



INTELLIGENT THINKING



Mind the gap: Overcoming the cognitive barriers to saving for retirement

Chris Wagstaff

Head of Pensions and Investment Education, Columbia Threadneedle,
and Senior Visiting Fellow, Finance Faculty, Cass Business School

Executive summary

- Addressing the inadequacy of retirement provision is one of the UK's biggest socio-economic challenges, as the aspiration to generate good financial outcomes at and in retirement typically fails to meet the reality by some margin.
- The consequences of making a wrong decision *to and through* retirement will rise over time as people increasingly become solely reliant on their defined contribution pension pots to support their standard of living in retirement.
- This comes against three secular trends: the time spent in retirement increasing, the continuing prospect of more modest real investment returns and yields, and individuals having to increasingly take more responsibility for their financial futures.
- Most people are ill equipped to determine how best to achieve a good retirement outcome, given a multitude of structural and behavioural impediments to informed decision making.
- Therefore, policymakers, regulators and the pensions community must be integral to the process of helping people achieve good financial outcomes *to and through* retirement by ensuring people save sufficiently, invest these savings appropriately and successfully navigate those risks that threaten the preservation of capital and the generation of a sustainable income stream throughout retirement.
- Reasonably simple behavioural interventions can be used by policymakers, regulators and the pensions community to harness the inertia of the disengaged and address many of the impediments to informed decision making for those willing and able to make an active decision.
- Policymakers have increasingly become more open to applying behavioural insights to public policy, notably using “nudges”.
- The simple, pragmatic and practical EAST framework (make it Easy, Attractive, Social and Timely), can be applied to the pre-, at and in-retirement stages to dramatically improve savings levels, investment decision making and the management of the key risks faced at and in retirement.
- The EAST framework or any other behavioural intervention should only be employed with a good working knowledge of the decision problem to be addressed and with the intended intervention having been adequately tested.
- Much can be achieved by employing user friendly, online tools, such as interactive decision trees that steadily guide the individual through the myriad of decisions they need to take to arrive at their end goal, and interventions used successfully by other industries.
- Ultimately, people need to be properly supported throughout the entire retirement planning and implementation process. They also need to be directed to sources of guidance. Only then will they engage with the process and feel empowered to make more informed decisions.

“We are primarily wanderers,
not decision makers.”

David Brooks
The Social Animal, p.25¹

The challenge

Addressing the inadequacy of retirement provision in the UK has arguably become the nation's number one socio economic challenge. Indeed, the aspiration to achieve a good financial outcome, however defined, *to and through retirement* typically fails to meet the reality by some margin and is projected to continue to do so unless there is radical change. Three key metrics illustrate the enormity of the challenge quite graphically.

Three key metrics

First, there's the inadequacy of current and projected median defined contribution (DC) pension pots sizes for those aged 55-64, as identified in the Pension Policy Institute's (PPI) *The Future Book*.² This projects today's paltry £14,100 to rise to £56,000, in 2015 earnings terms, in 2030. However, at a time when there will be a greater reliance on DC pots, as defined benefit (DB) pensions disappear and state pensions are paid ever later in life, this will prove to be a truly modest sum by which to potentially generate 20+ years of retirement income. Then there's the mean pensions wealth of the average earner, expressed as a multiple of median annual earnings, which trails the OECD average by over 40%.³ Finally, UK net replacement rates⁴ – the net retirement income of the UK's lower, median and higher earners expressed as a percentage of net pre-retirement income – also fall short of the OECD average by a considerable margin.⁵ Combined, these three metrics make the inadequacy of retirement provision plain for all to see.

Although pensions coverage and wealth will increase quite substantially over the next four years, purely as a consequence of the continued

roll out of auto enrolment⁶ and increases in auto enrolment minimum contributions, these measures alone will be insufficient. However, there are many other metrics of equal importance, notably those highlighted in the annual Melbourne Mercer Global Pensions Index⁷ and OECD Pensions at a Glance that should be targeted. One that is often overlooked and which should be a key focus is bridging the retirement income gap between women and men.

So what needs to be done if the calamitous retirement outcomes foreseen in *The Future Book* are to be avoided and a comfortable retirement is to become the rule, not the exception? Well, the solution to this seemingly intractable problem seems simple enough. People need to save sufficient over their working lives; invest these savings appropriately, and post-freedom and choice, successfully navigate the many potentially hazardous risks at and in retirement that threaten the preservation of capital and its ability to generate a sustainable income stream throughout retirement.

However, moving from inadequate to good financial outcomes is stymied by a number of structural and behavioural impediments to informed decision making, many of which can arguably be addressed by applying relatively simple behavioural insights and interventions.

In centring on both the structural and behavioural impediments to good decision making and the behavioural insights and interventions that can be applied to overcome these, the principal focus of this paper will be on how we can improve saving decisions. After all, the foundation of a good financial outcome at retirement starts with saving sufficient throughout one's working life, ideally from an early age.

The problems of inadequate saving and inappropriate investing

Delaying saving for just a few years, or taking a break from saving during one's working life, can have a marked impact on the percentage of earnings that will need to subsequently be saved if one's standard of living isn't to suffer in retirement.⁸

¹ David Brooks. *The Social Animal*. Random House. 2012. ISBN 978-1-78072-037-1.

² *The Future Book: unravelling workplace pensions*. Daniela Silcock, Tim Pike and Shamil Popat. Published by the Pensions Policy Institute, October 2015. ISBN: 978-1-906284-34-3.

³ OECD (2015), *Pensions at a Glance 2015: OECD and G20 indicators*, OECD Publishing, Paris. http://dx.doi.org/10.1787/pension_glance-2015-en. See p.151 Tables 6.15 and 6.16.

⁴ Gross or net replacement rates are typically used to define and quantify retirement outcomes. However, replacement rates do have shortcomings in that there is no standard definition of earnings and retirement income, while other sources of income outside of earnings and income from pensions are ignored, as are expenditure patterns, debt levels and debt servicing costs.

⁵ OECD (2015), op. cit. As noted on p.145 and depicted in Charts 6.8 and 6.9, UK net replacement rates for median and higher earners are typically circa 46-60% of the OECD average, although they exceed 90% of the OECD average for lower earners.

⁶ Auto enrolment was introduced in October 2012 to target those low to middle income employees between age 22 and state retirement age not saving in a workplace pension scheme. By “reversing the default”, auto enrolment harnesses the inertia of getting people to save into a pension by automatically opting people into a pension scheme, requiring them to opt out if they wish to leave the scheme.

⁷ Mercer (2015), *Melbourne Mercer Global Pension Index*, Australia Centre for Financial Studies, Melbourne.

⁸ According to *The Future Book* op. cit. p.24, for the median earner in the UK to have a 2/3 probability of replicating working life living standards in retirement, they need to contribute between 11% and 14% of band earnings (£5,824 to £43,000 in 2016/17) between the age of 22 and state pension age, assuming that the UK state pension retains its unique annual index linking in the “triple lock” (the higher of 2.5%, wage growth or the consumer price index). Delaying saving and/or taking a break from saving during their working life can mean this contribution rate could rise to 27%.

Then, of course, there's ensuring that these savings are invested appropriately to generate a stream of real returns in the run up to retirement. The UK falls short on both counts.⁹

The importance of investment growth

Although investing appropriately is typically given less emphasis than saving sufficiently, research shows, perhaps counter intuitively, for those with DC savings who draw down, rather than annuitise, their savings as an income in retirement, that the amount saved during one's working life typically accounts for only 10% of the stream of income paid out during retirement. Investment growth on those savings pre-retirement, however, might account for 30%. Even more surprisingly, that means up to 60% of retirement income is dependent on investment growth *during* retirement.¹⁰ Obviously, without saving, investment growth cannot materialise. However, the importance of investing these accumulated savings appropriately to and through retirement cannot be over emphasised.¹¹

Secular trends

The challenges posed by inadequate saving, acknowledging that saving via a pension is just part of the long-term savings jigsaw (and failing to invest these savings appropriately), must be viewed against the backdrop of three secular trends. First, demographic headwinds. With people living longer, time spent in retirement continues to increase. Indeed, in 1970, across the OECD the average female spent 15 years in retirement and the average male 11 years. By 2014, these respective averages in the UK were 23.7 and 18.5 years.¹² However, improvements in health longevity lag longevity improvements *per se*. Therefore, moves to raise the state pension age so as to limit the increasing amount of time spent in retirement are being challenged by very real physical and mental health impediments to higher employment participation rates amongst older workers. Secondly, individuals are increasingly having to take responsibility for their own financial futures, as collective passivity cedes to individual responsibility. This is a consequence of the ever increasing prevalence of DC workplace scheme provision and therefore an increasing reliance on DC provision to maintain peoples' standard of living in retirement.

Both trends compromise the ability to achieve a good financial outcome to and through retirement and are further compounded by a third – the continuing prospect of more modest real investment returns and income yields, especially if interest rates remain lower for longer.¹³ Combined, these three trends suggest the consequences of making a wrong decision to and through retirement will rise exponentially over time. This is, of course, a major concern.

Impediments to achieving a good financial outcome at retirement

Ill equipped

In assuming greater responsibility for their own financial futures doesn't mean individuals should be left to their own devices in determining what a good retirement outcome to and through retirement looks like and how best to go about achieving it. Indeed, most people are woefully ill equipped to do so, given the complexity and multiplicity of the decisions to be made, the alarmingly low level of basic numeracy and financial literacy amongst the UK adult population¹⁴ and a general tendency to avoid making decisions for fear of regret, not to mention overcoming perhaps the biggest hurdle of them all: inertia.

Establishing and realising a good retirement outcome, however defined, is especially problematic given the lack of frames of reference by which to gauge what is feasible and realistic to achieve to and through retirement and the paucity of guidance by which to navigate the plethora of financial jargon and evaluate the bewildering array of complex and opaque choices. This is compounded by a widespread unwillingness or inability to pay for financial advice, which is now firmly targeted at the more financially savvy top end mass affluent and high net worth markets rather than the less sophisticated mass market.¹⁵ Consequently, there remains a deep seated reluctance to engage with pensions and retirement outcomes.

The complexity surrounding retirement planning is exacerbated by the seemingly perpetual political tinkering with contribution limits, lifetime allowances and the taxation of pensions. Largely a consequence

⁹ According to the Department of Work and Pensions in its *Scenario analysis of future pension incomes*, August 2014, p.7, "around 11.9 million adults below State Pension Age are not saving enough to provide an adequate retirement income."

¹⁰ See: The Russell 10/30/60 Retirement Rule. Russell Investments. July 27, 2015.

¹¹ The importance of investing appropriately is considered in more detail in a separate paper: *Is your default fund fit-for-purpose?: Are we setting retirees up for failure by default?* Chris Wagstaff, June 2016.

¹² OECD (2015), p.164.

¹³ The neutral, or policy, rate of interest is central to forecasting the sustainable level of returns from risky assets.

¹⁴ According to *The Future Book*, op cit. p.10, "around 4 in 5 adults have a level of numeracy below GCSE grade C level". Source: Department for Business Innovation and Skills, 2011 Skills for Life Survey.

¹⁵ This has been an unintended consequence of the UK's 2013 Retail Distribution Review which, in moving the commissioned-based advice model to fee paying and in raising professional standards through professional examinations, saw the number of independent financial advisers fall quite dramatically.

of laudable long-term UK pension policy objectives being diametrically opposed to the UK Treasury's more immediate focus of balancing the country's books, this creates considerable uncertainty around retirement outcomes and renders pension policy a hostage to the UK's fiscal fortunes.

Building trust

Then, of course, there's the 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 collapse [in 1991] 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."¹⁶

How to restore people's trust in the system is a huge issue. NEST's qualitative research gave 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.

Suffice to say that while levels of engagement have marginally improved since the introduction of auto enrolment, pension freedom and choice and the new state pension,¹⁷ there is still some way to go before retirement planning becomes front and centre of the nation's consciousness.

Deeply engrained behavioural biases

This lack of engagement also emanates from deeply engrained behavioural biases, which act as a barrier to informed decision making and compound sub optimal levels of saving. Of these, *present bias* and *anchoring* are particularly prominent.

Present bias

"Present bias", a preference for consumption today over deferring consumption, by saving, until tomorrow, is a key source of bias in the pre-retirement phase. Indeed, the inability to align the upfront costs of saving with the benefits that will materialise (often far) in the distant future has culminated in most people simply not saving enough for their retirement. This is evidenced by the national household savings rate, which stood at 3.8% in the final quarter of 2015, the lowest rate of national household saving in 50 years.¹⁸ Just as *The Future Book* identifies, we are starting from a very low base and need to at least double current DC workplace pension contribution levels if there is to be a reasonable chance of securing good financial outcomes at retirement. This sentiment is reinforced by a recent report published by the Pensions Institute.¹⁹

However, for most, the possibility of being poor in retirement simply doesn't register as a tangible reality today. 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."²⁰ Of course, the consequences of this inaction will only be felt far into the distant future, when for many it will be too late to act.

Anchoring

This inter temporal preference for consumption over saving is compounded by the tendency by many DC savers to mentally "anchor"²¹ pension contributions to the minimum contribution level applied by their workplace pension scheme in the mistaken belief that this will provide an adequate sum in retirement. This problem is particularly acute amongst those passive DC savers auto enrolled to a workplace pension, where auto enrolment minimum contributions are typically seen as having been endorsed by the government and therefore adequate. Arguably this mental anchoring is preventing savings levels rising to wholly more appropriate levels.²²

¹⁶ *Improving 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

¹⁷ As noted earlier, auto enrolment was introduced in October 2012 to target those low to middle income employees between age 22 and state pension age not saving in a workplace pension scheme. Pension freedom and choice was introduced in April 2015 to empower individuals from age 55 to take a flexible and proactive approach to retirement planning at and in retirement by not being compelled to annuitise their pensions pot. The new state pension, which provides a pro-rated state pension based on an individual's national insurance contributions record, was introduced for those reaching state pension age on or after 6 April 2016.

¹⁸ ONS Quarterly National Accounts, October - December 2015.

¹⁹ *The Report of the Independent Review of Retirement Income. We Need a National Narrative: Building a Consensus around Retirement Income*. David Blake. Pensions Institute. March 2016. ISBN: 978-0-9935615-1-1 [v1/230216].

²⁰ House of Lords Select Committee on Public Service and Demographic Change. *Ready for Ageing?* HL 140. 2013.

²¹ Anchoring is when people latch onto a wholly irrelevant number that comes easily to hand when they are in uncharted territory and use it as a reference point in their decision making.

²² This sub optimal approach to saving is arguably compounded by the vast majority of DC pension scheme members, particularly auto enrollees, passively opting for the default fund, which is often unfit-for-purpose, or engaging in poorly executed active investment decisions. Just as minimum contribution rates are widely perceived as target saving levels, so default funds are seen as the "recommended" investment medium. For many, not least auto enrollees, the perception is that by adopting the minimum contribution rate and investing in the default fund their retirement needs are taken care of. The reality is so, so different.

Solutions

Overcoming the behavioural impediments to delivering good financial outcomes

As noted earlier, most people are ill equipped to determine how best to achieve a good retirement outcome. It is therefore, incumbent on policymakers, regulators and the pensions community to be integral to the process of helping people better help themselves by ensuring that pre-, at and in-retirement decision problems are adequately addressed.

Lack of support

Excepting (improving) DC member communications, employee seminars provided by some DC workplace schemes, behavioural interventions such as auto enrolment and the free-to-access guidance service provided by *Pension Wise*²³ for those at and in retirement, little is currently being done in the UK to either support people in the potentially life changing decisions they need to make pre-, at and in-retirement or “nudge”²⁴ them towards achieving better financial outcomes. Indeed, without the requisite frames of reference, guidance, advice and behavioural interventions, individuals, whether through action or inaction, are at risk of sleep walking into poor active and passive decisions and ending up in a very bad place. This hasn't gone unnoticed by the Financial Conduct Authority (FCA) which, within its recently published (85-page) Financial Advice Market Review, suggests that, “*The Financial Advice Working Group should lead a task force to design and test a set of rules of thumb and nudges.*”²⁵

As we'll see, integral to this process of generating good financial outcomes to and through retirement is applying behavioural economics and interventions in an intelligent, practical, tried and tested and typically subtle manner, to both help those potentially willing and able to engage with the process overcome the indiscriminate cognitive biases and barriers to good decision making and inaction to which we are all prone, and those who can't or won't engage, by harnessing their inertia.

So how can behavioural insights and interventions be used to generate better, even more optimal, individual and more socially desirable financial outcomes?

Policymakers

Let's start with policymakers. In seeking to generate better individual and more socially desirable financial outcomes to and through retirement, policymakers have the option of adopting paternalistic measures, such as compulsion²⁶ in getting the nation to save, at one end of the spectrum, to libertarian measures, pension freedom and choice for instance, at the other. However, there is a halfway house in *libertarian paternalism*. That is, using behavioural economics, a body of research that considers the emotional, cognitive and social factors that impact financial decision making, to help people better help themselves (and society).

Nudging

Indeed, policymakers have increasingly become more open to applying behavioural insights to public policy, using “nudges” in particular to generate socially desirable outcomes, with considerable thought being given to the design and implementation of behavioural interventions. Nudging is about moving people gently towards a positive outcome, rather than scaring or pressurising them into submission – a point we consider later in the paper.

For example, one particularly successful nudge has been using the “reverse default” in auto enrolment to utilise the inertia associated with getting people to save into a pension, by requiring them to opt out, rather than opt in. This has been applied with great success, not only in the UK, but also in the US, Chile, New Zealand and more recently Canada and Ireland.²⁷ This idea of reversing the default, or harnessing the inertia, from opting in to opting out, was largely driven by the success many countries experienced with reversing the default for organ donor cards.

That said, behavioural economics, in encouraging and reinforcing good behaviours, and in seeking to stimulate engagement is not simply confined to reversing the default to harness inertia. Nor are such one-size-fits-all nudges a silver bullet. As behavioural economists Greg B. Davies and Peter Brooks observe, “[Such] nudging can be a blunt tool... While [such] nudges may be effective in addressing specific, isolated behaviours, they

²³ See <http://www.pensions-expert.com/Special-Features/The-Cut/Pension-Wise-perception-and-reality>. Chris Wagstaff. 4 January 2016.

²⁴ The term “nudge” originated from the work of Richard Thaler and Cass Sunstein, captured in their book: *Nudge: Improving decisions about health, wealth and happiness*. Yale University Press. 2008.

²⁵ Financial Advice Market Review. Final Report. Financial Conduct Authority and H M Treasury. March 2016. Recommendation 18. p.50.

²⁶ Indeed, for those in society who can't or won't be helped, this, for many policymakers, is often seen as the only option. However, people, not least in the UK, generally don't like being told what to do, especially with their own money. Moreover, compulsion goes against the libertarian ethos of freedom and choice at and in retirement.

²⁷ Since October 2012, the UK has seen over 6m people auto enrolled into a workplace pension scheme, with opt out rates consistently below 10%. However, another 6m+ remain ineligible to be automatically enrolled into a workplace pension scheme by virtue of their age, the level of earned income per employment, being self-employed (or unemployed). This goes against a key recommendation of the Pensions Commission in 2005 that anyone who is working should be saving into a pension. See: *The under-pensioned*. Daniela Silcock, Shamil Popat and Tim Pike. The Pensions Policy Institute. March 2016. ISBN 978-1-906284-39-8.

are not particularly useful in helping people make confident, informed choices in complex decision environments.”²⁸

Indeed, auto enrolment can result in individuals being even more disengaged than before the intervention. In the mistaken belief that their retirement provision has been taken care of on their behalf, individuals are typically lulled into a false sense of security. Consequently, they are even less inclined to actively engage in retirement decision making. As already noted, the misplaced assumption among many auto enrollees who believe that making the minimum contribution and passively opting for the default fund within auto enrolment will provide them with a good financial outcome at and in retirement means that individual outcomes are not being optimised, even if a more socially desirable outcome overall has been achieved.

Encouraging engagement

The outcomes of those capable of making an active decision when presented with an easily and emotionally accessible opportunity with the requisite knowledge built into the decision making process, are typically compromised by one-size-fits-all nudges, given the defined default or deliberately limited choice that comes with “reversing the default” type solutions. Rather, within pensions, as with many other public policy issues, there is also a role for behavioural economics to encourage greater engagement amongst those able to decide for themselves, into making better and more informed decisions that will potentially lead to a more financially secure retirement (and an even more socially desirable outcome overall).

Indeed, as we’ll see shortly, interventions that seek to remove the cognitive barriers to inaction and poor decision making, include simplifying processes and removing the “hassle factor” associated with taking a course action; engaging with individuals at those times in their lives when they are most receptive; simplifying and personalising messages (we all like to be treated as individuals and devote more of our ever shorting attention spans to personalised and timely messaging); better framing the information people receive, not least in making benefits arising in the distant future more tangible and salient; using novel incentives to make the action more attractive;

integrating just-in-time education into the decision making process; employing gamification to simplify and make engagement with complex decisions more enjoyable; using positive peer comparisons or positive social norms to drive and reinforce better behaviours amongst and within particular groups, and reducing the time gap between the intention to act and implementation.

Education

A third policy option to overcoming disengagement is, of course, to simply inform people of their adverse behavioural traits and attempt to overcome them through education. However, despite conventional wisdom, this typically has little, if any, long-term effect in changing behaviour and securing engagement. Indeed, doing so can exacerbate these biases, given the multiplicity of effects that impact human behaviour. Moreover, as Bourdieu argues,²⁹ because contemporary behaviours, habits and choices are typically embodied in a person’s *habitus* – their gut feel, intuition and behaviours informed by their early life upbringing and experiences - attempting to change these through education, so as to improve decision making, may be of limited value. Instead the process of achieving more socially desirable behaviours must arguably be subtler (behavioural interventions) or even prescriptive (paternalism).³⁰

Using the full interventions toolbox

Therefore, in adopting a behavioural framework to moving people to better financial outcomes, the full interventions toolbox, or *asymmetric paternalism*, should be employed. That is one that focuses equally on both the disengaged, who can’t or won’t help themselves, and supporting the active engagement of those capable of helping themselves if given an easy and emotionally accessible opportunity to do so.

However, a word of warning. Behavioural interventions should never be applied superficially. To be effective, they require an understanding of the issues, the context in which the intervention is being made and a sophisticated programme of testing to determine what works and what doesn’t before applying an intervention to a real world decision problem. Indeed, as Davies and Brooks note,³¹ there is always the temptation to succumb to “academic lift and drop”. This is

²⁸ Greg B. Davies and Peter Brooks. Practical Challenges of Implementing Behavioural Finance: Reflections from the Field. Chapter 31. To be published.

²⁹ Bourdieu, P. 1984: *Distinction: A Social Critique of the Judgement of Taste*. London: Routledge.

³⁰ Mercer, in their paper, *Engage employees to take action and value their benefits: Improving financial outcomes through the merger of behavioural economics and digital innovation* (2016), acknowledge that, “Traditional forms of financial education have failed to improve financial decision making.” They suggest that, “the problem has its roots in information and choice overload and the delay between intervention and behaviour. [Therefore] by making relevant information available at the right moment – eliminating the delay between outreach and decision – we can increase the impact of financial education.”

³¹ Greg B. Davies and Peter Brooks (2016). op. cit.

when a behavioural intervention which, often over-engineered and without an understanding of the traditional approaches to remedy the decision problem, is taken from a purely academic setting and applied to a real world practical problem without proper testing.³²

Piggybacking on established behavioural interventions

In applying behavioural economics to pensions and retirement outcomes, policymakers, regulators and the pensions community can often draw, or piggyback, on the innovations and experiences of other industries. One only has to look at the success of the Food Standards Agency (FSA) in using behavioural economics to develop simple and intuitive food labelling to encourage healthier eating – a socio economic problem on a par with the inadequacy of pension provision. By highlighting the calorific value and levels of fat, saturates, sugars and salt contained within foods through traffic lighting (people identify particularly well with red and green), this simple change to food labelling has driven more informed decision making and socially desirable behaviours by nudging people into adopting healthier diets.³³

Employing the EAST framework

In using behavioural economics to drive more socially desirable behaviours and the achievement of better individual financial outcomes, a good place to start is with the EAST framework (make it Easy, Attractive, Social and Timely) devised by the UK's The Behavioural Insights Team (BIT).³⁴ This simple, pragmatic and practical framework can be applied by policymakers, regulators and the pensions community to the pre-, at and in-retirement stages to dramatically improve savings levels, investment decision making and the management of the key risks faced at and in retirement. Indeed, the EAST framework demonstrates that by employing the simplest of tactics, even just changing the merest detail to make an action simpler or outcome more attractive, behavioural interventions can often generate dramatic results. Indeed, doing so can often mean the difference between individuals performing or not performing an action. However, as with academic lift and drop, for the EAST framework to be effective it should only be employed with a good working knowledge of the decision problem to be addressed and with the intended intervention having been adequately tested.

Capturing many of the interventions that have already been discussed, at a generic level the EAST framework can be summarised as follows:³⁵

- **Making it Easy** is about minimising the “hassle factor”, making the process simpler, and reducing the amount of effort required to perform the desired action. As even the smallest increase in the required effort to perform an action can derail the process, this means conveying clear messages, breaking down the process or the achievement of a complex goal into simple, easy to manage steps and understanding the appeal of a default option. It's also about embracing new technologies, which enable more to be achieved with minimal effort, especially when engaging with those cohorts who are technology and socially media savvy.
- **Making it Attractive** is about using colour, images, personalisation and incentives to make adopting a course of action appealing.
- **Making it Social** draws on the fact that humans, as social animals, both act on the information, opinions and actions of others and like to have their own actions and opinions validated by others. Decisions are rarely made in a detached manner. Therefore, making it social is about demonstrating the importance of publicising, increasingly via social networks, that a desirable behaviour is the social norm, and how, by encouraging people to publically commit to a desirable course of action (commitment devices) increases the chances of them seeing it through.
- **Making it Timely** focuses on prompting people to change behaviours at times of major change or on special occasions in their lives when they are most receptive, overcoming present bias by better aligning the current costs and future benefits of a course of action, and committing to a plan of action to narrow the time gap between intention to act and implementation.

To this can be added a whole host of other behavioural insights, some of which have already been considered, and guidance frameworks that can be applied by policymakers, regulators and the pensions community to help people make better

³² Academic lift and drop is prevalent in pre-retirement default fund design. See: *Is your default fund fit-for-purpose?: Are we setting retirees up for failure by default?* Chris Wagstaff, June 2016.

³³ However, anecdotal evidence would suggest that this laudable policy objective needs to be extended to dining out at restaurants.

³⁴ EAST. *Four simple ways to apply behavioural insights*. The Behavioural Insights Team. 2014. The EAST framework, initially devised in 2012, draws on The Behavioural Insights Team's, more expansive, MINDSPACE framework and adds additional behavioural insights to make behavioural interventions potentially easier for busy policymakers to apply.

³⁵ Rob Gardner, co-founder of Redington, puts it very succinctly: Easy – saving into a pension is easy; Attractive – you'll get extra money; Social – millions are doing it; Timely – start sooner, get more. Source: Pensions Expert. Talking head. 9 May 2016, p.5.

choices and decisions for themselves and society if good financial outcomes to and through retirement are to be achieved.

Using behavioural insights and interventions to encourage greater levels of retirement saving

When applied correctly, behavioural economics has the capacity to motivate greater levels of retirement saving and ultimately move the nation towards achieving good financial outcomes. This we'll illustrate initially within the EAST framework.

Making it Easy

Improving engagement

The inadequacy of retirement saving in the UK is principally a problem of engagement. As intimated above, only if people are properly supported throughout the process and having had things explained to them in a practical, relevant and

understandable way, will they feel comfortable making a decision or pursuing a course of action.

Improving engagement levels is also about thinking how best to communicate and interact with the different generations and varying levels of affluence by using appropriate media, visuals and language, expressed in a simple and consistent manner, while making these communications more personalised. After all, people need to know what it will mean to *them* in taking any decision or action.

Framing messages

The way that messages are framed, or contextualised, is also key, as are the actual words used. Using positive words encourages more positive behaviour. This is known as priming.³⁹ As John Paul Sartre once said, "Words are loaded pistols." Messages that are seen as trying to scare

The importance of good pensions communications

To illustrate just how important good pensions communications are, a research report by NEST,³⁶ referred to earlier, emphasises how communications need to reassure, not just inform. Indeed, according to NEST, there are three central questions people want to know about their pension: "What happens to my money? Is my money safe? What will I get in the end?". Therefore, NEST have developed an approach to communications that emphasises the importance of clearly communicating the concepts of lifestyling and diversification, which implicitly deal with risk without sounding alarming. Its key principles include: 'Be a safe pair of hands', acting transparently and displaying integrity. Another is 'Show you have a plan'. According to the report: "NEST research shows that while members don't expect NEST to be able to make everything okay, they want to know that NEST is aware of the risks and has a plan to reduce them. NEST can do this by explaining the importance of a diversified portfolio and showing members the ways that NEST's investment team analyses and manages risk."

NEST is to be commended for considering its approach to member communications so carefully. Only by bringing savers on-side, instead of estranging them with unfamiliar language and

concepts, will they trust the system with their money.

NEST has also devised eight Golden Rules of Communication,³⁷ formulated to better understand the financial behaviours and attitudes of auto enrollees. These are instructive in that they're relevant to anyone communicating with the new generation of auto enrolled savers. NEST, perhaps unsurprisingly, found that simple is best. For instance, contributions should be expressed in pounds and pence rather than percentages. Indeed, although basing decisions around simple rules of thumb is typically sub-optimal and can result in anchoring, using simple messaging such as, "save 3 days' salary per month" or "save your age multiplied by 4 per month" do resonate with people and can lead to better financial outcomes.³⁸

Interestingly, there are also times when it is better to make it *less* easy. For example comprehension and recall seem to increase when online text is more difficult to read. Therefore, in an effort to increase financial capability it may well be possible to make things too easy. That said, communications that emphasise the advantages of saving via a pension shouldn't focus on the intricate details of retirement.

³⁶ *Improving 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.

³⁷ *Golden Rules of Communication. Talking about pensions with a new generation of savers*. NEST. 2014. NEST's research was conducted with private and voluntary sector members of the target group for automatic enrolment. NEST spoke with 540 target group members either in focus groups or through in-depth interviews and used the findings of a 1,874 person quantitative survey intended to help them understand financial behaviours and attitudes in the target group.

³⁸ We noted earlier that Recommendation 18 of the FCA's 85-page Financial Advice Market Review suggests, "The Financial Advice Working Group should lead a task force to design and test a set of rules of thumb and nudges."

³⁹ See *The Social Animal*, op. cit. pp.216/7.

people into saving or stress the negative side of not having saved are not well received and are often seen as threatening. Rather, people respond to messages that stress what they're entitled to or how they can take advantage of what's on offer.

Indeed, as noted earlier, the basis upon which nudging is built is to move people gently towards a positive outcome, rather than scaring or pressuring them into submission, as the latter fails to have the desired effect.⁴⁰ Research conducted by 56 Degrees shows that while potentially frightening, hard hitting messages about retirement – “if you don't save, you won't be able to afford even a basic standard of living when you retire” – catches peoples' attention in the first instance, ultimately it scares them into inaction. Moreover, if they see another message – whether negative or positive – from the same source that scared them, the chances are they won't engage with it.⁴¹ By contrast, messages that are simple, softer, positively positioned, signpost opportunities and outline the practical and manageable steps people can take to make the retirement they really want a reality, offer a more motivational style of engagement.⁴²

Employing simple, manageable steps

Indeed, breaking down the achievement of a complex goal into simple, manageable steps is key to engagement and stimulating a course of action. Online interactive decision trees that steadily take the individual through the myriad of decisions, or actions, they need to take to arrive at their end goal are one of the simplest and most effective guidance tools to employ for this purpose, whether the individual is pre-, at or in-retirement. This is the principle upon which robo advice is built.

Similarly, the approach adopted by *Pension Wise*, the free-to-access telephone and face-to-face based pensions guidance service for those aged 50+, illustrates how better retirement outcomes can be achieved by approaching an ultimately complex decision via logical and well framed questioning within a series of simple steps. Indeed, there is a strong argument for extending a Pension Wise-type service to those in the pre-retirement stage. If good financial outcomes are to materialise at retirement, people need the requisite guidance broken down into simple steps throughout the accumulation

phase to ensure they are saving sufficient of their income and investing their savings appropriately. Just as importantly, not least to reduce the hassle factor, people need to be directed to and be able to access these sources of guidance in a quick and easy manner.

Constructing a pensions dashboard

However, in order for pre-retirement decision trees (and a pre-retirement Pension Wise service) to operate efficiently and achieve the desired outcomes, it is crucial for individuals to be able to view all of their pension entitlements in one place. Very few are currently able to do so. That's why the FCA is keen for policymakers and the pensions community to work together to create a pensions dashboard that would do just that.

Bringing together all of an individual's pension entitlements in one place, as is now envisaged by 2019, and making the design of the dashboard intuitive and attractive if it is to gain traction with the intended audience, will help ensure people are aware of what they have, and therefore what they need to save if they're to realise the retirement they want – assuming that a good financial outcome has been defined and quantified. In fact, it has been suggested that at the very least, an employee's monthly payslip should show not only the employee's and employer's pension contributions made to the employee's pension account to date but it should also illustrate the monthly income stream these accumulated contributions might generate at the employee's normal retirement date. This would facilitate a direct comparison with what the employee is currently earning and so add some perspective to the need to save more for their retirement.

Making it Attractive

Overcoming “present bias”

As we know, one of the biggest hurdles to overcome in getting the nation to save sufficient for a comfortable retirement is the “present bias” preference for consumption today over deferring consumption, by saving, for tomorrow. In fact, as noted earlier, for many, retirement is too far away to be relevant to their decision making today, as individuals find it difficult to visualise themselves in later life. Indeed, research shows that benefits arising more two years away typically fall off

⁴⁰ Just witness the anti-smoking campaigns of the 1980s and 1990s, which used explicit pictures of diseased organs to shock people into quitting cigarette smoking. That didn't work. What have worked are more recent advertisements that focus on the support available to stop smoking, and the lifestyle benefits that result from quitting.

⁴¹ *Saving in mind: Understanding our emotions in saving for the future*. 56 Degrees. Standard Life. 2013.

⁴² See: *After the nudge: A pressing engagement with pensions*. 56 Degrees. Standard Life. 2015.

peoples' radars. Additionally, when thinking of but unable to visualise our future selves, we use the same part of the brain as when thinking 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. Therefore, projecting an image of how someone might look 20, 30 or 40 years from now dramatically improves their engagement with retirement planning,⁴³ if a smile rather than a grimace is to be put onto that ageing face. Aside from making the costs and benefits more "salient", this also makes the imperative to save personal. Indeed, the research from which this finding emanates found that those who had seen an avatar of their older selves were willing to put twice as much money into long-term savings accounts as those who had only seen a virtual image of their current selves.

Closely connected to this is the need for people to be able to visualise how many of the activities and expenditures they enjoy today they will still be enjoying far into the future. Therefore, re-framing the savings decision as creating a source of funds to be spent playing golf, scuba diving or taking skiing holidays later in life potentially overcomes this intertemporal preference. Indeed, in 2012, NEST, in its "Tomorrow's Worth Saving For" campaign, asked people on its Facebook page what they enjoying doing today and will want to carry on doing into the future, rather than forcing people to think about their circumstances in retirement. The challenge then is to motivate savers to think about the future without concerns about growing old getting in the way.

In seeking to overcome this "present bias", *Making it Attractive* would also suggest using novel, simple, and accessible incentives such as issuing a national lottery ticket for, say, every £100 per month saved. Lottery prizes are attractive in that people tend to focus on the prize (indeed, visualise themselves sitting on a big pile of cash) rather than the small probability of winning it. This is known as the *affect heuristic*. Indeed, people are typically poor at calibrating probabilities. They generally overestimate the probability of positive events materialising and underestimate the occurrence of adverse events.

Overcoming "anchoring"

In addition to better aligning the immediate "cost" of making this contribution with a potentially much larger immediate benefit (again making the cost-benefit more "salient"), introducing lottery tickets would also help to move contributions away from the minimum contribution "anchor".

Similarly, reframing pensions tax relief as a "savers bonus", rather than as the saver's marginal tax rate applied to a net contribution, would simplify the incentive, make it more appealing and, by using sufficiently, but not unpalatably, large numbers to illustrate how the bonus works, e.g. a £50 bonus for every £200 saved, move the contributions "anchor" to a more realistic level.

Likewise, positioning employer contributions, especially those that match or escalate at a faster rate than employee contributions as "free money" again encourages employees to move beyond the minimum contribution rate. Indeed, given that most employees implicitly trust their employer to act in their best interests, employees are very much guided and incentivised by the size of the employer contribution into DC workplace schemes. Those DC schemes into which the employer contribution at least matches the employee contribution typically experience much greater than average combined contributions.

Employing gamification

Gamification is also being increasingly used by a number of DC workplace schemes to make engagement with a complex decision like savings easier, more enjoyable and appealing, especially when the "game" pits players against each other.

Making it Social

Publicising positive social norms

As noted earlier, most people, despite feeling strongly about being an individual (hence the increased focus on personalisation), like to know that their behaviour doesn't fall outside social norms. Indeed, as social animals, we are heavily swayed by others in our actions and opinions, piggybacking on the information of others, and typically seek approval for what we do. *Making it Social* suggests that by publicising favourable statistics that show most people in a relevant cohort have started thinking about retirement or, even better, have started saving and disclosing

⁴³ See: Hal E. Hershey, Daniel G. Goldstein, William F. Sharpe, Jesse Fox, Leo Yeykelis, Laura L. Carstensen, Jeremy N. Bailenson. Increasing Saving Behavior Through Age-Progressed Renderings of the Future Self. *Journal of Marketing Research* Vol. XLVIII (November 2011), S23-S37. <http://vhil.stanford.edu/mm/2011/hershey-jmr-saving-behavior.pdf>.

the amounts involved, again if favourable, would encourage others in that cohort to do similarly.⁴⁴ This is particularly true where the power of social networks can be harnessed. Reassuring people that their behaviour fits with social norms reinforces that behaviour. By contrast, citing statistics that convey how much of a widespread socio-economic problem the lack of saving is simply compounds the problem as people accept their sub optimal behaviours as being the social norm.

Engineering commitment devices

Engineering “commitment devices”, whereby people publically commit to seeing through a course of action, whether verbally to friends and colleagues or online to their social network, plugs the gap between intention and implementation. Moreover, schemes and pension providers can reinforce the commitment made by the individual to save a set amount per month by acknowledging the commitment with wordings such as, “You have agreed to save £x per month”.

Making it Timely

Well timed messaging

In addition to making it easy, attractive and social, timing also matters. *Making it Timely* homes in the fact that people are more likely to engage, or be more receptive to ideas, during pivotal moments in their lives – birthdays, anniversaries and episodes of major change. Subject to all of the other factors discussed so far, well timed messaging can potentially increase savings take up rates quite markedly.

Save More Tomorrow

Additionally, a key tenet of *Making it Timely* is overcoming the challenges of “present bias” by better framing the alignment of the current costs and future benefits of a course of action, such as encouraging higher rates of saving. Introducing the automatic escalation of DC member contribution rates is one such initiative.

This, the so-called *Save More Tomorrow* approach, formulated by behavioural economists Shlomo Benartzi and Richard Thaler in 2004,⁴⁵ and originating from the same behavioural school of thought as auto enrolment, enables DC savers to commit today to paying increased contribution levels only in the event of receiving future pay rises. By not having to pay any money today, and not

experiencing any reduction in their current take-home pay, the individual delays this cost. Therefore, the much reduced costs today of pursuing this action are better aligned with the benefits that will ultimately accrue.

Indeed, the original 2004 research showed how, by signing up for the auto escalation of contributions, members very quickly achieved contribution rates in excess of those members who chose instead to follow the advice of a financial adviser for a one-off rise in contributions. So, whereas a one-off increase in contributions became the new default for the latter group, a constant rise in contributions became the new default for the former.

While popular in the US, auto escalation has yet to be introduced in the UK and has been put on the backburner by the UK Pensions Minister until the initial auto enrolment process is completed in 2018.

That said, while current auto enrolment contributions have been set at a level that doesn't materially reduce an individual's earnings, thereby minimising opt outs, these contribution rates will automatically increase to more realistic (though arguably still inadequate) levels in 2018 and 2019.⁴⁶ Moreover, like auto enrolment, auto escalation could be implemented on an ‘opt-out’ basis to ensure financially engaged individuals retain the flexibility to prioritise other potentially more pressing financial commitments. Indeed, people like to feel in control, even if that control is illusory. Showing people how they can exercise control over their pension if they want to, even though they are unlikely to, works better than saying everything's taken care of. After all, as we know, the perception that everything has been taken care of is an unintended consequence of nudging auto enrollees into paying the mandated minimum contribution and investing via the default fund.

Committing to a plan

Finally, just as using commitment devices can be used under *Make it Social* to plug the intention-implementation gap, so can helping people set out a plan for saving, which identifies the typical barriers to achieving savings intentions and the means to overcome them. This is yet another role for both policymakers and the pensions community.

⁴⁴ In so doing, there is always the danger that someone within that cohort is contributing considerably more than those held up as exemplars. That may result in the former reducing their contributions to the levels publicised.

⁴⁵ 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.

⁴⁶ In the current low wage growth environment this rapid increase in contribution levels could be problematic.

Conclusion

What we have seen throughout this paper is that reasonably simple behavioural interventions can be used to help people better help themselves pre-, at and in-retirement, whether by utilising the inertia of the disengaged or addressing many of the impediments to good, informed decision making for those willing and able to make an active decision.

However, despite advances in behavioural thinking and its application to solving real world problems, such as getting the nation to save sufficiently for retirement, behavioural interventions don't have all the answers.

Despite this, as Greg Davies so eloquently puts it, "If we genuinely want to design solutions that lead to better consumer decisions, then we have to be simultaneously... humble enough to admit we don't know all the answers, and bold enough to be prepared to put our hypotheses to the test."⁴⁷

This is exactly what policymakers, regulators and many of those within the pensions community have been doing in being more open to behavioural interventions. And they should continue to be open to constantly evolving behavioural thinking if good financial outcomes at and in retirement, however defined, are to become the norm.

Ultimately, however, behavioural interventions need to be accompanied by people being properly supported throughout the entire retirement planning and implementation process. People 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 with the process and feel empowered to make better and more informed decisions and only then will the inadequacy of retirement provision have been successfully addressed.

⁴⁷ Greg B. Davies. *Beyond Nudge – Building a UK savings and investment culture*. December 2015.

To find out more visit columbiathreadneedle.co.uk



Important information: For internal use and for Professional and/or Qualified Investors only (not to be used with or passed on to retail clients). Past performance is not a guide to future performance. The value of investments and any income is not guaranteed and can go down as well as up and may be affected by exchange rate fluctuations. This means that an investor may not get back the amount invested. The research and analysis included in this document has been produced by Columbia Threadneedle Investments for its own investment management activities, may have been acted upon prior to publication and is made available here incidentally. Any opinions expressed are made as at the date of publication but are subject to change without notice and should not be seen as investment advice. Information obtained from external sources is believed to be reliable but its accuracy or completeness cannot be guaranteed. This material is for information only and does not constitute an offer or solicitation of an order to buy or sell any securities or other financial instruments, or to provide investment advice or services. This document and its contents are confidential and proprietary. The information provided in this document is for the sole use of those attending the presentation. It may not be reproduced in any form or passed on to any third party without the express written permission of Columbia Threadneedle Investments. This document is the property of Columbia Threadneedle Investments and must be returned upon request. Issued by Threadneedle Asset Management Limited. Registered in England and Wales, Registered No. 573204, Cannon Place, 78 Cannon Street, London EC4N 6AG, United Kingdom. Authorised and regulated in the UK by the Financial Conduct Authority. Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies. columbiathreadneedle.com