When might I retire?
- How much do I need to live on in retirement?
- Am I on track to meet my savings goals and if not, what can be done to fill these gaps?

Adults generally have higher levels of financial confidence and capability, though women have lower levels than men

Capability and confidence grows with decision-making experience and therefore, adults have higher levels on average than young adults. Adults with little financial decision-making experience tend to have lower levels of capability and confidence.[108] As with other age groups, men have higher levels of engagement and capability than women, however, couples under age 45 tend to jointly manage finances, (unlike older couples). This implies that levels of financial responsibility are becoming less gendered, which could lead to higher levels of confidence and capability in women over time.[109]

Social pressure can reduce focus on long-term saving

Stigma associated with struggling financially, pressure to appear generous or to have certain cars or houses causes some people to live beyond their means or go without basic necessities.[110] Because of these pressures, alongside behavioural factors such as present-bias, many adults prioritise having readily available funds over longer-term savings.[111]

[108] Harrison ***et. al.*** (2016) page 1
[109] MAS (2014) page 56
[110] MAS (2014) page 34
[111] MAS (2016) page 41

Adults receive guidance, information and advice from many sources:

- Family and friends: In 2016, 25% of adults turned to family for support and guidance and 18% turned to friends.[112]
- When automatically enrolled, re-enrolled or joining a scheme voluntarily: Pension schemes are required to communicate with members at certain times such as joining or when annual statements are due.
- Employer: Employed adults receive statutory communications from their employer regarding their automatic enrolment pension scheme. Some employers provide further information about pension options at their discretion.
- Free support and guidance: While some adults are aware of free support and guidance, the majority access information and guidance digitally (see "internet" below).
- Engagement with financial products: Once people become engaged with one financial product, they are more likely to begin to use other products.[113]
- Financial services: The use of financial services and advisers is higher for adults than for young adults. In 2016, 20% of adults used a bank/building society, 6% used an insurance company, and 5% used a financial adviser for information/guidance/advice.[114]
- Internet: Adults are generally happy with using digital channels for advice and information. In 2016, 26% of adults used internet searches, 25% used price comparison sites, and 25% used moneysavingexpert.com for information and guidance.[115] Fewer adults use internet searches for financial help than young adults.

The older an adult is, the less they benefit from general financial education

General financial education has less efficacy as age, experience and income grows because:

- Cognitive ability and learning aptitude declines as people age,
- The more experience people have, the stronger behavioural barriers and biases become,
- Those with high levels of capability and/or income benefit less from financial education.

Financial education is still useful for adults but will benefit people more if it is tailored to specific needs, or aims to help people understand particular products or financial concepts.

Adults on low incomes find engaging with long-term saving difficult, even if they have high financial capability

Adults can be broadly separated into three financial categories:

112 Harrison ***et. al.*** (2016) page 19, table 2
113 Harrison ***et. al.*** (2016) page 5
114 Harrison ***et. al.*** (2016) page 19, table 2
115 Harrison ***et. al.*** (2016) page 19, table 2

- Struggling (low to average income),
- Squeezed (average income), or
- Cushioned (average to above average income).[116]

Those in the squeezed and struggling groups have lower levels of disposable income, generally lower financial capability and higher demands on day-to-day income (family and household expenses). These financial constraints can make information about long-term saving appear less relevant, reducing the "immediate goals" aspect of teachable moments. People are less likely to act on financial advice, guidance or information that does not appear relevant to current needs and goals. Those in the cushioned group are more likely to be saving and to have longer-term financial plans. Pension information will appear more relevant to their current situation and goals.[117]

Life events and financial shocks can trigger financial decision-making but can also lead to further financial problems

During adulthood, teachable moments occur during transitions or financial shocks. Often, transitions, such as divorce or losing a job, can be the direct cause of financial shock (Box 17).

Box 17: Teachable moments for adults

Transitions	Potential precedents of financial shocks[118]
· Making financial decisions · Leaving full time education · Changing (or starting) employment · Saving in a pension for the first time · Moving home · Getting married · Buying a property · Having children · Divorce · Onset of health problems · Need to provide care · Bereavement	· Unemployment · Divorce · Onset of health problems · Need to provide care · Bereavement

Adult transitions provide teachable moments because they motivate people to re-arrange priorities

When people start a family or buy a house, their priorities change:

[116] MAS (2016) page 10
[117] MAS (2016) page 10
[118] Financial shocks, such as debt or a reduction in income, can result from these but will not always

- Buying a house tends to coincide with a shift in financial priorities from socialising to home costs, meeting bill payments and saving.[119]
- Those who have taken out a mortgage tend to become more financially confident as a result of that experience.[120]
- Joining assets can positively influence financial behaviour especially when people are working together towards mutual goals.[121]

However, family responsibilities can also distract adults from long-term saving plans. Many of those with young families report being too "swept up in daily life" to plan for the future.[122]

People who don't adapt after financial shocks are more likely to cease contributing to their pension

Adults tend to respond to financial shocks in one of two ways:

- By adapting and adjusting financial behaviour, or
- By refusing to alter behaviour, thereby entrenching financial problems.

Those with higher capability are more likely to have savings set aside in order to cope with financial shocks and to adapt spending behaviour to accommodate a reduced income. Those with low levels of capability are less likely to have savings to fall back on or to have the disposition to adapt quickly.[123] During financial shocks and income reductions, those who are unprepared are more likely to cease contributing to their pension and to experience other financial difficulties.[124]

- Divorce can make finances more difficult to manage and the pension is often one of the financial commitments sacrificed at this time. Divorce is harder for those who did not manage their own finances within the relationship.[125]
- Losing a job can cause financial problems and many people don't prepare even if they know it is coming.[126]
- A combination of debt with relationship breakdown and/or job loss can cause financial difficulties to become entrenched.[127]
- An onset of health problems for an individual or family member can lead to work loss, time constraints on family members, and an increased need for money to spend on care.[128]

[119] MAS (2014) page 53
[120] MAS (2014) page 53
[121] MAS (2014) page 51
[122] MAS 92014) page 41
[123] CAB (2015b)
[124] CAB (2015b)
[125] MAS (2014) page 56 & 58
[126] MAS (2014) page 61
[127] MAS (2014) page 64
[128] MAS (2014) page 66 – prescriptions, accessibility / mobility costs etc.

Repositioning social norms can improve financial behaviour

Insurance providers use family responsibility messages to encourage investment in life insurance.[129] Similar campaigns could be run for pension saving, for example using the message: "saving in a pension could help both myself and my family to avoid poverty in retirement". Those on higher incomes are more responsive to national duty messages such as, "paying taxes is necessary for schools and hospitals to run effectively" than messages around family based social norms.[130]

Adults respond well to group education courses

The Universities Superannuation Scheme (USS) recently rolled out a new section to their pension scheme (changing their DB scheme into a DB/DC hybrid for people with an income over a certain level, and open to voluntary joiners). As part of their engagement strategy for members they sent out messages about the new scheme (and the offer of an employer match) through emails, letters, posters, and presentations to over 10,000 members across 80 locations. Overall, the response was that the presentations in particular helped people to understand what was happening with their pension scheme, people's options and some of the implications of making different choices.[131]

More engaged adults, and/or those on higher incomes, benefit more from consumer protection measures than policies which attempt to change behaviour

Engaged adults and many of those on higher incomes may not exhibit a high degree of detrimental financial behaviour or, if they do, might have a higher cushion of wealth and income to soften the impact of financial shocks. However, those with high income and low levels of engagement and/or capability are still vulnerable to making poor decisions which could lead to financial difficulties.

Adults with high incomes and high capability are less susceptible to (and less in need of) behavioural interventions. However, engaged adults with high incomes still require protection from fraud, neglect or badly managed/unduly highly charged products and services. Therefore consumer protection policies play an important role in helping high income, engaged adults to achieve positive pension outcomes.

Box 18: Most and least effective behavioural interventions with adults

Adults	Male	Female	High income	Low to medium income
		· Focus on enhancing confidence		
Marginalised	· ***Compulsion, defaults, safety nets***			

[129] Smart Insurance television campaign 2017
[130] Hallsworth et. al. (2017)
[131] USS data

<table>
<tr><td>Non-engaged</td><td rowspan="2">Most effective
· Implemented during teachable moments
· Focused on repositioning social norms: family responsibilities, simple actions
· Tailored, specific education (for example on pensions and long-term savings)
· Shifting focus from short-term to long-term
· Peer or organisation-led (scheme, employer), (face-to-face, telephone, web –chat, group or individual) personalised, educational, long-term
· Scheme-led (digital, individual) choice architecture - allowing people to choose whether or not to make active decisions (within regulatory boundaries)
· Multimedia (TV, internet or individual / group work) visualising or engaging with future self, (group or individual, short-term)
· Compulsion, defaults, safety nets</td><td rowspan="2">Most effective
· Organisation-led (work or adviser) (face-to-face), personalised, focussed on loss aversion, national pride / duty
· Consumer protection, freedoms</td><td rowspan="2">Most effective
· Peer or organisation-led (scheme, employer), (face-to-face, group or individual) personalised, educational, long-term
· Focused on repositioning social norms and simple actions
· Recognises financial constraints, personalised, relevant to peoples' goals and needs
· Compulsion, defaults, safety nets</td></tr>
<tr><td rowspan="2">Somewhat engaged</td></tr>
<tr><td colspan="3">Least effective
· Interventions which do not take peoples' current needs, goals and resources into account
· General education
· Complex, high-level education
· Financial institution-led education</td></tr>
<tr><td>Engaged</td><td>Most effective
· Organisation led (work or adviser) (face-to-face) complex, tailored, focussed on explaining discrete issues / products
· Focus on social responsibility rather than social norms
· Also: consumer protection, freedoms</td><td colspan="2">Most effective
· Organisation led (work or adviser) (face-to-face)
· Personalised, focussed on explaining discrete issues / products and simple approaches
· Safety nets, consumer protection, freedoms</td></tr>
</table>

Box 19: Case study: voluntarily joining a pension scheme

Sapna is a self-employed median earning female who works every year from age 22 (in 2017) to her SPa. In each year she earns at median earnings for her age and gender. She engages in informal, peer-led education with someone from a local community group. As a result of this she could make many decisions including joining a pension schemes. This case study is designed to show the financial impact of behavioural changes in relation to contributions.

1. Baseline scenario: Sapna makes no private pension savings.
2. Alternative scenario 1: Voluntary joining – Sapna joins NEST at age 40 and contributes at 10% of her total earnings every year until SPa.
3. Alternative scenario 2: Voluntary joining – Sapna joins NEST at age 30 and contributes at 10% of her total earnings every year until SPa.
4. Alternative scenario 3: Voluntary joining –Sapna joins NEST at age 22 and contributes at 10% of her total earnings every year until SPa.

The below table shows the likelihood that Sapna will receive an income (£13,100) which allows her to replicate working life living standards in retirement through a combination of state and private pension income.

	Baseline – private pension saving	Joining at age 40	Joining at age 30	Joining at age 22
Chance of replicating working life living standards	0.2%	70%	96%	98%

If Sapna joins a pension scheme as a result of behavioural interventions (and saves 10% of her earnings), she could increase her chance of replicating working life living standards in retirement up to 98% from less than 1%. The earlier she begins saving, the higher her chances will be of reaching a suitable income.

Chapter five: how do people approaching retirement engage?

This chapter looks at the ways people approaching retirement engage and how people's particular needs for guidance and support pre-retirement might be met.

Older age before retirement – aged 55 to SPa

Box 20: What types of financial decision-making (relevant to long-term saving) might people approaching retirement need to make?

- When should I leave work and how (flexible transition vs. cliff edge etc.)? What will leaving work at that time and in that way mean for supporting retirement?
- How could longevity, inflation, market turbulence and the need for care affect both my need for, and sources of, income?
- What methods should I use for accessing my pension savings? What will these mean for the level of tax I will pay? What might be the other implications?
- How will I use my pension savings and other savings in retirement?
- How do market and financial products work?
- What will different choices mean for future income needs and for leaving a bequest (if desired)?
- How and when should I access the State Pension?
- How will eligibility for means-tested benefits interact with my pension saving choices?
- How can I differentiate between fraudsters and genuine providers?
- What are the implications of accessing savings at particular ages or transferring DB entitlement into DC schemes?
- If I have DB savings, are these sufficient to support me? Do I need supplementary savings?

Pre-retirement age adults have higher financial confidence and capability than younger or older adults, though gender differences are pronounced

By the time adults reach age 55, they generally have significant financial experience which increases capability (though some people have persistent low capability throughout their lives). Pre-retirement age adults are more financially confident than adults at any other age. 73% of retirement age adults are "very confident" compared to an average of 58% for all adults.[132]

However, pre-retirement aged people are generally worried about how they will access savings and support themselves during retirement. Those making access decisions report that it can take eight months or more because of the complexity.

[132] Harrison ***et. al.*** (2016) page 12

People require around 20-40 hours of research in order to feel they can make an informed decision about accessing pension savings.[133]

Women close to SPa struggle more with finances, capability and confidence

While gender divisions in capability and confidence are reducing for those at younger levels, women at older ages are still far less likely than men to be financially engaged, capable or confident.

- Older men in couples generally handle long-term finances, whereas women manage day-to-day household budgets.[134]
- Women aged 55 to 74 are less likely to ask for support, advice or help than men because they are more likely to live alone (though men who live alone are also less likely to seek help than men in family units).[135]

Women approaching retirement are more risk-averse than men

Women close to SPa are generally risk-averse. Some of this risk aversion may arise from women wishing to conserve savings or income which is lower than men's, on average.

- Of people enquiring about Freedom and Choice options between April 2015 and December 2016, men were more likely to take an adjustable income or lump sums, while women were more likely to take a guaranteed income or leave their pot untouched. Women were more likely than men, however, to take their entire pot as cash.[136]
- Women are more likely to use words like worried and anxious when discussing pensions, while men are more likely to talk in terms of key risks and diversifying.[137]

Older people who have a mortgage are more likely to struggle financially than those renting or who own their homes outright

While people aged over 55 tend to manage day-to-day finances quite well, a few struggle to meet bills and pay off debts. Those with a mortgage are particularly likely to struggle, especially if they have already left work, though only 21% or less of people aged 55 to 64 have a mortgage.[138]

People reaching retirement receive guidance, information and advice from many sources:

- Scheme: Pension schemes are required to communicate with members at certain times such as joining or when annual statements are due. Those approaching retirement pay more attention to scheme communications than adults at younger ages.[139]

[133] TPP, SSGA (2016) pages 12-14
[134] MAS (2014) page 56
[135] Young (2016)
[136] TPAS data provided December 2016
[137] TPAS data provided December 2016
[138] Young (2016) page 14
[139] TPP, SSGA (2016) page 15

- Those approaching retirement are sent pre-retirement communications by their scheme provider six months before selected retirement date (or on request) which details their options for accessing their pension savings. Many recipients of these communications report feeling a sense of urgency to "do something with their pension savings" and are unaware that "do nothing" is a viable option.[140]
- The majority of people (82%) find pre-retirement communications "very" or "fairly easy" to understand. People who read the pre-retirement communications are more likely to feel they have a reasonable understanding of annuities than non-readers (89% vs 63% respectively).[141] Some people do not read the packs because they appear overly long and complex.[142]
- Pre-retirement communications vary between organisations. Some are limited to an information pack while others follow up with emails and travelling events where members can attend and ask questions. Some providers issue educational newsletters to pre-retirement customers.[143]

- "Gone away" communications: Gone away customers are those who have changed address and have not notified their pension provider of how they can be reached. Through an identity verification process, providers acquire addresses that may be linked to their consumer. Identity verification communications, or gone away communications, are then sent out, with response rates ranging from 28% to 56%.[144]
- Employer: Employed adults receive statutory communications from their employer regarding their automatic enrolment pension scheme. Some employers provide further information about pension options at their discretion.
- Free support and guidance: People approaching retirement are more likely than younger adults to know about and use free guidance and advice services such as Which?, the Money Advice Service and Pension Wise.[145]
- Engagement with financial products: Engagement with financial products is associated with higher levels of engagement with other products and higher levels of financial capability.[146]
- Financial services: Those approaching retirement are generally reluctant to use a financial adviser for help with making decisions about how to support retirement due to the cost. Out of a small sample (around 80 people) making retirement decisions, 31 went to a financial adviser for help.[147]

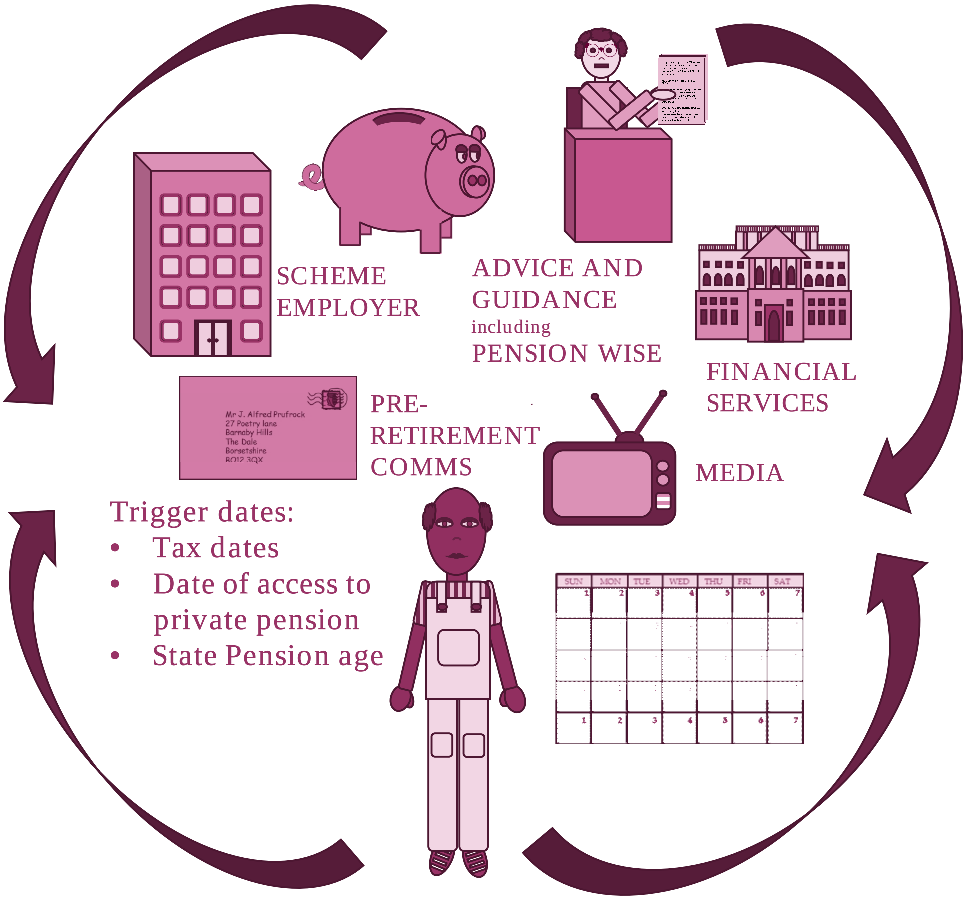
[140] TPP, SSGA (2016) page 9
[141] ABI 92014) pages 4 & 18
[142] The data covers information from ABI data providers for 2016. The information is from an ad hoc data collection and not from the ABI's regular data collection series.
[143] The data covers information from ABI data providers for 2016. The information is from an ad hoc data collection and not from the ABI's regular data collection series.
[144] The data covers information from ABI data providers for 2016. The information is from an ad hoc data collection and not from the ABI's regular data collection series.
[145] TPP, SSGA (2016) page 14
[146] Harrison ***et. al.*** (2016) page 5
[147] TPP, SSGA (2016) page 17

- Internet: Some people approaching retirement use the internet to explore options for accessing retirement savings, however many report that the sheer amount of information and advice is overwhelming and difficult to sort through.[148]
- Offer of Pension Wise: Those aged between 50 and SPa with DC pension savings are eligible to use a free, impartial guidance service called Pension Wise (in person, over the phone or via the internet). This service explains the options and implications of accessing pension savings through different routes. Most people approaching retirement with DC savings are aware of Pension Wise, though not all of those who are eligible use it.[149] Those who know about Pension Wise generally learned of it through advertising (39%) or their pension provider (39%).[150]

Those approaching retirement often respond to triggers prompting use of advice or guidance:

- Accessing pension savings and other savings and assets - The top trigger for the use of The Pensions Advisory Service (TPAS) webchat or helpline is accessing pension benefits.[151]
- Statutory pension dates – Ages significant to release of benefits act as a trigger; prior to age 55 calls to TPAS regarding Freedom and Choice peak. However, calls also peak prior to peoples' SPa's indicating that release of one benefit (State Pension) promotes thoughts about accessing other types of retirement income such as DC pension savings.[152]
- Tax dates - There are more calls to TPAS around March as the end of the tax year promotes financial consideration.[153]

[148] TPP, SSGA (2016) pages 9 & 14
[149] TPP, SSGA (2016) pages 14 & 16 low take-up was due to perceived negative qualities of advisers generally, or because Pension Wise offered only guidance with no advice
[150] DWP (2016b) page 8, figure 1
[151] TPAS data provided December 2016
[152] TPAS data provided December 2016
[153] TPAS data provided December 2016



People approaching retirement require detailed and tailored information about their options and the implications of different choices

Those approaching retirement need detailed information about their options for accessing pensions and other savings and assets to support retirement. This applies to people with DC savings, those with DB, or a mix of both, though people solely with DB savings may have fewer access options. Some people with DB savings may be contemplating transferring their entitlement into a DC pot, and will require support to make an informed choice.

In order to make an informed choice, particularly in relation to DC savings and / or non-pension savings and assets, people need to understand the potential effects of inflation, longevity and the need for care on their retirement income.

Low levels of numeracy within the UK, coupled with low average levels of capability mean that many people struggle with understanding their options and the implications of taking different courses of action. A vast quantity of information provided through the internet, media, friends and family, schemes and advisers can leave people confused and uncertain as to how to proceed.[154] In these cases, an increase in information will only cause further confusion and a tailored approach which simplifies complex information and relates it to people's own life is more effective.

Providers are required to give "risk warnings" to those who wish to access their pension funds. Risk warnings are generally given over the phone though some providers mix communication methods by combining some or all of: letters, email, and telephone conversations. Some members feel that questions asked are intrusive or view them as a barrier to getting access to their savings. Where data is available, risk warnings do not seem to alter consumer behaviour.[155]

People close to retirement prefer face-to-face guidance sessions over those conducted over the phone

People are able to access Pension Wise guidance on the phone, through a face-to-face session or on line. Of the people who used Pension Wise guidance between April 2015 and January 2017, 70% chose face-to-face and 30% chose guidance by phone.[156] 89% of people who received guidance from Pension Wise took at least one concrete action within the subsequent three to four weeks.[157] As of May 2017, 140,517 people used Pension Wise guidance and there were 4.82 million visits to the website for information.

People approaching retirement find scheme communications by letter confusing and too general

Those approaching retirement are likely to find letters more confusing than information provided face-to-face, by phone, webchat or group education. People approaching retirement report that scheme communications contain too much information, are too generalised and use words and phrases that they don't understand. This confusion impedes decision-making as people do not wish to take action unless they feel they can understand the implications.[158]

The most common response is to withdraw some or all of the pension pot in cash, both for requesters and those who receive packs at the scheduled time. Many of those who receive pre-retirement options packs feel that they are required to make a decision with their pension savings and are unaware that they can leave their savings in their pots.[159] There may be an unintended consequence that the arrival of scheduled retirement packs prompts a behaviour to access one's pension fund, most commonly by withdrawing cash. This is a behaviour which might not otherwise be present. This relationship between

[154] TPP, SSGA (2016) part 2, page 9
[155] The data covers information from ABI data providers for 2016. The information is from an ad hoc data collection and not from the ABI's regular data collection series.
[156] www.gov.uk/performance/pension-wise (accessed 10.03.17)
[157] DWP (2016b) page 14, paragraph 3.5
[158] TPP, SSGA (2016) page 15
[159] The data covers information from ABI data providers for 2016. The information is from an ad hoc data collection and not from the ABI's regular data collection series.

scheduled retirement packs and behavioural prompts may be worth exploring in the future, particularly around retirement income sustainability issues.

"Gone away" communications are also generally sent out by letter and have response rates of 28%-56%.[160] Using more personalised forms of communication might help raise the response rate and provide further opportunities to engage with members.

Framing of options can affect people's responses to information and advice

Framing of options can influence behaviour. For example:

- Presenting annuities and other drawdown options in terms of the actual income that people will receive makes people prefer the annuity option.
- Presenting options in terms of investment and growth potential makes people prefer other drawdown options.[161]
- Using the word "annuity" over other words such as "guaranteed income" reduces favour from consumers by 16% (from 66% to 50%) over other access methods.[162]

Framing is more effective on households with annual incomes below £30,000.[163]

Tax arrangements affect people's decisions

Decisions are sensitive to tax arrangements; the 25% tax-free lump sum is viewed as a good reason to access some pension savings as early as possible, while the marginal tax rate applied to the rest of the DC pot is generally an inhibitor to withdrawing the whole pot.[164] Most of those fully withdrawing their DC savings have smaller pots and are younger.[165]

Some people cite the possibility of the Government changing their mind and deciding to apply tax to all DC pension savings withdrawals as a reason for taking their 25% tax-free lump sum as soon as possible.[166] Most people who take a tax-free lump sum and enter drawdown do not immediately start taking income from their drawdown pot.[167]

[160] The data covers information from ABI data providers for 2016. The information is from an ad hoc data collection and not from the ABI's regular data collection series.
[161] FCA (2015b) pages 4-6
[162] FCA (2015b) page 4
[163] FCA (2015b) pages 4-6
[164] TPP, SSGA (2016) pages 22 & 23
[165] The data covers information from ABI data providers for 2016. The information is from an ad hoc data collection and not from the ABI's regular data collection series; ABI (2017) page 4.
[166] TPP, SSGA (2016) pages 22 & 23
[167] ABI (2017)

Box 21: Most and least effective behavioural interventions with pre-State Pension aged adults

<table>
<tr><td>Pre-retirement</td><td>Male</td><td>Female
· Focused on raising levels of confidence and capability among women
· Outreach to isolated older women who are less likely to seek support
· Focussed on risk-mitigation</td><td>High income</td><td>Low to medium income</td></tr>
<tr><td>Marginalised
Non-engaged</td><td colspan="4">Most effective
· Local voluntary organisations, peer or organisation-led (scheme, employer) (face-to-face, phone, web-chat or group education) educational, long-term
· Tailored, simple to understand, personalised and practical information which takes into account low levels of numeracy and capability, avoids jargon and breaks down complex information
· It needs to be made clear that people are not required to access pension savings at age 55, or at their selected retirement date
Least effective
· Interventions which rely solely on digital access and capability
· Overly complex information or too many options
· Scheme communications by letter</td></tr>
<tr><td>Somewhat engagement
Engaged</td><td colspan="3">Most effective
· Implemented around ages of pension access (state and private pensions) and tax dates
· Decision-making processes with long-time frames and ongoing support
· Guidance and support service-led (face-to-face, phone, web-chat, individual) personalised, specific and practical information which takes into account varying levels of capability and confidence and explains the implications of options
· Scheme communications (face-to-face, phone, web-chat or group education) which are specific and jargon-free
· Scheme-led (digital, individual) choice architecture - allowing people to choose whether or not to make active decisions
· It needs to be made clear that people do not have to access pension savings at age 55
Least effective
· Interventions which rely solely on digital access and capability
· Overly complex information or too many options
· Scheme communications by letter</td><td>Most effective
· Options framed as actual income rather than investments and growth</td></tr>
</table>

Box 22: Case study: working longer

John is a low earning male who works part-time every year from age 22 (in 2017) to age 25 (or above). During this time he is automatically enrolled and contributes with his employer, at 8% of band earnings. At age 25 he moves overseas and spend 20 years self-employed in another country where he does not accrue state or private pension entitlement. At age 45 he returns to the UK and receives Job Seekers Allowance for two years while he looks for a job. At age 51 he starts to work full-time and earns at low earnings (30th percentile level). He is automatically enrolled and contributes, with his employer, 8% of band earnings until his SPa or later. This case study is designed to show the financial impact of behavioural changes in relation to working longer.

1. Baseline scenario: John joins NEST at age 22 and contributes at 3% of earnings when he is in work until his SPa.
2. Alternative scenario 1: Working 1 year longer - John contributes at 8% of band earnings when he is in employment every year until SPa + 1 year.
3. Alternative scenario 2: Working 2 years longer – John contributes at 8% of band earnings when he is in employment every year until SPa + 2 years.
4. Alternative scenario 3: Working 3 years longer – John contributes at 8% of band earnings when he is in employment every year until SPa + 3 years.

The below table shows the likelihood that John will receive an income above the poverty line (£9,000)[168] in retirement through a combination of state and private pension income.

	Contributing while employed until SPa	1 year longer	2 years longer	3 years longer
Chance of replicating working life living standards	22%	47%	73%	91%

For every year of working longer, John's chances of receiving an income at the relative poverty line increase dramatically, from 22% if he retires at SPa to 91% if he works for a further three years after SPa. This is because John defers his State Pension when he works longer and receives an uplift in the payments of 5.8%. Therefore, for every year that John works longer, he receives an increase to both his state and his private pension income.

[168] Sourced from DWP (Households Below Average Income). After Housing Costs, 2017.

Chapter six: how do people at and over State Pension age engage?

This chapter explores the needs of people at and over State Pension age (SPa) and how a range of policy measures could help them to achieve better pension outcomes.

At and during retirement – SPa and over

Box 23: What types of financial decision-making (relevant to long-term saving) might people at and over State Pension age need to make?

- What are the different options for using savings and assets? What are the implications of choosing different options?
- Is my income sustainable?
- How do I differentiate between fraudsters and genuine providers?
- How much should I take from different income sources in order to preserve my capital?
- What options are available if financial difficulties arise during retirement?
- How could different choices interact with eligibility for means-tested benefits?
- How can I ensure that contingencies are in place for when/if I am no longer capable of managing my own money?
- How could longevity, inflation, market turbulence and the need for care affect both my need for, and sources of, income?

Levels of financial capability decline as people age, though confidence among older people remains high

Those aged SPa to age 75 tend to have financial capability just at or below the average for working age, but once people reach the age of 75, financial capability declines more quickly. Of those over age 75 only half are able to calculate the effects of interest and inflation and only 62% can correctly read a bank balance statement (compared to around 80% of those under age 75).[169]

Many older people lack the knowledge and understanding to manage tax, benefits and pensions, and many are unaware whether they are eligible for Pension Credit, Housing Benefit, or Council Tax Reduction.[170]

Lower levels of capability among older people are related to several factors:

- Cognitive decline accelerates as people age,[171]
- Today's older people had lower average levels of literacy and numeracy when they were young than today's working-age population,[172]

[169] Young (2016) page 18
[170] CAB (2007) page 5
[171] Young (2016) page 19
[172] Young (2016) page 19

- Older people struggle more when choosing between several options (choice overload),[173]
- Older people are more susceptible to advertising which promises gain and are less influenced by previous negative financial experiences.[174]

While capability declines rapidly after the age of 75, financial confidence tends to remain high, at around 74%, among older people.[175] Women over age 75 have lower incomes and lower levels of financial capability than men. Older people on low incomes are also more likely to have lower capability than older people on higher incomes.

People over SPa generally manage day-to-day finances, though few make plans to fund long-term care

Those over SPa tend to manage day-to-day fairly well and a third actively save, though few plan for the possibility that they or their partner might need long-term care.[176] Older people struggle, on the whole, with decisions around managing their money in the long-term and deciding how to use income from different sources such as housing, savings and pensions.[177]

Those who do plan for long-term care generally feel a higher than average sense of control over their financial situation, though this characteristic is not correlated with income.[178]

People aged over SPa are less likely to seek help with finances than any other age group

People over SPa are less likely to seek information or advice about finances than those in any other age group. This is generally due to having fewer immediate family members to turn to (especially for those living alone), and being less likely to use the internet to search for information or guidance.[179] People in retirement also have less access to advice and guidance from their employer or pension scheme than people of working age or still in employment.

The following events and organisations might provide support or act as a trigger for active decision-making:

- Friends and family: Older people generally use friends and family (if available) as the first port of call for financial information, advice and guidance.[180]

[173] Chen ***et. al.*** (2011), due to cognitive decline
[174] Fung, Carstensen (2003)
[175] Young (2016) page 17
[176] Young (2016) page 13; because of an aversion to thinking about negative events and optimism bias, which leads people to think that negative outcomes are unlikely to happen to them
[177] Young (2016) page 17
[178] Young (2016)
[179] Young (2016)
[180] CAB (2015b) page 34

- Free support and guidance: Some older people use free advice services (like the Citizens Advice Bureaux) if they do not have other, less formal, sources of support, or are still unsure after speaking with their friends and family.[181]
- Financial services: Some older people use financial advisers, though many have concerns about their independence or believe that they are unaffordable.[182]
- Internet: A minority of people over SPa use the internet for financial advice and information, but the majority do not use the internet or find it difficult to navigate. By age 80, a third of men and 14% of women use the internet frequently.[183]
- Media: Older and retired people spend more time watching TV than those in employment, particularly if they have mobility limitations. When TV watching is accompanied by low exposure to other social influences, messages given through this medium can be fairly powerful. Many older people turn to free support services as a result of information learned from watching TV.[184]
- Government letters about tax and benefits: Some older people find Government communications intimidating and have difficulties absorbing the information contained.[185]
- Need for significant outlay: Such as accessibility adaptions, house repairs, dependents requiring funding.
- Changes in need: Dependents moving in or needing care. The need for care significantly increases financial outlay and/or the need to access state support.
- Financial shocks: These can be precipitated by bereavement, divorce or loss of income through market changes.

People over SPa are the least likely of all age groups to be using the internet, particularly those over age 75

Older people who use the internet, switch between financial products on the basis of price more often than those who do not,[186] but the older the person, the less likely they are to have access to or understand the internet (especially those over age 75).[187] This means that older people are less able to compare and contrast providers online. Particularly with older people, digital channels should be used in conjunction with face-to-face, phone, web-chat or group education, where messages can be personalised and individual needs and responses can be assessed.[188]

[181] CAB (2015b) page 35
[182] CAB (2015b) page 37
[183] Matthews & Nazroo (2015) page 2
[184] CAB (2015b) page 34-35
[185] CAB (2009) page 5
[186] Young (2016) page 36
[187] Young (2016) page 36
[188] Age UK (2011) page 6

Exposure to others who incur care needs can prompt planning for care among older people

The majority of older people do not plan for long-term care, regardless of gender or income level. The main trigger prompting planning is first-hand experience of a family member or friend needing care which brings home what happens to people who can't fund their own care and how much individual care might cost. This exposure causes some older people to start saving and making plans with family members for the possibility of their developing care needs.[189]

People over SPa benefit from protection based policies such as defaults, compulsion, safety nets and consumer protection

As people age and cognition declines, the dangers of poor decision-making or falling prey to fraud or poor business practices increases. Therefore, those over SPa are particularly dependent on:

- Defaults and compulsions which can support key transitions and decisions,
- Safety nets, such as means-tested benefits, to help those unable to support themselves due to either lack of funds or poor outcomes from saving,
- Consumer protection against fraudulent or poor business practices.

Box 24: Most and least effective behavioural interventions with at and over State Pension aged adults

<table>
<tr><th>At and post retirement</th><th>Male</th><th>Female</th><th>High income</th><th>Low to medium income</th></tr>
<tr><td>Marginalised</td><td colspan="4" rowspan="4">Most effective
· Organisation or peer-led (face-to-face, phone, web-chat or group education) information which assumes lower than average levels of financial capability and numeracy and potential cognitive decline, especially for those over age 75
· Fewer options than might be offered to those at younger ages or use of choice architecture to let people decide the level of choice that they want
· Direct exposure to others experiencing need for care (face-to-face, individual or group work or multimedia channel) focus on practical financial planning and pre-arranging with family,
· Community interventions (through peer groups or community organisations) using peers with direct experience of care or other retirement needs
· Community organisations using outreach to engage with hard-to-reach or isolated community members (face-to-face, individual or group) educational interventions and needs assessments
· Defaults, compulsion, safety nets and consumer protection. These are especially important for those over the age of 75.</td></tr>
<tr><td>Non-engaged</td></tr>
<tr><td>Somewhat engaged</td></tr>
<tr><td>Engaged</td></tr>
</table>

[189] Young (2016) page 41

	Least effective · Digital or postal communications · A wide array of choices · Complex information

Box 25: Case study: accessing savings in retirement

Ayesha is a median earning female who works every year from age 22 (in 2017) to her SPa. In each year she earns at median earnings for her age and gender. Ayesha is auto-enrolled at age 22 and contributes at 8% of band earnings with her employer every year until SPa. Ayesha discusses her retirement income options with a provider of free, impartial guidance and information. As a result there are many decisions she might take. This case study is designed to show the financial impact of behavioural changes in relation to accessing DC savings.

1. Baseline scenario: At Ayesha's SPa she uses 100%of her DC savings to buy a level, single-life annuity.
2. Alternative scenario 1: Drawdown – At Ayesha's SPa she invests 100%of her DC savings in drawdown and draws down at the same rate she would receive from an annuity.
3. Alternative scenario 2: Cash lump sum – At Ayesha's SPa she withdraws 100% of her savings in cash and puts it in a savings account and draws out money at the same rate she would receive from an annuity.
4. Alternative scenario 3: Drawdown + annuity – At Ayesha's SPa she purchases a deferred annuity with one half of her DC savings to begin paying out during the year of her average life expectancy and puts the rest of her savings into a drawdown fund. She withdraws from the drawdown fund at the same rate that she would receive income from an annuity.

The below table shows the likelihood that Ayesha will receive an income (£13,100) which allows her to replicate working life living standards in retirement through a combination of state and private pension income. It also shows the age she might run out of funds and the chance of leaving an inheritance if she dies at the median life expectancy of a 68 year old woman in 2063 (age 94.5) or lives for longer than average until age 106 (the 90th percentile of the age distribution).

Example of outputs	Baseline	Drawdown	Cash	Annuity + drawdown
Chance of replacing working life living standards at SPa	77%	77%	77%	77%
Age funds run out	Never	94	82	79

Chance of leaving an inheritance if she lives until age 94.5	0%	48%	0%	0%
Inheritance remaining if she lives until age 106	0%	24%	0%	0%

Free, impartial guidance might result in Ayesha making better decisions regarding accessing her retirement savings. There are a wide range of methods for accessing retirement savings and the list above is not exhaustive. However, this range shows that different decisions can affect the chance that she runs out of savings during her retirement.

- Under the annuity scenario, she never runs out of savings income.
- Under the cash and drawdown scenarios, she might run out at different ages, though these ages will vary if she decides to draw down greater or lesser income from her cash or drawdown account.
- Under all scenarios, she only has 77% chance of replicating working life living standards at her State Pension age. If she withdraws at a higher amount under the cash and drawdown scenarios in order to top up her income to a sufficient level, she will run out of savings more quickly.

Appendix one: what is engagement and how can it be helpful?

This appendix explores the concept of engagement, how it can be helpful in achieving positive outcomes and looks at the history of pension communication and regulation.

Engagement in long-term saving is becoming more important

Several economic and social trends have conflated recently in order to increase focus on the need for pension engagement. In summary these are:

- Historically low levels of saving and current low contribution levels
- An increase in the number of people saving in Defined Contribution (DC) pension schemes
- The introduction of flexible access to pension saving
- A lack of interest and involvement in saving
- An “advice gap”

This appendix explores each of these trends in further detail.

More people are saving as a result of automatic enrolment, but ineligible groups still have low saving levels

The Pensions Commission warned in 2004 that people were not saving enough on average to achieve decent retirement incomes.[190] As a result of automatic enrolment, the number of people saving in a private pension has increased since then from 56% of employed people in 2002/03 to 64% in 2015.[191] The proportion of employed people saving in a private pension is likely to continue to grow during the life of the automatic enrolment programme. As of October 2016, 6.9 million people were newly saving into a workplace pension scheme;[192] the DWP estimates that 10 million people will be newly saving or saving more as a result of automatic enrolment by 2019.[193]

However, saving levels are still low among people ineligible for automatic enrolment. Participation among the self-employed (who are ineligible for automatic enrolment) remains very low at around 16% (2013/14).[194]

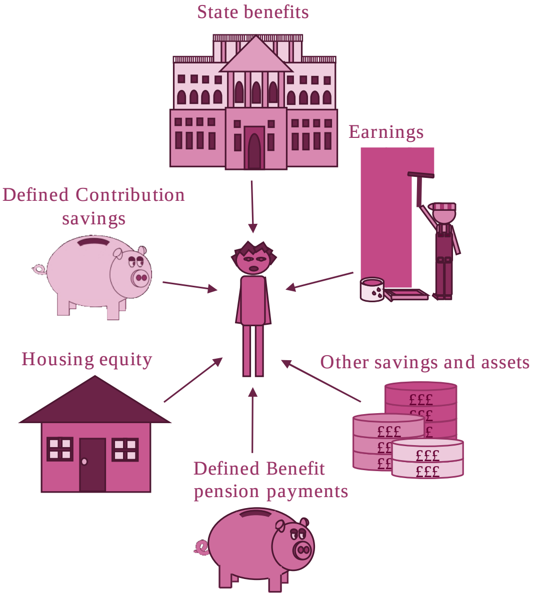
People do not contribute at sufficient levels to replicate working life living standards in retirement solely from state and private pensions

In order to replicate working life living standards in retirement, people require around two thirds of their gross working age income (though the precise

[190] Pensions Commission (2004) page 63, figure 3.5, includes self-employed people.
[191] ONS (2016) page 4
[192] TPR (2016) page 2
[193] DWP (2016) page 1
[194] ONS (2015a) page 17

percentage required varies by income level).[195] State Pension, currently provides a gross income worth around 22% of average earnings.[196] On top of State Pension income, an average earner may need to provide themselves with a gross income equal to 44% or more of their working age earnings in retirement in order to replicate working life living standards. People who wish to top up State Pension income may do so from other sources, including, but not limited to the following (Figure A1):

Figure A1: Sources to top up State Pension income from[199]



Current contribution levels are unlikely to enable the majority of people to replicate working life living standards solely from state and private pension income. In 2014, average DC pension contributions by employees were 1% of salary (DC trust-based pensions) and 2.4% of salary (Group Personal Pensions).[197] Average contribution levels will rise with the phasing in of automatic enrolment minimum contribution rates. By 2019, employers and workers (who do not opt out) must jointly contribute at least 8% of band earnings (£5,824 - £43,000 in 2016/17).[198]

- A median earner contributing 8% of band earnings annually from age 22 until SPa would have a 50% chance of replicating working life living standards (using state and private pension income).[199]

[195] Pensions Commission (2004) page 143, figure 4.11
[196] OECD (2015a) page 139, figure 6.1, the full value of the new State Pension is currently worth 24% of National Average Earnings.
[197] ONS (2015b) page 14, figure 8, employee contributions for DB schemes averaged 6.5%.
[198] DWP (2015)
[199] Assuming State Pension uprated in line with triple lock.

- A median earner would need to contribute between 11% and 14% of band earnings to have a 2/3 chance of replicating working life living standards if contributing between age 22 and SPa.
- In many cases, people do not contribute steadily for their entire working life. Those who begin contributing later or who take career breaks might need to contribute up to 27% (if not starting to contribute until age 40) or higher in order to have a 2/3 chance of replicating working life living standards.[200]

More people are saving in Defined Contribution pensions than ever before

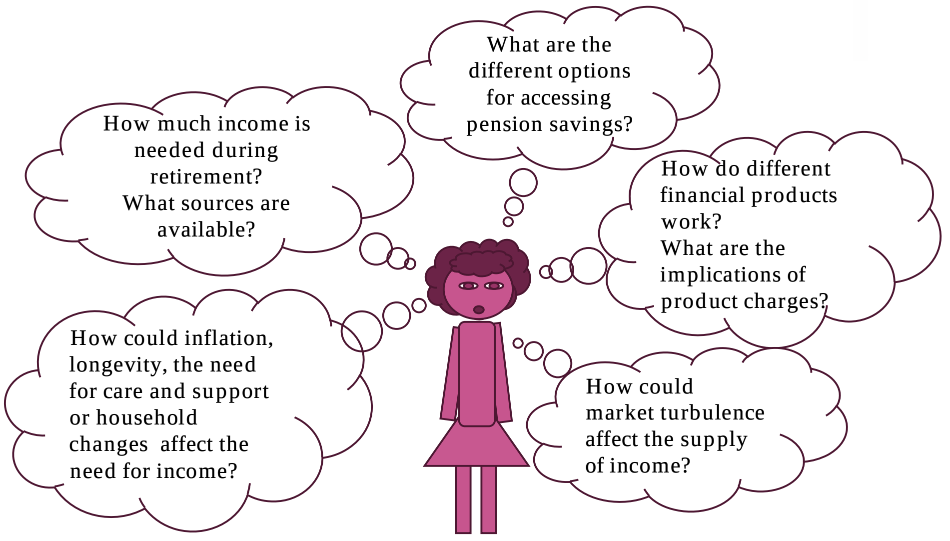
As a consequence of automatic enrolment there are more people saving into workplace pension schemes than previously. Many of these people work in the private sector; the vast majority of public sector employees were already saving into Defined Benefit (DB) schemes when automatic enrolment began staging.

On the whole, private sector employers are choosing to offer Defined Contribution (DC) schemes to automatically enrol employees, as DB schemes have become increasingly unattractive to employers. In 2016, 86% of private sector DB schemes were closed to new members or to both new members and future accruals.[201] Membership of DC schemes grew from around 5.7 million members in 2012 to 12.2 million in 2016, and could grow to around 14.7 million active members by 2030.[202] There are already more active members in DC schemes than there are in DB schemes.[203]

Unlike in DB schemes where members generally receive an inflating income for life, members of DC schemes must make active decisions at retirement regarding how to access their private pension savings. In order for people to make fully informed decisions about how to access their DC pension savings they need to consider many factors (Figure A2). However, in practice many DC savers find making decisions at and during retirement difficult because of a lack of financial capability and behavioural biases.[204]

[200] PPI (2013)
[201] TPR, PPF (2016) page 20, figure 3.1
[202] PPI aggregate model
[203] PPI (2016)
[204] PPI (2017)

Figure A2: What people need to ask and understand to make informed decisions about accessing DC pensions



Though advice and guidance is available in many forms, not everyone who requires support uses it, and those who do engage do not all make the most optimal decisions post-engagement.

People are generally uninterested in long-term saving, particularly at younger ages

Working aged people, particularly when younger, tend to have little interest in saving and are often put off retirement planning until middle to older age,[205] due to a combination of several factors, including:

- An information deficit concerning long-term saving,
- A lack of knowledge regarding where to seek appropriate advice,
- A lack of trust in pension schemes and expected returns,
- Difficulty planning for a future that seems far away,
- Difficulty affording pension contributions.[206]

Pension savings generally require extended periods of contributions in order to accrue sufficient capital, which means that putting off saving can result in financial difficulties in later life. Even those automatically enrolled might not accrue sufficient pots without engaging, because unengaged people are more likely to contribute at minimum levels than to make calculations based on their desired level of retirement income.

[205] Foster (2015) page 21
[206] Foster (2015) page 21

Those enrolled into DB pension schemes may not need to engage as early, as DB schemes are designed to deliver a higher minimum top up to State Pension income than most DC schemes. However, many people with DB savings also have some DC savings. Retirees in future will be more likely to have DC savings due to the decline of DB provision in the private sector.

Around 43 million people are not accessing the support that they would need in order to make informed financial decisions

While there are several forms of financial advice, guidance and support available to people, not everyone who could benefit from these services accesses them. These people fall into four broad categories:

- Around 4.5 million people are willing to pay for advice but feel that current prices are too high.
- Around 14.5 million people need advice but cannot afford it.
- Around 10 million people would benefit from advice but are not aware that it exists or how to access it.
- Around 23 million people would have benefited from advice which aimed to prevent avoidable financial problems from developing.[207]

The rest of this chapter looks at the history of pensions communication.

> The word "pension" originates from the Latin word "pendere" which means "to pay". Over time, the word developed to mean a series of regular payments.

Private pension schemes have existed since 1590

The first Occupational Pension scheme (the Chatham Chest) was introduced in 1590. It provided a pension to injured seamen in return for a monthly contribution of 5% of salary. This was followed in 1672 by an Occupational Pension scheme for Royal Naval Officers. In 1684, the Government started to provide pensions to Civil Servants and, from the late 1800s / early 1900s, rolled the scheme out to other public sector workers such as teachers, poor law officials,[208] the police and nurses. Private sector companies also began to introduce Occupational Pension schemes during this time (primarily to those in the middle classes) and during the 1900s, private sector Occupational Pension schemes grew rapidly in volume:

- By 1956 one in three workers were members of a private pension scheme.
- By 1970, 78% of non-manual, 50% of manual and 38% of unskilled manual workers were members of an Occupational Pension scheme (DB or DC).[209]

[207] CAB (2015a)
[208] Officials responsible for ensuring the Poor Laws were followed. These were in force from 1587 to just before World War II
[209] Thane (2000)

Regulation helped shape communication with pension scheme members after the 1980s

Pensions language developed organically over time as organisations chose how to communicate with their employees without regulatory oversight, though there were regulations on the behaviour of trustees with regards to fund management and reporting.[210] Towards the end of the 20th century, the industry began to self-regulate through representative bodies. In 1995, new legislation was passed, which provided for a Government backed regulatory authority for pensions and led to the creation of the Occupational Pensions Regulatory Authority (OPRA). The Pensions Regulator replaced OPRA in 2005.[211]

The late 1900s / early 2000s saw the expansion of contract-based individual or group pension schemes, often accessed via an employer. These scheme types expanded with the introduction of Stakeholder Schemes in 2001, which enabled employers to provide lower cost Group Personal Pension schemes to their employees.[212] These schemes were regulated by the Financial Services Authority (which became the Financial Conduct Authority in 2013).

Over time the regulators provided further guidance on member communications and imposed obligations on schemes to notify members of account changes and provide forecasts. As contract-based DC pensions became more popular in the private sector, the amount of regulation regarding communications increased.

By 2012, there was a concern across stakeholders that communications by private pension providers, particularly for contract-based schemes, were difficult for members to understand. Consumer representatives claimed that mandated communications by schemes caused disengagement by overwhelming or confusing consumers.[213] There was also a sense that the language used such as “annuity”, “pension”, “trivial commutation” was difficult for consumers to understand as it is not consumer-focussed or non-technical. Some industry representatives maintain that it is not easy to communicate clearly because regulations require them to communicate such an array of information (Box A1).[214]

Box A1: Pension scheme communication regulations

All schemes are required by their regulator to communicate with scheme members at specific times:

- To potential scheme members and new joiners
- Annually to all members
- Upon request by members

[210] For example: Pension Schemes Act 1993
[211] Pensions Act 1995
[212] Charge cap of 1.5% for the first 10 years and 1% thereafter
[213] CAB BIT (2016) page 11, HoC Work and Pensions Committee (2013)
[214] HoC Work and Pensions Committee (2013)

- Upon request of benefits
- In the run-up to retirement date

Each of these communications must include specific information. For example, annual communications by trust-based schemes must include:
- Amount of contributions made during preceding year,
- Value of the member's rights (and cash equivalent transfer value if different),
- An illustration of the likely accrual by retirement date, (including specific retirement illustration dates).

Annual communications by contract-based schemes must state clearly:
- That the information given is for the purposes of illustration, expressed in today's prices and based on assumptions about the nature of the investments and their likely performance,
- That future annuity rates will depend on considerations which may differ from the schemes assumptions,
- Where further information is available, if required.[215]

Employers are also required, through automatic enrolment regulations, to write to their employees about their pensions:
- Prior to their automatic enrolment staging date letting them know whether they are eligible or not,
- At their staging date if there has been any change in circumstance,
- If a non-eligible employee becomes eligible,
- When a new employee joins,
- At an employee's automatic re-enrolment date.

The introduction of automatic enrolment motivated efforts to simplify pensions language used in member communications

The introduction of automatic enrolment focused attention on communication with its target group of lower earners with no pension saving experience. People in the target group have lower risk-appetites and lower levels of financial capability on average than those who were already saving in a pension prior to automatic enrolment.[216]

The National Employment Savings Trust (NEST) published a phrasebook and a communications guide setting out the best language to use, and ways to frame

[215] Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013; Occupational Pension Schemes (Transfer Values) Regulations 1996 - a full list of trust-based schemes requirements for communication can be accessed through these regulations. For a list of communication requirements on contract-based schemes, please see the Financial Conduct Authorities Codes of Business (COBs) 13, 14 & 19.4. Further, contract-based schemes are required to abide by an overarching principle to have due regard to the information needs of their customers and communicate information in a way that is clear, fair and not misleading. This principle is spelt out in number 7 of the FCAs Principles of Business.
[216] NEST (2012)

messages in order to communicate effectively by taking into account "how people think and feel about their money and how they'd prefer ideas like pensions and automatic enrolment to be explained to them."[217] The guide stipulates that communications should be:

- Simple – complex communications can be alienating.
- Framed around entitlement rather than obligation – people respond more positively to rights than to responsibilities.
- Related to current experience – people are less likely to engage with concepts relating to their future selves.
- Reassuring that others are making the same choices – people feel more comfortable when others are taking the same actions
- Factual and expressed in plain language – so that people can form their own value judgements (Box A2).
- Giving control to the member – people like to feel in control even if they do not exercise control.
- Designed to appeal to those with limited knowledge about pensions
- Constructive – presenting solutions to problems is more motivational than scaring people.

Box A2: Examples from the NEST phrasebook of ways to phrase comments that are clear and avoid jargon[218]

Standard word	Consumer friendly phrase
Accumulation	Building your retirement pot
Crystallisation	Accessing your retirement savings, for example, this could be by taking a cash lump sum
Pension	A regular income paid to you from a pension scheme or an annuity

Most schemes created for automatic enrolment, particularly master-trust schemes, have designed their communications to appeal to employees (and employers) who are interacting with pension saving for the first time. Some schemes and industry bodies also provide guidance and templates to employers to use in statutory communications with their employees.[219]

The Government has also taken an increasing interest in how schemes communicate with members. In 2011 (updated 2014), the Department for Work and Pensions published a language guide to be used for pensions and automatic enrolment.[220]

[217] NEST (2016a); NEST (2016b)
[218] NEST (2016b)
[219] For example, NOW pensions www.nowpensions.com/resource/template-letter-for-employees-being-auto-enrolled-2/
[220] DWP (2014)

There are moves towards a standard language to be used in member communications

After the introduction of increased flexibility of access to DC savings introduced in 2015 (the "pension freedoms"), the Financial Conduct Authority (FCA) asked providers, advisors and trade bodies to agree on a set of standard, non-technical descriptions of key financial concepts and terms to use in communications with consumers of all of financial services including the pensions industry, "FCA's Smarter Communications".[221]

The Association of British Insurers, in collaboration with money guidance providers, consumer representatives, industry and other stakeholders, conducted research and consumer testing in order to develop a member communications guide to be used by the pensions industry, specifically focussing on new retirement options in the wake of Freedom and Choice. The guide builds on earlier work on language and phrases and uses these to create a coherent framework of communication on pensions and retirement that is intended to be consistent throughout the industry.

The Pensions Regulator has also issued guides for DB and DC scheme managers on how to communicate with employees about their pension schemes, transferring DB benefits to DC schemes, and how to access savings in retirement under the new flexibilities.

Several bodies provide free, impartial guidance and support on financial matters

In 2011, the Government introduced the Money Advice Service (MAS) to help people who were struggling with finances and budgeting and to help increase overall knowledge of financial matters. Alongside MAS, the Citizens Advice Bureau (CAB) provides support with some financial issues and the Pensions Advisory Services (TPAS) provides information and guidance on state and private pensions. CAB and TPAS also provide face-to-face and telephone services under the Government's Pension Wise banner, and an in-house Pension Wise team provides web services. Pension Wise provides free impartial guidance to those over age 50 with Defined Contribution pension savings. As of 2018, MAS, TPAS and Pension Wise will form one financial support and guidance service which will include pensions.

FAMR

In March 2016, the FCA published its final report of the Financial Advice Market Review (FAMR) which aimed: ***(…)to explore ways in which Government, industry and regulators can take individual and collective steps to stimulate the development of a market which delivers affordable and accessible financial advice and guidance to everyone, at all stages of their lives.***[222]

[221] FCA (2015a) page 34, paragraph 8.16
[222] HMT, FCA (2016) page 3

The FAMR explored ways of making financial advice more accessible to consumers. The final report put forth recommendations which could help widen the range and sources of information, guidance and advice for consumers including:

- Providing clearer information to trustees and employers about the ways in which they can advise and support employees without being subject to regulation.
- A move towards providing employers with guidance outlining the top ten ways they can contribute to their employees' financial help.
- The creation of a pension dashboard which will allow people to view all their pension savings in one place.
- The introduction of new terms that describe advice and guidance in a way understandable to consumers.
- The design, implementation and monitoring of a set of nudges and rules of thumb used to help consumers achieve better pension outcomes.
- HMT to explore ways to improve the existing £150 income tax and National Insurance exemption for employer-arranged advice on pensions. (Members are now eligible for £500 of tax-free employer arranged advice and may take £500 from their pension pots up to three times, to use for advice).[223]

[223] HMT, FCA (2016)

Appendix two: modelling

The areas of modelling performed in this report consider the projection of an individual using the PPI's Individual Model using a stochastic approach of economic assumptions. The economic scenarios are generated using the PPIs economic scenario generator. Both models are detailed below. All results are based in current (2017) earnings terms.

Key assumptions

Except where explicitly stated in the report, the key assumptions used in the report are detailed below.

The pensions system

The pension system modelled is as currently legislated. The triple lock is assumed to be maintained. Individuals are assumed to be members of a Defined Contribution (DC) occupational pension scheme.

Investment returns

The economic scenario generator uses volatility derived from historical data and central rates of:

- Median equity return: 7%
- Median gilt return: 4%
- Median earnings growth: 4.3%
- Median CPI growth: 2%

These are derived from the Office for Budget Responsibility projected figures. The investment strategies employed are detailed in the body of the report.

Where volatility has been adjusted this is measured against the historical volatility of equity returns.

Other economic assumptions

Other economic assumptions are taken from the Office for Budget Responsibility's Economic and Fiscal Outlook (for short-term assumptions) and Fiscal Sustainability Report (for long-term assumptions).

Limitations of analysis

Care should be taken when interpreting the modelling results used in this report. In particular, individuals are not considered to change their behaviour in response to investment performance. For example, if investments are performing poorly, an individual may choose to decrease their withdrawal rate and vice versa.

Monte Carlo simulation can be a powerful tool when trying to gain an understanding of the distribution of possible future outcomes. However, in common with other projection techniques, it is highly dependent on the assumptions made about the future. In this case, the choice of distribution and parameters of the underlying variables, the investment returns of equities, gilts and cash are important to the results.

The Individual Model

The Individual Model is the PPI's tool for modelling illustrative individual's income during retirement. It can model income for different individuals under current policy, or look at how an individual's income would be affected by policy changes. This income includes benefits from the State Pension system and private pension arrangements, and can also include income from earnings and equity release. It is useful to see how changes in policy can affect individuals' incomes in the future.

This model can be used in conjunction with economic stochastic scenarios derived from the PPI's economic scenario generator to produce stochastic output.

Key results

The key output from the model is the built-up pension wealth and entitlement over the course of the individual's work history and the post-retirement income that results from this.

The post-retirement income is presented as projected cashflows from retirement over the future lifespan of the individual. These are annual cashflows which include the following key items:

- State Pension
  - Reflects entitlement and the projected benefit level of State Pension components.
- Private pension
  - Derived from the decumulation of the pension pot, allowing for tax-free cash lump sum and the chosen decumulation style (e.g. annuity or drawdown).
- Other state benefits
  - Other benefits contributing to post-retirement income such as pension credit.
- Tax
  - Tax payable on the post-retirement income, to understand the net income available to the individual.

These cashflows are calculated as nominal amounts and restated in current earnings terms.

Outcomes are expressed in current earnings terms for two reasons; it improves the comprehension of the results and reduces the liability of either overly optimistic or cautious economic assumptions.

Application of output

The model is best used to compare outcomes between different individuals, policy options, or other scenarios. The results are best used in conjunction with an appropriate counterfactual to illustrate the variables under test.

Key data sources

The specification of a model run is based upon three areas:

1. The individual

The individual to be modelled is specified based upon an earnings and career profile. Saving behaviour for private pension accumulation is considered, as well as the behaviour at retirement.

These are generally parameterised according to the project in question, designed to create vignettes to highlight representative individuals of the groups under investigation.

2. The policy options

The policy option maps the pension framework in which the individual exists. It can accommodate the current system and alternatives derived through parameterisation. This allows flexing of the current system to consider potential policy options to assess their impact upon individuals under investigation.

This area has the scope to consider the build-up of pensions in their framework such as the auto-enrolment regulations for private pensions and the qualification for entitlement to state benefits.

The framework in retirement allows for the tax treatment and decumulation options taken by the individual as well as other sources of state benefits which influence the post-retirement outcomes for individuals.

3. Economic assumptions and scenarios

The model is capable of running with either deterministic or stochastic economic assumptions.

The deterministic assumptions used are generally taken from the Office of Budget Responsibility (OBR) Economic and Fiscal Outlook (EFO) to ensure consistency. They cover both historical data and future projected values. Alternatively the model can be used in conjunction with the PPI's Economic Scenario Generator (ESG) to produce a distribution of outputs based upon potential future economic conditions.

Summary of modelling approach

The model projects the pension features of the individual, both in accumulation (pre-retirement) and decumulation (post-retirement) phases.

It projects the pre-retirement features of the individual through the accumulation of pension entitlement, both state benefits and occupational Defined Benefit schemes.

This is done through the modelling of the career history of the individual, deriving pension contributions and entitlement from the projected earnings profile.

The entitlement to and the level of state benefits are projected such that from retirement, their contribution to the income of the individual can be calculated. Private pension income is modelled and assumes a decision about the behaviour of the individual at retirement. This allows for the chosen decumulation path of any accrued private pension wealth.

The Economic Scenario Generator

The PPI's Economic Scenario Generator (ESG) is used to produce randomly generated future economic scenarios based upon historical returns and an assumption of the median long-term rates of return. It was developed by the financial mathematics department at King's College London. It is used to test how the distribution of outcomes is influenced by the uncertainty of future economic assumptions.

Key results

The model generates projected future inflation rates, and earnings growth

- Inflation rates
  - Future CPI increases and earnings inflation rates.
- Investment returns
  - Returns are produced for the major asset classes of equity, cash and gilts.

This produces nominal returns which can be combined to produce investment returns for a more complex portfolio.

Application of output

The output of the ESG is a number of economic scenarios which are employed by the PPI's other models to analyse the distribution of impacts on a stochastic economic basis.

Key data sources

The specification of the model is based upon historical information to determine a base volatility and future assumptions to determine a median future return:

1. Historical returns

Historical yields and returns as well as inflation measures are used to determine the key attributes for the projected rates.

2. Future returns

Future returns are generally taken from the Office for Budget Responsibility (OBR) Economic and Fiscal Outlook (EFO) to ensure consistency with other assumptions used in the model for which the economic scenarios are being generated. Volatility can also be scaled against historical levels.

Summary of modelling approach

The six identified risk factors modelled are:

G Nominal GDP
P CPI
W Average weekly earnings
Y^l Long-term yields
Y^s Money market yields
S Stock returns

Using these variables, a six dimensional process, x_t is defined.

$$x_t = \begin{bmatrix} \ln G_t - \ln G_{t-12} \\ \ln(P_t - \ln P_{t-12} + 0.02) \\ \ln W_t - \ln W_{t-12} \\ \ln\left(e^{Y_t^l} - 1\right) \\ \ln\left(e^{Y_t^s} - 1\right) \\ \ln S_t \end{bmatrix}$$

Where t denotes time in months.

The development of the vector x_t is modelled by the first order stochastic difference equation:

$$\Delta x_t = A x_{t-1} + a + \varepsilon_t$$

Where A is a 6 by 6 matrix, a is a six dimensional vector and ε_t are independent multivariate Gaussian random variables with zero mean. The matrix A and the covariance matrix of the ε_t were determined by calibrating against the historical data. The coefficients of a were then selected to match the long-term economic assumptions.

It follows that the values of x_t will have a multivariate normal distribution. Simulated investment returns will, however, be non-Gaussian partly because of the nonlinear transformations above. Moreover, the yields are nonlinearly related to bond investments.

The first component and third components of x_t give the annual growth rates of GDP and wages, respectively. The fourth and fifth components are transformed yields. The transformation applied ensures that the yields are always positive in simulations. Similarly the second component gives a transformed growth rate of CPI. In this case, the transformation applied ensures that inflation never drops below -2% in the simulations. This figure was selected to be twice the maximum rate of deflation ever found in the historical data.

Individual modelling

The case studies in the report were generated using the Individual Model from the PPI's modelling suite. The individual model was run 1,000 times for each case study using the output of 1,000 runs of the Economic Scenario Generator.

The PPI's individual model calculates streams of retirement incomes for constructed individuals. The streams of income include State Pension, private pension and various state benefits in retirement. The individual model uses flexible policy parameters to define the pension landscape throughout the individual's working life and retirement. The individual is constructed by setting out the work history in terms of working patterns and salary level throughout their working life, along with pension scheme membership details.

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