PRESS RELEASE
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"Insights from behavioural economics can improve pensions outcomes" says Pensions Policy Institute

The Pensions Policy Institute (PPI) is today publishing *Consumer engagement: barriers and biases*, a report which explores behavioural economic theory and the way in which the barriers and biases it identifies can inhibit decision-making and outcomes in pensions. *Consumer engagement: barriers and biases* is sponsored by Pinsent Masons, and is the first in a series of three reports on the topic of engagement in pension provision.

As the pension landscape evolves, future pensioners face increasingly complex decisions about retirement, from decisions about saving throughout working life to decisions about how to access savings upon and during retirement. The way that people engage with these decisions can significantly impact their retirement income. It is therefore important that there is an understanding of the behavioural barriers and biases which can lead people to make less optimal choices about their savings.

Lauren Wilkinson, Policy Researcher at the PPI said "Automatic enrolment has illustrated the impact that a carefully designed behavioural intervention can have on retirement savings. By redesigning the choices involved in enrolment decisions so that saving is the default and opting-out requires an active choice, automatic enrolment has harnessed people's tendency towards inertia and increased the number of savers in workplace pension schemes by more than 6 million."

"But automatic enrolment hasn't fixed the pensions engagement problem entirely; in fact, in many ways it has complicated it. People who are defaulted into saving are by definition less engaged than those who choose to save voluntarily, and this can lead to insufficient engagement with other aspects of the decision-making process, such as decisions about contribution amounts."

"With the automatic enrolment review focussing on consumer engagement as a key theme, it is important that policy takes account of the way that individuals naturally behave when considering how to further improve retirement outcomes. Using behavioural techniques in a pension environment is not straightforward. But if used alongside a range of other policy levers there is evidence to suggest that behavioural techniques can improve decision-making and outcomes."

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Notes for editors

1. The Pensions Policy Institute (PPI) is an educational research charity, which provides non-political, independent comment and analysis on policy on pensions and retirement income provision in the UK. Its aim is to improve the information and understanding about pensions policy and retirement income provision through research and analysis, discussion and publication. Further information on the PPI is available on our website www.pensionspolicyinstitute.org.uk.

2. *Consumer engagement: barriers and biases* is the first in a series of three reports on engagement in pension provision.

3. This report was sponsored by Pinsent Masons LLP.

Executive Summary

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

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

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

Behavioural interventions have been successful in reducing harmful behaviour:

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

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

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

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

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

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

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