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White Paper Series

ENGAGING WITH YOUR PENSION

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Since its introduction, an automatic-enrolment workplace pension has become one of the cornerstones of long-term financial planning. While automatic-enrolment has, to a large extent, achieved what it set out to do, which was to reverse the decline in the number of employees in a workplace pension scheme, there are still many millions who are choosing the default savings option so that they are not saving enough for a well-funded retirement. One of the reasons for this is that there is a lack of engagement with workplace pensions, and if greater engagement did take place, then the assumption is that employees would save more. After comparing the UK with other countries, this paper proposes that activity to improve engagement needs to happen at the right point during an employee's working life. If too early, it may be lost amongst other day-to-day commitments, while leaving it too late could mean an ill-funded retirement. The key to engagement is the pensions conversations that need to take place.

Introduction

This paper looks at being engaged with your pension by reviewing some of the evidence from an empirical study which compared the UK with three other countries, before presenting possible pathways to engagement.

The principal transformative change to workplace pensions was brought about by the 2008 Pensions Act, with the introduction of Automatic-Enrolment (AE) workplace pensions, whereby employers are required to enrol all eligible staff into a workplace pension and contribute towards it. AE into a workplace pension was designed to supplement the state pension that forms the cornerstone of a retirement income.

The introduction of AE pensions in 2012 and the final rollout has without doubt stalled the decline during the early 2000s of workplace pension scheme participation, particularly amongst those employed in the private sector[1]. The reduction in workplace pension schemes' participation rates, particularly in the private sector, during the 2000s happened at a time when employer generosity declined and the benefits provided by the schemes, which switched from defined benefit to defined contribution invariably, reduced.

Automatic-enrolment has been a success as it has brought more than 10 million individuals into a workplace pension[2] with 87% of individuals in a workplace pension in 2018, which is up from 55% in 2012[3]. The rollout of AE has brought into the fold many, such as part-time or temporary workers and others, who were previously poorly served by a workplace pension or excluded.

The benefit of AE is likely to go some way towards addressing the shortfall in pensions savings by halving, by 2050, the proportion of pensioners who will retire with no private income[4]. But, the direction and significance of the impact of AE on employees' engagement is not entirely clear; neither is the promise of greater freedom to choose how to use one's pension fund in later life. This means that modelling and development of pensions are of crucial importance for the finances of ageing,

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[1] https://www.ifs.org.uk/uploads/publications/comms/Requiring%20Auto-Enrollment%20-%20Lessons%20from%20UK%20Retirement%20Plans.pdf
[2] Thurley, D. (2020). Pensions: Automatic enrolment – current issues. Briefing Paper No. CBP-06417. House of Commons Library.
[3] https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/automatic-enrolment-commentary-analysis-2019.ashx
[4] Thurley, D. (2020). Pensions: Automatic enrolment – current issues. Briefing Paper No. CBP-06417. House of Commons Library.

because a lack of adequate pension provision is likely to result in detrimental consequences for individuals and society as a whole.

As the demographic make-up of the UK population alters, resulting in a greater proportion of retired older individuals, the challenge of ensuring that an ageing society makes adequate pension provision, earlier in life, becomes ever-more pertinent. Recent pension reforms could provide a positive influence on attitudes and behaviour towards pension savings; however, such an outcome is by no means assured. AE has generally been considered a success, with opt-out rates at the larger firms covered by the legislation being relatively low[5]. At face value, it would appear that *status quo* bias, commonly observed in behavioural science, is acting to "nudge" people in an advantageous direction. However, AE default contribution rates are lower than those necessary to fund an adequate retirement for most people. This means that the eventual success or otherwise of the approach rests on the assumption that AE will act as a trigger for many individuals to become more involved and engaged in pension decision making, with the net result being greater levels of provision than merely the default contributions of AE.

The underlying concern is that while the emphasis for responsibility has shifted from the state to the individual, it does not necessarily follow that the individual will actively engage to ensure that they achieve a reasonably well-funded retirement. Whilst AE is accompanied by a new flat-rate pension, not all will qualify for maximum state pension benefits. Moreover, not all individuals are giving sufficient thought to long-term planning[6] by savings enough via their workplace pension to ensure that they achieve the retirement that they seek. Indeed, there is evidence that three quarters of pension scheme members did not adequately examine their pension[7] and were thus unaware of the

[5] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/883289/automatic-enrolment-evaluation-report-2019.pdf
[6] http://www.ifs.org.uk/comms/r73.pdf
[7] http://www.thepensionsregulator.gov.uk/docs/survey-of-dc-pension-scheme-members.pdf

size of their savings pot. More recently in 2019, more than three quarters of those surveyed were unaware of how much they will need during their retirement and half continue to believe the default minimum will adequately fund a retirement[8], giving a false sense of security. It is a puzzle that such a view prevails despite the Government's campaign Get to Know Your Pension designed to encourage greater engagement and savings.

However, an alternative perspective is that AE may encourage individuals to assume that there is no need to act further or engage in decision making, on the assumption that AE means they can look forward to a comfortable retirement. In effect, they may adopt a "job-done" mind-set, without fully appreciating the years of retirement they need to fund[9] to meet lifestyle expectations[10]. Evidence from the New Zealand KiwiSaver scheme launched in 2007, points towards the overriding factor influencing investor engagement, i.e. the default option presented to investors on AE, leading to passive decision making for retirement investments that do not match investors' age or risk profiles[11]. Such a situation is dangerous from both an individual and societal perspective because individuals may lack the provision that they seek to support later life. This is what appears to be happening at the moment in the UK, via lower contribution rates, with the default option the norm for many[12].

As a consequence of passive behaviour, if a large number of individuals find themselves in a position where they do not have sufficient funds to retire when planned, they may well accuse Government, policymakers and pension providers of failing to ensure that AE schemes were sufficient to fund retirement adequately. Indeed, a poorly funded retirement may have a negative psychological effect on retirees and lead to greater recourse to the state for other benefits.

Alongside debates about AE, there is an ongoing discussion regarding the statutory retirement age and when that will next be raised, with an expectation that those joining the workforce today will need to work well into their 70s, at the very least.

[8] Padley, M., & Shepherd, C. (2019). *Developing retirement living standards*. Pensions and Lifetime Savings Association, London.
[9] http://www.ifs.org.uk/comms/r73.pdf
[10] https://www.pensionspolicyinstitute.org.uk/uploaded/documents/20131022_AE_Adequacy_FINAL_REPORT.pdf
[11] Lee, A., Xu, Y., & Hyde, K. F. (2013), Factors influencing investor choice of retirement funds. *Journal of Financial Services Marketing*, 18 (2), 137-151.
[12] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/883289/automatic-enrolment-evaluation-report-2019.pdf

UK Compared With Other Countries

Image: www.aag.com

The evidence points toward attitudes and engagement with pensions - behavioural scientists would argue as being cognitive - as being the key to a suitably funded retirement, which for retirees can mitigate against financial shock(s) and so create financial resilience during retirement. While the benefits of early planning for the individual are clear, there are also benefits for the employer. One such benefit is that employees may not need to work as long, meaning that the employer does not need to manage an ageing workforce. In addition, there could be other issues associated with an ageing workforce, such as absenteeism, motivation and succession planning, if employees are unable to retire when they desire.

By joining an AE workplace pension scheme and continuing to be a part of it, employees are in-effect purchasers of a product; i.e. customers. In their broadest sense, purchases are emotional, and attitude is the pre-requisite to engagement, and both are cognitive. While the central premise being discussed is that engagement is the key to increasing savings, the pertinent question is how does behaviour the UK compare with other countries? Is it is the case that attitude and engagement with pensions in the UK lags behind other countries?

An empirical study was conducted[13], generating a number of interesting insights, with the UK compared side by side with other countries, namely USA, India and New Zealand. So, why the comparison with these countries? We know that in the USA, there are states such as Connecticut that are looking to introduce a form of AE and there is a long history of private pension provision. In India there is a state pension which is “modest at best” and thus where applicable there is a culture of workplace pensions – it should be noted that the notion of a workplace pension is not for all and millions of daily wage workers and migrants have no pension provision at all. In regards to New Zealand, it was included because it introduced an AE scheme in 2007, and the learning that can be accrued.

[13] Funded by the Faculty of Law of Business, Coventry University.

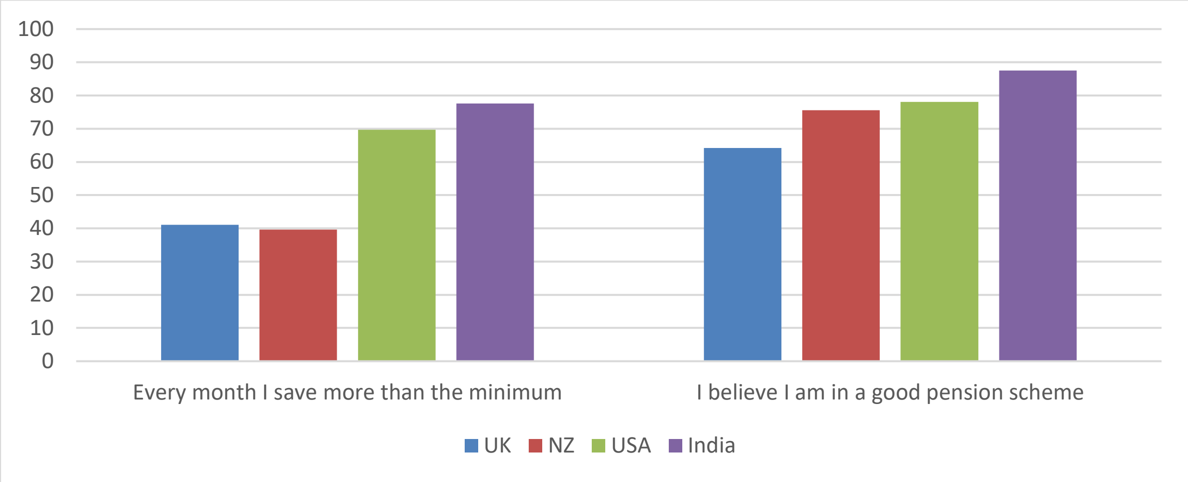
Attitude to Pensions

In India, they tend to save more than the minimum, and this can be partly explained by a historical savings culture in India. Another possible reason is the traditional inter-generational family structure, whereby there is no commitment to repay a home loan on a property that has been in the family for a number of years. However, in the UK, one of the reasons for the savings culture not extending too much beyond the minimum is that the workplace pension may be viewed as being supplementary to the state provision, or individuals not understanding how much they will need during their retirement.

Furthermore, in the UK it may be the case that the decision regarding the amount to save per month is delegated to surrogates. This may be related to bounded rationality, which posits that people are unable to make a decision because they lack the capacity to store information to make a rational decision. Delegating the decision to others means that it can alleviate stressful situations but could also lead to decreased autonomy.

When it comes to whether the pension scheme is viewed as being good, in India this is rated more highly than in the other countries that were compared. This may be a consequence of pensions in India being largely defined benefit schemes, which in the last 20 years in the UK have chiefly been replaced by defined contribution schemes. In the UK, two thirds in the 40-49 age group were of the view that they were not in a good pension scheme. This viewpoint may be based on historical expectations, in the sense that they may have witnessed their parents being a part of a defined benefit scheme but they are now in what they may view as being an inferior defined contribution scheme.

Figure One: Attitude to Pension Schemes



Engagement with Pensions

The Department for Work and Pensions (DWP) in its 2017 year-end annual report reviewing AE, stated that one of the reasons for the lack of savings via a workplace AE pensions was that scheme members are not engaged enough with their pension. Purchases are emotional and engagement is broadly a mental state accompanied by active mental processing (Harmeling et al., 2017[14]), which means that it goes beyond a simple transaction. Engaged customers are also positive advocates meaning that they can spread the virtues of AE pensions to others. When enrolling in an AE pension, the employee is in-effect becoming a customer because they continue to be included in that scheme – although they can opt-out – notwithstanding that consumption; i.e. becoming a retiree and relying on the pension will not happen for a number of years. Current AE rules mean that "the customer" has to make a positive choice to opt-out.

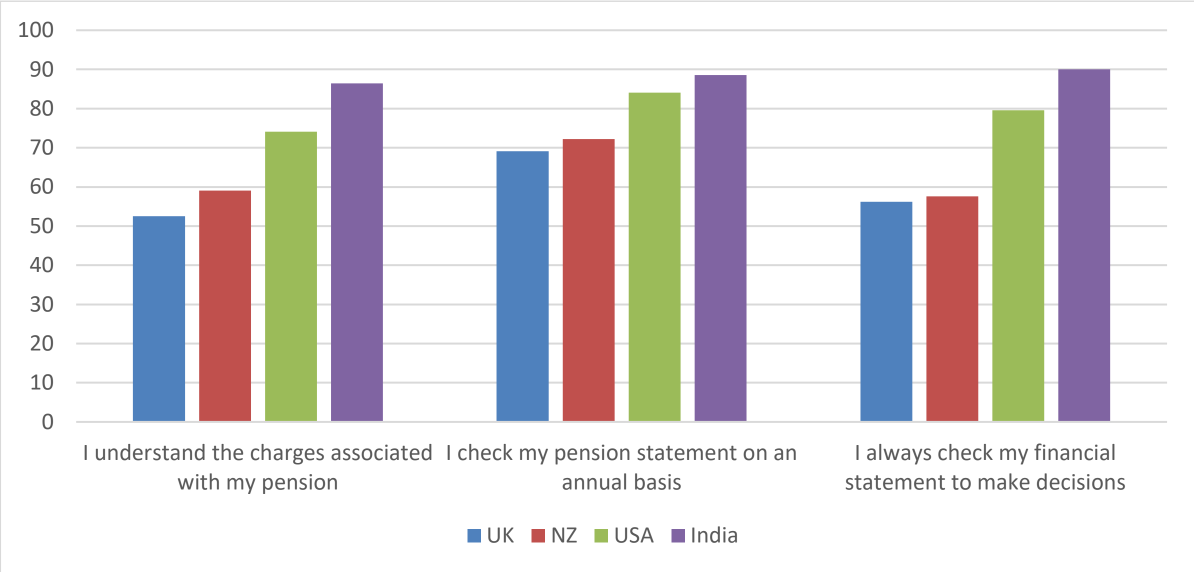
Automatic-enrolment relies on inertia to ensure that scheme members remain a part of a scheme, but that does not mean they will be engaged with their pension, which the DWP argues is the root cause of savings levels not being at the level required to fund an adequate retirement. In short, engagement is a behaviour that individuals display through their cognitive processes.

Engagement with pensions can be the result of a number of behavioural factors; for example, financial literacy, motivation, trust etc., but at the most basic level it is about being aware of the cost and value of pension funds and making decisions. In comparing the UK with other countries, the pertinent

[14] Harmeling, C. M., Moffett, J. W. Arnold, M. J., & Carlson, B. D. (2017). Toward a theory of customer engagement marketing. *Journal of the Academy of Marketing Science, 45*, 312-335.

questions are do individuals understand the cost and do they review their pension on an annual basis? Figure Two reveals that across all four countries, the UK rates are the lowest when it comes to being actively involved.

Figure Two: Engagement with Pensions



Across all four countries, those in the 20-29 age groups are the least likely to check their pension on an annual basis. This can probably be elucidated by the fact that retirement, for that age group, is a long time into the future and it may be difficult to conceptualise how much will be needed during retirement. As retirement begins to loom larger over the horizon, older individuals are more likely to check their pension statement on an annual basis. The evidence in the UK indicates just over a half understand the cost of their pension, which is lower than the other countries that formed this.

The UK largely displays the lowest levels of engagement when it comes to understanding their pensions and checking their pension before making a decision. In India, for example, 90% check their statement before making a decision, while in the UK it is just over two-thirds. This, as noted earlier, could be because of the power of defaults; i.e. they could be relying on others to make the decision for them, which could be because of a host of reasons such as a lack of financial knowledge.

How to Get Individuals Engaged

Automatic-enrolment's introduction has nudged individuals to save via a workplace pension scheme and there may be conscious and unconscious influences that conflict with rationale thinking.

Prima facie, it is a good idea to increase levels of pension engagement, but that is not without its potential pitfalls. The central question is whether it is sensible to increase engagement for all individuals so that they take a keener interest. For some individuals, the default saving option is the best option and if they were to engage and take a keen interest, they may actually decide they no longer want to be a member of the scheme and instead prefer to boost their take-home pay by opting out. From a behavioural science viewpoint, one of the reasons for AE's great success has been its reliance on natural inertia, meaning that individuals make some retirement provision without being too engaged - there is a danger there could be too much engagement followed by a knee jerk reaction. For example, when the Covid-19 crisis struck many stock markets plunged and so too did the value of the accrued "pension pots" – there was anecdotal evidence that some individuals were making telephone calls about the value of their "pension pot". Some of those taking a keen interest could have ceased paying into their pension because of the fall in stock markets reducing the value of their pension pot not realizing they would be accumulating more for their pension contribution when stock market values were lower. Therefore, the issue is one of financial knowledge as to how the pension investment works and what decisions need to be made and when, and the gap can only be closed through improved financial educational programmes. These financial education programmes are needed so that individuals can make informed decisions giving a sense of empowerment. These programmes, supported by employers, should at least seek to make certain employees understand their pension scheme and how it works.

Clear communications are a way to improve engagement with pensions and it is life events that could have the greater impact. These life events could have a major impact on individuals' finances, for example becoming a parent, and so may want to take an interest in their pension and save more. The challenge is to convert younger individuals – who as this research shows, are the least engaged – a group which has to juggle financial priorities and this could mean money that was going into a pension is now spent on other things, such as a larger family car to accommodate a growing family.

The pension conversations are important. Therefore, the key is to hold those conversations at a time that is right, otherwise they may be viewed as being uninspiring and irrelevant. For someone in their 30s, it may not be the right time, given a growing family, buying a home and thinking about getting children through University, and so they may not want to tie their money up in a pension.

There is a compelling argument to be made to communicate with employees in their earlier years, but it should not be forgotten those in their 50s still have time in which to boost their pension. Retirement may be on the horizon and there may be active discussions around what retirement will look like and the pathway to achieve it. During their 50s, the commitment to a mortgage may have finished and any children will have left home, meaning that those empty-nest employees have disposable income to spend and save.

It is also important the way that communications are put to employees. What needs to be avoided is a “big” presentation about their AE workplace pension. Instead short and sharp messages about the benefits of their AE pension and how the employer contributes will probably resonate the most with employees. Showing the employer’s contribution could have the benefit of demonstrating their commitment to an employee’s long-term well-being and it could result in the additional benefit of potentially reducing employee churn.

Lessons to be Gained

Automatic-enrolment workplace pensions with clear engagement by employees has the potential to be a real benefit for the long-term financial well-being of employees. This is important as there are countries now evaluating the introduction of a form of AE, Germany and Poland for example, while states in the USA (e.g. Connecticut) are also looking to do so. While there is no one simple solution as to how to save more for a retirement, there are lessons that can be learnt from the preceding discussion as to why some groups are more likely to be engaged than others.

There is no single “off the shelf” blueprint to ensure increased pensions savings, but the pathway has to be built around pragmatic engagement. The pathway to engagement can take a number of forms, but the key is to make sure that any engagement activity is relevant to the individual, so that it empowers them to make a proactive and informed decision. It has to be a two-way process rather than a simple one-way flow of information, so this means that the employer and employee are engaged. There is also the issue of timing. At what life stage do the conversations take place? Too early and they will be lost given the pressures of day-to-day life for someone in their 30s, while leaving it too late could mean a poorly funded retirement. As there is no silver bullet, the way forward, around which strategy needs to be built, has to be centred on tailoring the communications. This will help to ensure they are relevant as possible but and this is no exact science given individual circumstances alter through various life stages.

Further Information

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