Public understanding of risk and its effect on pension engagement

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@PUFin_Sharon #PUFin @OUBSchool
About True Potential PUFin

Multi-disciplinary centre for personal finance research and learning
Aim to improve the public’s understanding of personal finance, providing people with the tools to make sound financial decisions
... and looking at ways to make financial services work better for people, and to ensure effective regulation and consumer protection
Context is important

1. Fast-changing pension landscape
2. Retirement is evolving
3. Poorly-quipped citizens
4. Savings ‘doublethink’
5. Financial health
Context is important:

(1) Fast-changing pension landscape

- Shift from paternalism (DB) to libertarianism and individual responsibility (DC)
- Automatic enrolment – the classic ‘nudge’
- But freedom and choice at age 55
Context is important:

(2) Retirement is evolving

- 49% of DC members think idea of retirement ‘outdated’
- Majority expect to work for longer than parents
- 1 in 5 people have no idea when they expect to retire
- Pension will only be ‘part of the mix’ for upcoming DC members

Source: *Steps towards a Living Pension*, Barclays, 2014
Context is important:

(3) Poorly equipped citizens

• People accept responsibility for ensuring they have sufficient income in retirement
  – 60 per cent in 2012, up from 52 per cent in 2006
  (*Attitudes to Pensions: The 2012 Survey. DWP Research Report 813*)

• Financial education in National Curriculum from Sept 2014 in England – not all schools

• Complexity and change create confusion
Pension worries

- How does the new pension regime work?
- How do I take advantage of new pension freedoms?
- How do I transfer to another pension scheme and what are the costs?
- How do I evaluate different pension products?
- How do I check that my pension plans are on track for the outcome I want?

Source: Comments from OU Managing My Money learners, February 2015, http://tinyurl.com/p4ctn4l
Context is important:

(4) Savings ‘doublethink’

- ‘People aren’t programmed to save’
- ‘British consumers are spending beyond their means, warns OBR …’
- ‘The BoE recently raised its 2015 forecast for growth in real post-tax household income from 1¼% to 3½%. Forecasters expect that this will likely support strong consumer spending growth and thus underpin overall GDP growth in 2015.’
Context is important:
(5) Financial health

- 46% of employees worry about their finances
- Just 35% of employees feel optimistic about their financial future
- 18% of employees lose sleep worrying about their finances
- 20% of employees avoid thinking about finances because they find it upsetting
- 25% of employees are concerned about their debt levels

Source: *Financial Well-being: The Last Taboo in the Workplace?* Barclays, 2014
How can the public’s understanding of risk help explain low levels of engagement with DC pensions and planning for later life?
Weak personal investment culture

Percentage of households in Britain with formal financial assets (excluding private pensions), 2010/12

<table>
<thead>
<tr>
<th>Type of Investment</th>
<th>Percentage</th>
</tr>
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<tbody>
<tr>
<td>Savings accounts</td>
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<tr>
<td>ISAs (including PEPs)</td>
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<tr>
<td>National Savings certificates and bonds</td>
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<td>Insurance products&lt;sup&gt;1&lt;/sup&gt;</td>
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<td>Employee shares and share options</td>
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<td>UK bonds/gilts</td>
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Pension ‘journey’ characterised by inertia and low engagement

• Auto-enrolment, the classic ‘nudge’
  – 5 million UK workers auto-enrolled so far
  – Opt out rates running at one in ten

• Low levels of active investment choice and switching
  – 98%+ of AUM for NEST’s 1m members is in default option
  – 4% of NEST members registered online with the scheme, to get additional information
Through a savers’ eyes: Are pensions fit for purpose?

• People ‘get’ the risk-reward trade-off
  – 72% aware that final value of personal pensions depends on stock market performance, up from 61% in 2006 (Attitudes to Pensions: The 2012 Survey. DWP Research Report 813)

• But still reluctant to take investment risk
  – 52% of people would prefer to miss their savings goal than take investment risk, only 12% would not (How do savers think about and respond to risk? Pensions Institute, Cass Business School, 2014)
Through a savers’ eyes:
Are pensions fit for purpose?

• People intolerant of risks with certain characteristics:
  – Unknown
  – Uncontrollable
  – Not easily reduced
  – The risks have catastrophic (financial) potential, and
  – Perceived inequitable distribution of risks and benefits

Through a savers’ eyes:
Are pensions fit for purpose?

• So DC pensions seem at odds with the purpose of pension saving: ‘Security in Retirement’

• In savers’ eyes, pensions fraught with risks
  – May not get back the money invested
  – Pension savings don’t make sufficient returns to provide adequate retirement income
  – Principle of deferred gratification doesn’t hold
Through a savers’ eyes: Are pensions fit for purpose?

• Tendency to ‘catastrophise’: people ‘see the chance that their money is at risk as the same as the chance of losing everything’. (NEST, 2014, Improving consumer confidence in saving for retirement, p9)

• Reinforced by other risks and uncertainties
  – Legacy of mis-selling and mismanagements
  – Low trust in longer-term financial products
Through a savers’ eyes:
Are pensions fit for purpose?

- 24% trust longer-term financial products (Feb 2015, up from 19% in Feb 2014)
  - Joint second lowest with Gas & Elec Companies, Car Dealers lowest (12%)
  - Day-to-day banking 36%
  - Food/grocery 55%

Which? Consumer Insight survey, http://consumerinsight.which.co.uk/
What’s it all for?

• 41% private pension savers have no idea what their income in retirement will be (Attitudes to Pensions: The 2012 Survey. DWP Research Report 813)
  – 21% vague idea
  – 36% good or reasonable idea

• ‘Rules of thumb’ based simply on current situation
What’s it all for?

• What is a ‘good’ outcome, and how to get there
  – Help with ‘the whole picture’
  – Help to work out how much to pay into pension
  – Help to work out likely annual income in retirement, from all income sources

• In employee’s eyes, important role for employers

*Steps towards a Living Pension*, Barclays, 2014
New freedoms, new motivations?

• Positive impact on perceptions and aspirations
  – 34% of people say they will think about planning for retirement sooner, increasing to 40% among 22-30 year olds
  – 29% of people say they are more likely to increase their pension contributions as a result of the new freedoms

*NEST Insight 2015: Taking the temperature of auto enrolment*
New freedoms, new confusions?

- More choice is not a great behavioural motivator
- UK public’s risk aversion
- Desire for income security
- Under-estimate life expectancy at retirement
New freedoms, new opportunities?

- Harness (relatively) positive public mood?
- Practical steps that give people more control and autonomy?
  - Outcome-focused help and support
  - Probabilistic projections?
  - Pensions Dashboard?
  - Digital Passport?
Summing up

• People do ‘get it’
• More variables than ever in the retirement equation
  – As citizens, not well-prepared or well-equipped
  – Self help vs guidance vs financial advice
• In savers’ eyes, pensions misaligned with ‘Security in Retirement’ and difficult to get ‘full picture’
• Window of opportunity? But many want to ‘save, forget, collect’
Find out more about True Potential PUFin

www.open.ac.uk/pufin

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