



INTELLIGENT THINKING



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Committed, Disengaged, Suspicious or Falsely Secure: What type of pension saver are you?

Executive summary

- Saving for retirement is for most a complex and inaccessible topic, which is perhaps why many people switch off rather than engage with it head-on.
- Failing to engage with pension saving could be critical. At £155.65 a week, the *full* state pension is unlikely to provide everyone with the income they desire through retirement; while many people who do start a pension fail to contribute enough or are invested in unsuitable assets.
- We have identified the four archetypal pension personas that are most at risk of failing to generate a good retirement outcome: the Committed, the Disengaged, the Suspicious, and the False Security Brigade. If you can relate to one of these personas, the chances are your future prosperity is at threat from the risks identified for each type.
- Understanding which of these personas people identify with will help savers make the decisions that could lead to meaningful change in their financial habits and give them a much better chance of achieving a good retirement outcome.

The four types of pension saver (or non-saver)

Understanding what type of pensions saver, or non-saver, you are is crucial if you are to make the decisions that could lead to meaningful change in your financial habits and give you a chance of a better retirement outcome. With that in mind, we've

identified the four archetypal pension personas that we believe are most at risk. This we did having researched and documented the typical behavioural impediments to making informed retirement savings and investment decisions.¹

¹See: *Is your default fund fit for purpose? Are we setting retirees up for failure by default?* Chris Wagstaff. Columbia Threadneedle. July 2016. *Mind the gap: Overcoming the cognitive barriers to saving for retirement.* Chris Wagstaff. Columbia Threadneedle. July 2016.

The four types of pension saver (or non-saver)

The Committed: You understand that you need to put money aside for your retirement and you are committed to doing so. But are you squirreling enough away and are your pension savings working as hard as they should?

The Disengaged: You find the subject of money and investing something of a turn-off and disengage whenever the issues are raised. The future is a long way off so you'll worry about your retirement when it gets a bit closer. Indeed, the possibility of living frugally in retirement hasn't occurred to you at all.

The Suspicious: You have read so much about banking and investment scandals that you do not trust anyone who says they can help you grow your money. You're not going to be taken for a ride, so you keep your money somewhere where you believe it's 'safe'.

The False Security Brigade: You are contributing to a pension, perhaps through auto-enrolment, and are perfectly content with your retirement planning. But you and your employer are only contributing the bare minimum and you are investing in your pension scheme's default fund. So is everything as rosy as it first appears?

The Committed

If you are one of *the Committed*, the chances are that you believe you have everything in place to generate a sizeable retirement pot by the time you wish to stop working. You are contributing to your workplace pension, and you have chosen what you think is a sensible investment strategy. You can now sit back and relax. Or can you? The Committed may initially approach their retirement planning with some gusto, but even the most prudent among this group are likely to have underestimated how much they need to contribute for a successful outcome.

Even after having put a decent pension pot in place, the Committed often then chose to leave it alone, safe in the knowledge that their contributions are benefiting from *pound cost averaging* and compounding investment returns. But what if your choice of pension fund is no longer appropriate? Poor fund selection might only become apparent over time, when market conditions alter, or a fund's investment mandate changes.

A Committed saver may have been fully committed to starting and/or contributing to a defined contribution (DC) pension scheme, but did so without any advice or guidance. Research suggests that individuals who have attempted to make active investment decisions without the requisite tools, guidance or advice haven't fared at all well. Indeed, statistics regularly point to well over half of those making investment decisions more generally, as seeking little, if any, financial advice.

Solutions: The Committed pension saver should conduct a pensions review, whether on their own or with the help of a qualified independent financial adviser, to check they are contributing enough to their pension and that the funds in which they are invested are suitable for their circumstances and achieving their desired goals. Many funds are arguably unfit for purpose.²

The Disengaged

If you are one of *the Disengaged*, there is a good chance you will face a difficult retirement, depending on what other assets and/or income you have access to. For many, a lack of engagement results from a deeply engrained "present bias" – which is when you prefer to spend today, rather than save for tomorrow. The Disengaged focus far more on the upfront costs of saving, without thinking of the benefits a large nest egg will deliver in the future. Indeed, a two-year timeframe is typically the limit for most peoples' radars. Present bias also arises from the difficulty individuals have in visualising their future selves much later in life. In fact, when thinking of but unable to visualise our future selves, we use the same part of the brain as when we think about strangers. So the savings decision effectively becomes a choice between spending today and saving for a stranger to spend *our* money in the future! Consequently, the lure of instant gratification, compared to the delayed gratification that results from saving (for that perceived stranger), means many people simply switch off and do not save enough for their retirement.

²See: *Is your default fund fit for purpose? Are we setting retirees up for failure by default?* Chris Wagstaff. Columbia Threadneedle. July 2016.

For most of the Disengaged, the possibility of living frugally in retirement simply doesn't register as a tangible risk. Indeed, as the House of Lords Select Committee on Public Service and Demographic Change said in its 2013 report, 'Ready for Ageing?': "The UK is the worst in the world in saving for retirement."³ The problem is that the consequences of this inaction will only be felt far into the distant future, when for many it will be too late to act.

Some Disengaged fail to grasp the fact that, if their employer pays contributions on their behalf into a DC workplace pension scheme, and they do not join the scheme, they are effectively turning down part of their total remuneration package – or "free money". Contrast that with someone earning £40,000 per annum who pays 5% of their salary into a pension, which is matched by their employer. They will contribute a combined £4,000 a year which, when compounded over 35 years at an assumed return of 5% a year, could result in a pension pot of nearly £380,000. This could top up a state pension by nearly £10,500 a year with annual index linking (based on a healthy 65-year-old purchasing a RPI-linked annuity of £2,762 per £100,000).⁴

For the Disengaged, a lack of guidance by which to navigate the complex world of pensions and evaluate the bewildering array of complex choices is compounded by a widespread unwillingness or inability to pay for financial advice. Consequently, there remains a deep seated reluctance to engage with pensions and retirement outcomes.

The question then, is how to get the Disengaged to engage?

Solutions: Policymakers, regulators and pension providers can all help the Disengaged achieve better financial outcomes to and through retirement. Indeed, policymakers increasingly apply behavioural insights to public policy, both through initiatives such as auto enrolment to harness the inertia of the Disengaged and by using other "nudges" to move people gently towards a positive outcome, rather than scaring or pressurising them into a course of action.⁵ For instance, publicising positive peer comparisons to influence the savings behaviour of those who have yet to conform with the considered social norm for that demographic. Then there's helping people to overcome present bias by projecting an image of how they might look 20, 30 or 40 years from now.

Novel incentives to raise the level and coverage of saving amongst the Disengaged, such as issuing lottery tickets if a particular sum is saved each month, are attractive in that people tend to focus on the prize, by visualising themselves sitting on a big pile of cash at the end of the month, rather than the small probability of winning it. This helps to better align the cost and potential benefit of saving today. Regulators can help by simplifying the process and removing the "hassle factor" associated with starting a pension. Pension providers can help by engaging with individuals at those times in their lives when they are most receptive – birthdays and anniversaries, for example; simplifying and personalising messages; better framing or contextualising the information people receive, and breaking down the achievement of a complex goal into simple, manageable steps, by using online interactive decision trees, for example.

The simple, pragmatic and practical EAST framework (make it Easy, Attractive, Social and Timely), devised by the UK's The Behavioural Insights Team, which harnesses the above features, can be applied before, at and during retirement to dramatically improve retirement decision making.

The Suspicious

Sadly there is a widespread lack of trust in pensions and the pensions industry. Indeed, a research report conducted by the UK's National Employment Savings Trust (NEST) observes: "Stories of people losing all their money endure in the collective public memory. In our focus groups people still referred to Robert Maxwell and his role in the 1991 collapse of the Mirror Group pension scheme. It seems that for many consumers 'Maxwell' is the biggest brand in pensions. People also tell stories of relatives or acquaintances that 'lost' money in a company pension or ended up with a disappointing outcome after years of saving. This has created a consensus that pensions are insecure and open to corruption and mismanagement."⁶

This view has been exacerbated by frequent reports of fraud and misconduct across the financial services industry, with the payment protection scandal (costing the five big banks guilty of mis-selling policies a total of £32 billion⁷), defining for many consumers just how untrustworthy the people who manage our money can be. The global financial

³Ready for Ageing? House of Lords Select Committee on Public Service and Demographic Change. HL 140. 2013.

⁴The net cost to the employee of making a 5% contribution would be reduced to 4% by tax relief, with additional relief from National Insurance Contributions if paid by the employer under a "salary sacrifice arrangement". A final pensions pot of £379,345.29 would initially generate an annual RPI-linked income of £10,477.52. Source: Columbia Threadneedle and Hargreaves Lansdown, 11 August 2016.

⁵See: *Mind the gap: Overcoming the cognitive barriers to saving for retirement*. Chris Wagstaff. Columbia Threadneedle. July 2016.

crisis did not help, with 'investment' vaguely identified as the chief culprit by many consumers. As NEST says: "Given a lack of knowledge about what the investment industry is and what it does, [people] struggle to differentiate it from betting."

However, the Suspicious who refuse to become pension savers for any of these reasons are at risk of throwing the baby out with the bathwater – with potentially dire consequences.

Solutions: Restoring people's trust in the system is a very emotive issue. NEST's research offers some insights which could prove instructive. Many people told NEST they would feel reassured by a pension provider that was 'honest' and 'caring'. Indeed, NEST's key principles include: 'Be a safe pair of hands', acting transparently and displaying integrity.

Transparency around how pension funds invest and what their charges comprise, along with education centred on risk and reward, have been cited by NEST as areas where providers can improve communications with current and prospective pension savers. Over time this will help drive a change in attitude, so that people view the world of pensions as desirable, sensible and prudent.

The False Security Brigade

The people in this demographic are in almost as dangerous a place as the Disengaged. They are contributing to a pension they believe is working hard to build a meaningful pot at retirement, but many of them are not contributing anywhere near enough to that pension or have invested in unsuitable underlying pension funds.

Many of the *False Security Brigade* will mentally "anchor" pension contributions to the minimum contribution level applied by their workplace pension scheme in the mistaken belief that this is a target savings level and will provide an adequate sum in retirement. This problem is particularly acute among those auto-enrolled into a workplace pension, where auto-enrolment minimum contributions are typically seen as having been endorsed as being adequate by the government.

But anchoring to minimum contribution levels could see savers' pension pots experience considerable shortfalls. This is exacerbated by the fact that many savers also opt for their pension scheme's default

fund option. They figure that if it's right for most people, it must be right for them. But while most default funds do meet the needs of most savers, they are not suitable for everyone and are not always fit-for-purpose. Many do not employ active asset allocation or active fund management, are almost wholly exposed to equity markets, so are not as diversified as they could be, while others have high charges which can eat into investment returns and erode savers' capital.⁹

Another problem is that many default funds automatically 'lifestyle' savers pension pots the closer they are to retirement - meaning they switch from riskier assets to less risky ones. But the new pension freedoms mean that increasingly savers may wish to remain exposed to a diversified pool of riskier assets as they look to grow their capital to provide them with a sustainable income over a retirement which could last for 20, maybe 30 years or more.

Solutions: Four "nudges" can help to move contribution levels away from the minimum contribution "anchor": issuing a lottery ticket for, say, every £100 per month saved; signing employees up to the automatic escalation of their contribution rates on receiving future pay rises;⁸ publicising favourable statistics that show most people in a relevant cohort have started saving and disclosing the amounts involved, again if favourable; and illustrating on employees' monthly payslips the monthly income stream their accumulated contributions might generate at their normal retirement date. By facilitating a direct comparison with what the employee is currently earning, this adds perspective to the need to save more for their retirement.

Education and messaging are also key to ensuring the False Security Brigade do not sleepwalk their way to an uncomfortable retirement. This demographic would similarly benefit from more user friendly, online tools, such as interactive decision trees that steadily take the individual step-by-step through the myriad of decisions they need to take to arrive at their end goal, and behavioural interventions used successfully by other industries, such as traffic lighting by the Food Standards Agency to develop simple and intuitive food labelling to encourage healthier eating.

⁹Improving Consumer Confidence in Saving for Retirement. The National Employment Savings Trust file:///C:/Users/louis/Downloads/improving-consumer-confidence-in-saving-for-retirement.PDF.pdf

⁸Watchdog warns of the dangers of a PPI time limit, Which.co.uk, 13/4/2016.

⁸See: Richard H. Thaler, University of Chicago and Shlomo Benartzi, University of California, Los Angeles. *Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving*. Journal of Political Economy, 2004, vol. 112, no. 1, pt. 2.

⁸See: *Is your default fund fit for purpose? Are we setting retirees up for failure by default?* Chris Wagstaff. Columbia Threadneedle. July 2016.

Why you need to save for your retirement

Saving for retirement is for most a complex and seemingly inaccessible topic, which is perhaps why many people switch off rather than engage with it head-on. But while retirement planning for many may not be the most engaging of subjects, it is crucial to our future wellbeing. Those who get it right can live a fulfilling life in retirement while those who get it wrong may end up living frugally or be unable to stop working well into their twilight years. Saving sufficient is the bedrock of achieving a good retirement outcome. For most people without a defined benefit (DB) pension, there's no time like the present for them to take a look at what they are doing to plan for their future. Indeed, time is of the essence because, generally, the longer one can save and invest, the greater the chance of accumulating a meaningful nest egg. Such is the power of compounding investment returns. Ultimately, the success of any DC workplace pension scheme depends on two things: how much you and your employer contribute and the return you make over time on those accumulated savings.

But despite the ticking clock, many people do not plan ahead. Some believe the state will look after them in retirement, while others do not care to think about the distant future or believe they will receive some kind of financial windfall before they retire. In all three cases, this is more wishful thinking than sensible financial planning.

Relying on the state to provide you with a decent income is not a prudent strategy. The maximum state pension pays just £155.65 per week, or £675 a month, based on today's figures; but many people will receive nowhere near that sum because the maximum is based on someone having a full 35-year record of National Insurance Contributions and not having been contracted out of the state earnings related pension scheme (SERPS) or second state pension (S2P). Even so, that maximum of £8,094 a year is unlikely to be enough to keep most people in the lifestyle they currently enjoy or aspire to.

Research published by Prudential in April 2016 indicates that two in five pensioners (41%) regret their retirement planning decisions, with common regrets including not saving enough, not starting to save early enough and not setting a retirement budget.

The problem is common and widespread: people are either not putting enough aside for their future or are doing so belatedly. According to research published in the first edition of the Pension Policy Institute's (PPI's) *The Future Book* in October 2015, the average combined (employer and employee) contribution into a DC workplace pension is just shy of 6% of salary. Yet a median earner might need to contribute 11% to 14% of band earnings from the age of 22 to state pension age just to have a two in three chance of achieving an adequate income throughout retirement. And that's assuming the state pension retains its generous "triple-lock" method of annual indexation (the higher of 2.5%, wage growth or the consumer price index).

According to research from Royal London, those who start saving at 35 will need to work to 79 for a 'gold standard' pension (with DB-type index-linking and provision for a spouse). Those who delay starting saving until 45 would have to work into their eighties to make up the shortfall. Clearly, there is a dramatic shortfall between what people are currently saving in a DC pension and what they need to save to build a pension pot that stands a chance of generating an adequate income for life without working into old age. Of course, publicising inadequate pension saving as being a widespread problem simply exacerbates people's sub optimal behaviour. It becomes the social norm.

While engagement levels have improved since the introduction of auto enrolment, in 2012 and the new pension freedoms, in 2015, there is still some way to go before retirement planning becomes front and centre of the nation's consciousness.

Achieving a retirement to be enjoyed, not endured

Whichever type of pension saver, or non-saver, you are, the chances are your future prosperity is at threat from one or a number of the risks identified above. Not contributing enough to a pension, not taking an appropriate level of risk, sticking with a default fund that isn't necessarily fit-for-purpose, and hoping other assets will come good, are all threats to enjoying a comfortable retirement. Take a moment to analyse which type of pension saver you are and whether there is scope to improve your current pension provision.

Whatever type of pension saver people are – or will be – it is clear that policymakers, regulators and the pensions industry can and should do more to properly support individuals throughout the entire retirement planning and implementation process. Using behavioural solutions is a start but pension savers also need to have their options, choices and potential outcomes explained and illustrated to them in a simple, clear, understandable, relevant and practical manner. They also need to be directed to sources of guidance. Only then will they engage more with the process and feel empowered to make better and more informed decisions and only then will people achieve a retirement that is to be enjoyed rather than endured.

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