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NATIONAL EMPLOYMENT SAVINGS TRUST

Improving consumer confidence in saving for retirement

About this report

Automatic enrolment introduces a large audience to the world of pensions.

For many consumers this will be their first experience of saving for retirement.

Building on our *NEST insight* publications, this report explores what the new generation of savers understands about long-term saving, what they expect from a pension and what concerns them the most. It brings together several in-depth research projects undertaken by NEST between 2010 and 2013 to consider the role that member communications and product innovations can play in improving consumer confidence in saving for retirement.

Contents

Foreword

Automatic enrolment is proving to be a real success story. As a result of its introduction, over three million more people are saving for their retirement. As we set out in our 2014 *NEST insight* report, the number of people opting out is far lower than expected. In *NEST insight*, however, we sounded a note of caution about the challenges in the years to come. These include helping to increase understanding among consumers about how pensions work and build confidence that saving for retirement is worthwhile.

In this latest research report from NEST we further explore these challenges, providing detailed evidence on consumer attitudes to defined contribution (DC) pensions, investing and risk. It reports on the outcomes of primary research that get to the heart of consumer attitudes about pensions, sets out better ways to communicate with members and unpicks what lies behind consumers' appetite for greater certainty, including what they are and are not prepared to trade off to achieve it.

Since inception NEST has placed significant emphasis on the importance of a robust member evidence base when designing our approach, whether that's our investment strategy, member communications or our administration systems. In light of the proposals outlined in the Queen's 2014 speech proposing radical reform to the way occupational pensions are regulated and the ways in which pension pots are accessed at retirement, we believe that understanding the needs, attitudes and aspirations of our current and future members is more important than ever.

I believe this report offers a fascinating insight into the new generation of savers who will benefit from automatic enrolment and the freedoms and flexibility we expect to be available from April 2015. The evidence contained here provides valuable pointers of consumer expectations and concerns when it comes to saving for the long term. As the industry looks to develop new products and ways of engaging with their members and policyholders, we hope this report can contribute to better design and innovation to meet the opportunities afforded by the pension reforms.

As we set out in our response to the Department for Work and Pensions (DWP) consultation, *Reshaping workplace pensions for future generations*, NEST's research over recent years supports the idea that greater certainty and 'guarantees' are attractive to savers, at least superficially. However, what's most striking in our findings are savers' expectations of pensions in general. Most are surprised to find out their money is invested at all and fail to appreciate the rationale for why. Taking any kind of risk with their savings appears to them counter-intuitive and paying extra to guarantee outcomes seems shocking. Pensions for most are presumed to be already guaranteed and there's a degree of incredulity that a retirement savings vehicle doesn't offer certainty as a matter of course.

Within this report we set out principles of the ways in which some of these issues can be addressed. We have tips about what works - and what doesn't - when communicating investment, risk and future outcomes. Beyond improving communications, our findings also suggest there's a real consumer appetite to gain a better idea of what saving in a workplace pension is likely to deliver. Being able to answer the simple question of 'What will I get at the end?' appears to be one of the most important things for new savers to know, but also one of the hardest for providers to answer. A striking finding from our research is that traditional - and still common - approaches to DC investment design are seen as least likely to meet expectations of those automatically enrolled. If given the choice, few would wish to save for their retirement in this way.

Although more people than ever are now saving in a pension, there's a concern from many that pensions will fail to deliver for them. Savers are confused about how pensions work. An information asymmetry between providers and members exists and contributes to a sense of fear and suspicion, both around pension products and the industry that provides them.

The Minister of State for Pensions' defined-ambition challenge to the industry in 2013 was welcome and timely. There is, however, an equal challenge to the industry than just being able to develop new ways of saving for retirement. The pension industry needs to rebuild consumer trust. Our latest research goes some distance to helping us understand the consumer mind-set and sets out better ways of engaging on their terms. The next challenge for us - and the rest of the industry - is to build on this understanding and offer the millions benefitting from automatic enrolment good reasons to place their trust in us.

Tim Jones
Chief executive officer

Summary

This report brings together several research projects undertaken by NEST into consumer attitudes of long-term saving, better ways of communicating and the appetite for greater certainty.

Chapter 1
Understanding attitudes - the problems to solve

Low consumer confidence in the financial sector

Optimism within the financial services industry might be growing but consumers still have very little trust in the sector. The financial crisis has been particularly damaging for the image of investment and there are genuine concerns about what happens to money invested in a pension scheme. Poor investment performance is associated with embezzlement, and market downturns are blamed on bad fund management.

See page 12 for more

Saving and investing seen as very different things

While saving in a bank is considered safe, investing is dismissed as something rich people do with money they can afford to lose. Pensions are seen as a third way between saving and investing - expected to provide higher returns than a savings account but with none of the ups and downs of investing.

See page 14 for more

Disengaged savers

Consumers feel far more disconnected from their money in a pension than they do in other savings vehicles like a cash ISA or a bank account. Identifying themselves as members not investors, once their money leaves their pay packet they feel that someone else has taken control and some decades later they'll see the result. A profound information asymmetry between providers and consumers further distances members from their pension. As passive users, they don't think they can take any action to affect what happens to their money.

See page 15 for more

Low appetite for volatility in pensions

For consumers, the idea of retirement planning is all about being prudent and conservative. Most people don't perceive any difference between volatility and risk. They're seen as synonymous with the potential for absolute loss and trigger emotions like anger and confusion. As a result, consumers are uncomfortable exposing their retirement savings to any sort of investment risk.

See page 16 for more

Greater certainty preferred to potential for highest growth

Consumers understand that a savings account is likely to provide lower returns than money invested in financial markets over the long term. Despite this, the desire for stability in a pension is so strong that they'd rather face a lower, more certain outcome than go through ups and downs on the way to higher returns. People aren't against investment itself, they're just concerned about it as a route to building a retirement income.

See page 17 for more

Inertia vs action

The international picture on default effects indicates that people are generally inert when it comes to pensions. However, analysis of existing savers' behaviour in UK defined contribution pension schemes immediately before and after the onset of the financial downturn in 2008 shows many did react to market turmoil. 15 per cent stopped contributing to their pension and 6 per cent decreased their contribution levels. It appears that external events can trigger actions and inertia doesn't always win out.

See page 21 for more

For consumers, the idea of retirement planning is all about being prudent and conservative.

Chapter 2
Communicating investment

Reassurance not more knowledge

Providers should be aware that most people tend not to proactively engage with pension communications, and when they do, it's often driven by concern. However, simply giving more information won't necessarily boost their understanding or give them peace of mind. It can even introduce concerns that weren't there before. What consumers really want to know is that the people looking after their retirement savings have their interests in mind and are managing their money responsibly. Rather than just describing risk, for example, it's more effective to explain how the downside of risk is managed.

See page 24 for more

What consumers want to know

Although consumers are confused about how pensions actually work, this is more to do with a lack of accessible and clear information than apathy or disinterest. In particular, they find it difficult to find answers to the three key questions that matter to them when weighing up pensions:

- What happens to my money?
- Is my money safe?
- What will I get in the end?

See page 26 for more

Demystifying pension outcomes

Consumers feel more connected to their retirement savings when they understand what makes up their pension pot. Showing them that the value of their pension is affected by factors that aren't fixed - like member contributions, employer contributions and the length of time they save - helps them see that they can actually influence what happens to their money in a pension scheme.

See page 37 for more

Probabilistic approach more effective in projecting outcomes than deterministic models

Although deterministic projections of outcomes look more straightforward than probabilistic ones, they aren't easier for people to understand. They can even create more misunderstanding, as people assume that the projection tells them what they'll get and think of the worst case scenario when they realise the outcome isn't certain. Probabilistic projections appear more complicated at first, but once people see that there is a range of possible outcomes, and that some are more likely than others, their understanding is much improved.

See page 39 for more

Chapter 3
Unpicking the appetite for certainty

Guarantees and quality

For consumers things that are guaranteed - outside of pension products - are perceived to be of higher quality than things that aren't. Free guarantees suggest a better product than those that come with guarantees carrying an additional cost, as this infers that the provider has less faith in the reliability of their product. So while it's the case that uncertainty is undesirable, guarantees aren't necessarily viewed positively. It should not be assumed, therefore, that providing any form of guarantee will improve confidence.

See page 46 for more

Guarantees are not a silver bullet

Although consumers want certainty when it comes to retirement outcomes, they aren't necessarily prepared to pay more for it. Many are incredulous when they learn that pensions don't already guarantee to give them back their contributions. Rather than paying for a guarantee, consumers would prefer to reduce downside risk and are prepared to accept giving up some potential upside to achieve this.

See page 47 for more

Worst case scenario dominates

Being presented with uncertainty provokes an emotional response in consumers and a tendency to focus on the worst case scenario - to 'catastrophise'. They see the chance that their money is at risk as the same as the chance of losing everything. As a result, for many people the chance of loss - particularly total loss - dominates and becomes all pervading, not because of its probability but because of its impact.

See page 51 for more

Emotionally driven decision making

When presented with four different pension products, 40 per cent of respondents in our research favoured the product with the lowest risk attached. From a rational economic perspective this is highly unlikely to be in their best interests in terms of achieving reasonable outcomes. While this is the case, the majority of people appear to balance their desire to protect themselves from downside risk with the need to build a retirement income that far exceeds what they contributed.

See page 62 for more

Trading off difficult concepts

Consumers are able to size up pension products on the key attributes of cost, outcome and protection. While protecting their money is always a key concern, the desire to achieve a good outcome can be dramatically influenced by the level of detail they're given about a pension product.

See page 62 for more

Differentiating pension products

When asked to list pension product features consumers struggle to think of any. Despite the fact that people will become members of several pension schemes with different product features in their working lifetime, the product landscape is entirely undifferentiated to them. They don't know, nor is it easy for them to find out, the difference between one scheme and another. Crucially, there is also a lack of understanding that providers may treat the task of growing their money differently, and that there are different views about what the right approach is.

See page 64 for more

Steps to improve consumer confidence

No one pension product can meet the demand for the lowest cost, greatest protection and highest outcome in one neat package. Innovations in product design could, however, aim for a better balance between these three features. Additionally, consumer confidence can be improved by providing reassurances about how risk is being managed and empowering members to control their outcomes by engaging with their savings. Taking the right approach to communicating investment and pension product innovation could provide consumers with genuine choices that minimise their concerns about uncertainty while maximising growth in their retirement savings.

See page 64 for more

Useful information

Defining some terms

Throughout this report we use the term 'investment' to mean allocating capital to more volatile securities, like shares, rather than more general savings and investment activity, such as saving in a current account. As we'll see, while financial professionals use the words 'saving' and 'investment' interchangeably, for many people there's a critical distinction.

When we talk about 'consumers' we mean existing or potential members of NEST. This covers everyone that's eligible for automatic enrolment. This includes people who are:

- in employment in the private sector
- working full or part-time
- earning more than £9,440 per year
- aged at least 22 and under State Pension age.

We use the term 'the unpensioned' as shorthand for people eligible for automatic enrolment who aren't currently saving in a qualifying workplace pension scheme.

We took a snapshot of the unpensioned before the onset of automatic enrolment in October 2012 and presented our findings in our publication *NEST insight 2013*. We found that 68 per cent of people working in the private sector were not contributing to a workplace pension at all. Of these, almost half had never had a pension before. So for most of the unpensioned automatic enrolment is their first experience of saving into a workplace pension.

We also identified that just over two-thirds of the unpensioned are men. People in this group are also likely to be young, with 31 per cent aged under 30.

Median annual earnings for the unpensioned are close to the median earnings for the working age population in general. It's considerably less, however, than the median for those workers who were saving into a workplace pension scheme before the onset of automatic enrolment.

A more in-depth explanation of the unpensioned can be found in *NEST insight 2013*.

Chapter 1

Understanding attitudes – the problems to solve

Consumers find pensions both dull and emotive. They're considered dull because they're seen as complex and hard work to understand. They're emotive because ultimately they're about future financial security.

NEST research shows that consumers are emotional about pensions for other reasons too and that these largely concern 'investment' as an approach to building a retirement income.

Throughout NEST's research projects, we've heard repeated concerns about trust in the sector, fear of losing money and demands for a guarantee. This chapter explores why many of the unpensioned may be innately averse to the concept of a defined contribution (DC) scheme to save for their retirement. It seeks to explore what underpins consumers' worst fears and their desire for protection from these.

Attitudes to pensions and the financial sector

It won't be news to anyone that the pensions sector has issues with consumer confidence. While optimism within the financial services industry generally might be growing[1], consumers' trust in the industry shows little sign of improvement. Globally, banks and financial services sit at the bottom of a list of industries that consumers trust to do what is 'right'[2].

[1] CBI/PwC (2013) 'Financial Services Survey - September 2013'. Available at www.pwc.co.uk
[2] Edelman Berland (2013) 'Edelman Trust Barometer: annual global study'. Available at www.edelman.com

People 'win or lose' with pensions

Pensions tend to be in the news for the wrong reasons. As a result, the public has a generally sceptical view of the industry. 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 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. As a result, the minority of 'bad apples' dominates perceptions of pensions.

As well as eroding consumer confidence, these stories leave people confused as to how pensions work. Poor investment performance is associated with embezzlement, and market downturns are blamed on bad fund management.

The effect of the financial crisis on consumer confidence

This ingrained wariness of the pensions sector has been made worse by the broader damage to the reputation of the finance industry following the global financial crisis. Recent financial history gives consumers the impression that the people looking after our money - and indeed the economy - are not only greedy but also incompetent. There's a gulf between how people see the sector and the characteristics of the type of organisation that they want and expect to see looking after their money. In NEST's large-scale qualitative research into communicating investment concepts to members, many said they'd feel reassured by a pension provider that was 'honest', 'caring', and whose staff are 'salary, not commission-based'.

The financial crisis has been particularly damaging for the image of investment. 'Investment' is considered to be the main culprit in the crisis. Given a lack of knowledge about what the investment industry is and what it does, members struggle to differentiate it from betting. Reports of 'casino banking' have underlined the perception that the investment industry is characterised by gamblers.

Poor investment performance is associated with embezzlement, and market downturns are blamed on bad fund management.

The crisis also served to validate their worst fears, that it's entirely possible that their money will be mismanaged and lost. It underlines that anything can happen. Indeed, evidence suggests that people tend to expect recent history to repeat itself, especially when the consequences are severe, regardless of how likely that possibility actually is[3].

NEST's research supports this. People point to recent financial events to explain their fear of losing their money and why they see this as a likely outcome. It's so strongly felt that even when shown the performance of equities over the last 40 years - an uneven but inexorable rise in value - they remain concerned about the last few years and the next few years to come.

"Traders and investment people; it's just people taking risks. Sly, aren't they? People gambling away your money!"

Workshop participant, investment communications research

Expectations out of step

For consumers, the idea of retirement planning is all about being prudent and conservative. It's implicitly about safety and securing the future, and therefore at odds with the idea of taking risks. The decision to give up money now in order to have an income in retirement is a protectionist course of action on both an emotional and practical level.

This paradigm produces a desire for certainty. A pension is seen through the lens of an insurance policy rather than a growth-seeking investment vehicle.

Pensions as a third way between saving and investing

We found that around two-thirds of the unpensioned were brand new to pensions, having never had one before. The remaining third had some previous experience and were more likely to be aware that their money in a pension is invested in financial markets. For many of those new to pensions, discovering that their contributions would be invested in this way was a surprise.

It seems that the people who are aware that pension contributions are invested hope that it's different to other kinds of investing, that it offers benefits - scope to grow your money - but limits the risks associated with investment. Even people who knew that this isn't absolutely the case agreed unanimously that this is how it ought to be. Where there is apparent understanding that money in a pension is money invested, there's still shock and incredulity that the risks in pensions and investments are one and the same.

[3] Kahneman, D. (2011) Thinking, Fast and Slow. Penguin.

People seem to see pensions as a sort of third way, offering higher returns than saving but without the risks of investing. They have quite clear concepts of both saving and investing but struggle to reconcile the two. They're perceived as two distinct practices, serving different purposes and with different ends. Investing is seen to be a luxury, something to do with surplus income. It's not considered a suitable use of money put aside for a better retirement. In the minds of savers, it seems like common sense that a risky investment isn't the appropriate approach to take to build a retirement income.

"Investing money yourself is one of the most dangerous things you could do."

Workshop participant, communicating investment research

Members as opposed to investors

Investment isn't well understood by the lay consumer. At best it's considered to be something of a mystery, and at worst it's quite frightening. It's seen as a different world of specialist technical language and complicated practices and not possible for a lay consumer to understand. Many consumers feel that they're not themselves investors, instead seeing the people in charge of managing their money as investors. As a result they feel disconnected from their contributions. Among the most common questions we encounter are 'What happens to my money?' and 'Where does my money go?'

Investment is perceived, then, as only for the professionals, the wealthy and indeed only the foolhardy. While there are successful investments and unsuccessful ones, the scope for managing risk appears both elusive and tenuous.

"Imagine someone saying 'We're going to take some money from you, we're going to put it in to something, you've got no choice in the matter, but you might lose your money', that'd be just like 'What?!?'"

Workshop participant, reactions to loss research

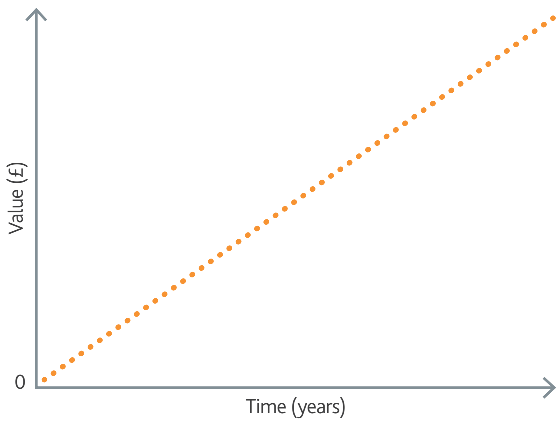
Pensions without volatility

NEST research into reactions to volatility and interim loss found that consumers aren't generally expecting to see, nor do they think they ought to see, any volatility in the value of their pension pot. Pension pots are expected to grow like a savings account, but with contributions stacking up and attracting more growth than standard savings interest rates. Rather than frequent ups and downs, consumers expect to see smooth and continuous upward growth, as depicted in figure 1.

"The pension is always supposed to go up, not down. If the value is going down it's disastrous."

Workshop participant, reactions to loss research

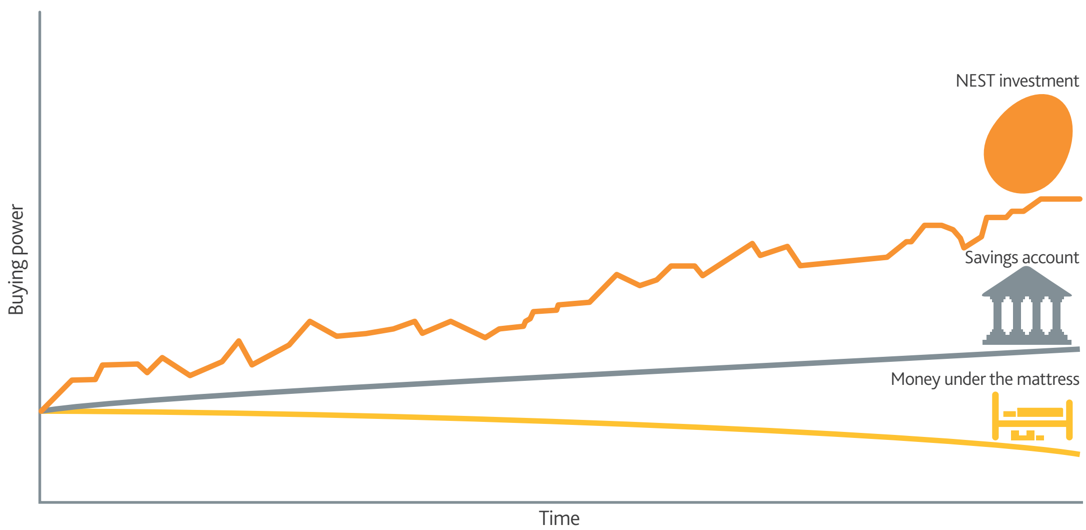
Figure 1 - Member expectations of pension performance



Stimulus

Pension performance

Figure 2 - Research stimulus showing different types of long-term saving



What they're not expecting is the more accurate representation of fund growth, as shown in figure 2.

The desire for steady growth is so strong that many people would prefer an option offering predictable returns even if it didn't keep up with inflation over the long term.

In NEST research looking at how best to communicate investment, we showed figure 2 as stimulus to participants. It shows how a NEST pension might perform over 40 years compared with putting an equivalent amount of money in a bank or under the proverbial mattress. Despite the explanations given, many participants preferred the straight savings option to a pension. Their response to volatility appears to be so emotionally driven that it isn't possible to change their views with rational economic arguments.

It's a struggle for consumers to accept that volatility over the lifetime of their pension won't necessarily mean an outcome of less than they contributed. They see volatility as inextricably linked with risk, and risk is seen as synonymous with loss. While experts will recognise both an upside and a downside to investment risk, for consumers the downside of investment risk dominates. Even if they understand that some investments present more risk than others, the presence of any risk opens up the possibility of losing what was invested and is therefore unacceptable.

While figure 2 seeks to illustrate that there are more dimensions to risk than just volatility, many people felt that money under the mattress was safer than in a pension. Few perceived the inflation risk that comes with putting their money under the mattress or in a bank account. This isn't to say people don't understand what inflation is - we found that little explanation was necessary - but participants simply didn't see inflation risk as a compelling enough reason to take investment risk with their retirement savings. Even with an understanding that keeping money under the mattress means it will almost certainly be worth less in the future, the possibility of losing money through taking investment risk is seen as much worse. There's a perception that when investment risk erodes contributed capital, it demolishes it.

"A pension is a gamble but with a savings account, you're guaranteed that small amount of interest on your money. Whereas with a pension you're guaranteed basically nothing."

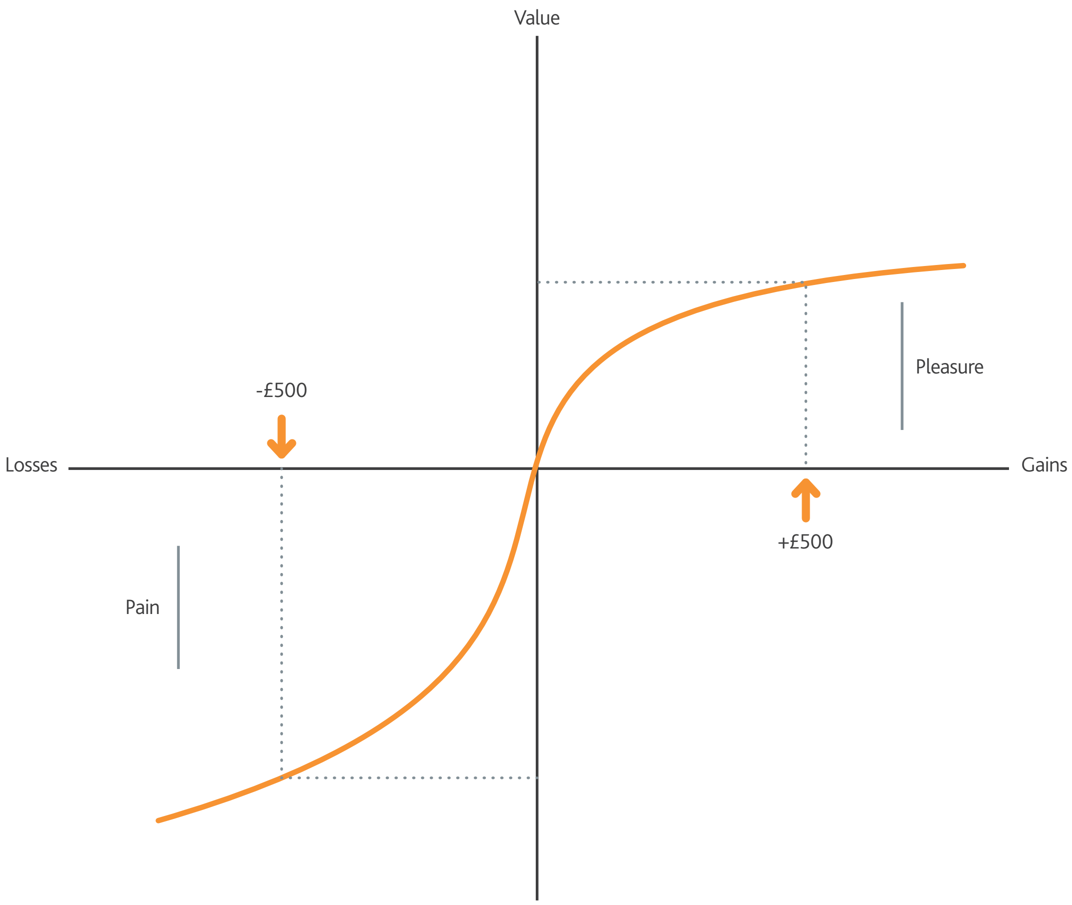
Workshop participant, communicating investment research

How consumers feel about loss

Prospect theory[4] shows that people are more sensitive to losses than gains, valuing losses twice as much as gains. This is illustrated in figure 3 and can drive people to make choices that don't make rational economic sense.

NEST research explored the emotional experience of absolute loss - having less than was put in - and relative loss - falls in fund value from one year to the next. This identified the main emotional responses to loss as anger and confusion. Given that consumers don't see themselves as investors and have misconceptions about how pensions should work, they feel like victims in these situations - something has gone wrong and someone is therefore to blame.

Figure 3 - Prospect theory



[4] Kahneman, D. and Tversky, A. (1979). 'Prospect Theory: an analysis of decision under risk' *Econometrica* XLVII: 263-291.

This research also identified that losses that eat into contributions are considered to be completely unacceptable. Loss of previous gains is less objectionable but only relatively so. There's a sense of relief that at least the contributions have not been lost. However, this scenario sparked passionate discussion amongst participants about the point of a pension in the first place. That is, if gains can be lost, why bother to contribute to a pension?

"I don't think I'd be too peed off [if the value had gone down on the previous year]. I'd be a bit, 'urgh, that money I told you about had gone up last year, it's gone down again', but I'd be safe thinking that my money I'd put in, is actually still there."

Workshop participant, reactions to loss aversion

Similarly, in later NEST research, a nonchalant response was given to NEST's main investment objective of outperforming inflation plus 3 per cent after all charges. There was a strong feeling that this should be a given and that if a pension isn't able to deliver this, then what's the point? To the expert, achieving such returns is impossible without taking investment risk. To the average consumer, however, this connection was completely lacking.

How consumers might behave in response to loss

Our research has shown that once people become aware of the potential for loss, their faith in pensions is reduced. How might this realisation affect the way that consumers behave?

There's only so much we can learn about people's behaviour from research, even in an experimental context. Evidence from behavioural science shows that what people say they will do and what they actually do don't always match up. Automatic enrolment is a policy that falls directly out of this. Consumers apparently recognise the need for a pension and even say that they intend to join one, but pension participation is low. It's so low[5], in fact, that unpensioned people in the private sector have historically been the majority, as we highlighted in *NEST insight 2013*.

Behavioural science has also revealed that consumers are often influenced in ways that they're not aware of. For example, we wouldn't necessarily be able to identify for ourselves that we'd be more likely to buy something if it was placed near the checkout desk but evidence shows that we absolutely are. In essence, whether they realise it or not people tend to be influenced by environmental factors.

[5] Bourne, T., Shaw, A. and Butt, B. (2010) 'Individuals' attitudes and likely reactions to the workplace pension reforms 2009'. DWP Research report No 669.

How consumers might respond to interim loss?

The most commonly-stated response to loss is to stop contributing or to switch funds. NEST research into members' reactions to loss found that people would employ a heuristic that is employed for bad behaviour elsewhere in life. Although some research participants suggested they would stop contributing after experiencing - and noticing - losses in one year, the tipping point more commonly came after three years. It seems that loss over three consecutive years was ample and convincing evidence of incompetence from the scheme or the fund management supporting it. Many equated this to other areas of life, such as punishment of a child or performance management in the workplace, and applied a 'three strikes and you're out' approach to the problem.

"If I got my letter saying £500 [was lost] in the first year, I'd think 'Gutted', but then to wait another whole year to then get another £500 down, and then the triple whammy … to me, that would be devastating."

Workshop participant, reactions to loss research

We won't know for many years whether members will actually behave as they've said they would in this study. There's no research or evidence base that tells us conclusively how millions of automatically enrolled members will behave. The available evidence is at best unclear and at worst unreliable.

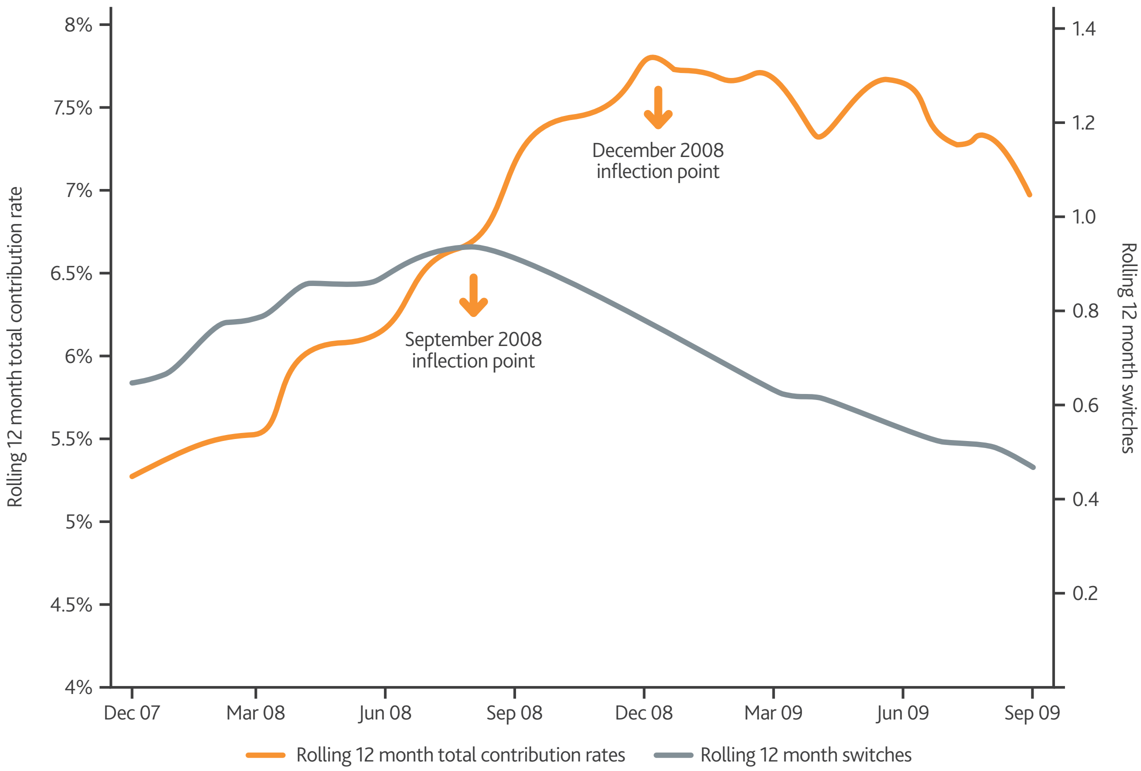
"It hasn't just happened once it's happened three years in a row and you just wouldn't be happy. It'd be worse because you'd just think 'I'm paying into a company that's losing my money all the time'."

Workshop participant, reactions to loss research

Evidence from other countries tells us that default effects are likely to be strong enough to keep people contributing regardless of how they feel about loss and the uncertain nature of DC pensions. Experience in the US suggests that after automatic enrolment, workplace pension participation stabilises at around 85 per cent and willingness to remain in does not vary substantially by income. Something similar has been observed with KiwiSaver in New Zealand, where there's been a decreasing trend in the number of opt-outs since its introduction. In the USA, new hires into a 401(k) plan featuring automatic enrolment were much more likely to invest 100 per cent of their contributions in the default fund. In Chile, 70 per cent of people in the multi-funds system didn't make an active investment choice[6]. In Sweden, three years after its launch, only 8.4 per cent of people enrolled in the public pensions system were making an active fund choice[7]. However, it's important to remember that in all these cases both the nature of the intervention and the social and cultural context is different to the UK.

The international picture on default effects indicates that people are generally inert when it comes to pensions. While this may seem to be the case, we've found evidence that periodically savers will take decisions and act. Analysis commissioned by NEST looked at the contributions and switching behaviour of existing savers' in UK DC pension schemes immediately before and after the onset of the financial downturn, between December 2007 and September 2009. The sample of 25,000 existing DC scheme members had similar demographic characteristics to the unpensioned and were pulled from a variety of UK DC schemes.

Figure 4 - Fund activity of actual DC savers before and after the credit crunch



[6] Rozinka, E. and Tapia, W. (2007). 'Survey of Investment Choice by Pension Fund Members', OECD Working Papers on Insurance and Private Pensions, No.7, OECD Publishing.

[7] Cronqvist, H. and Thaler, R. H. (2004). 'Design Choices in Privatized Social-Security Systems: learning from the Swedish experience' *The American Economic Review*. Vol 94, No.2: 424-428.

Figure 4 shows that the financial crisis, in which existing DC pension scheme members would have experienced interim loss of some kind, did have an impact on the sample's pension behaviour in terms of both contributions and fund switch activity.

All of these individuals remained in employment during the period and all of them retained the option to continue contributing. Though the majority of the group - 54 per cent - didn't take any action at all in the period observed, a high proportion - 46 per cent - did. This action took the form of changing their contribution patterns, increasing their fund switching activity or a mixture of both. The most striking and concerning behaviour is that 15 per cent stopped contributing to their pension altogether and 6 per cent decreased their contribution levels.

The results of our research suggest that people did take steps in response to the situation happening around them. The changes in contribution trends correlated with the Lehmen Brothers' company filing for bankruptcy, marking a clear departure from prior behaviour as the financial crisis unfolded. So it seems that where circumstances are serious enough, reported attitudes are reflected in people's actions. Inertia, it appears, doesn't always win out.

Inertia, it appears, doesn't always win out.

Uncertain outcomes

Our research into communicating investment concepts found that the question that consumers want answered the most is 'What will I get in the end?'

Our staged research methodology allowed the work to be genuinely iterative. In the first round we discovered what was important to communicate to members about investment. In subsequent rounds we were able to work with them to develop communications that answered their questions, spoke to their concerns and at the same time didn't erode confidence.

Designing a response to the question 'What will I get in the end?' was by far the most difficult challenge. What people ultimately wanted to know is what they'll get if all the variables that are in their control, like how much they contribute and how long they save for, are fixed. The research tried various approaches to answering this question but none were considered to be entirely satisfactory by the participants. Uncertainty and, by extension, likelihood of loss cannot be entirely communicated away.

Helping members understand what they might get out of a pension is perhaps the biggest communication challenge we face.

In chapter 2 we look at the merits of different approaches to communicating outcomes and giving projections in more detail. We provide examples of how NEST has used our research to develop better ways of communicating with our members and the key principles for communicating saving, investment and risk.

In chapter 3 we look at consumers' response to uncertainty when presented with different savings and investment products. We also assess their appetite for guarantee-type products and explore a direction of travel for future product evolution for the automatic enrolment market.

Conclusions

Our research into attitudes towards automatic enrolment shows that most of the unpensioned know that they need to do something for their retirement. While behavioural science shows that default effects are powerful enough to increase participation, people are generally supportive of a policy that's intended to boost their retirement. While many people found pensions so complicated that they were paralysed by having to make choices, they're now largely relieved of the burden of decision making.

Although many more people are now saving for a pension, there's a widespread anxiety that pensions will most likely fail their beneficiaries. Consumers are confused about how pensions work and the limited knowledge and misinformation they have makes many of them fearful and concerned about what they'll get at the end. People aren't against investment itself, they're just concerned about it as a route to building a retirement income. They're also concerned about the reputation of the financial sector and the ability and motivations of those in control of building their retirement income.

Automatic enrolment means that millions more are being enrolled in pension schemes that have features they wouldn't necessarily choose for themselves. This isn't about branding, reputation of individual schemes or their respective propositions. It's a problem shared by all DC schemes. Many consumers are uncomfortable with elements that are at the heart of any DC scheme - investment and uncertainty.

At NEST, we've used our research into the attitudes, characteristics and behaviours of the unpensioned to design an investment approach driven by our understanding of what we believe is in our members' best interests. But despite this, our research suggests that people are still unlikely to be happy about the prospect of things like their capital contribution not being 'guaranteed' and will still feel uncomfortable about exposing their retirement savings to investment risk.

While consumers might want an alternative approach that would give them the best chance of growing their money so it beats or keeps up with inflation, the circle that providers will find difficult to square is that this is highly unlikely without exposing member contributions to some investment risk, significantly increasing the costs of providing a pension and/or implementing elements of risk sharing.

One way that we've tried to change member attitudes about the reality of DC products is by being clearer about what happens to their money. We know that people want more protection for their capital, a certain - and good - outcome, zero volatility and low charges. If no one product can deliver all of this satisfactorily, what role might member communications play in improving consumer confidence and mitigating the possible emotional responses to loss and uncertainty?

In the next chapter we share our research looking into better ways to communicate with consumers to give them more confidence when saving for a pension.

Chapter 2

Communicating investment

Given that many of the challenges facing consumer confidence in defined contribution (DC) schemes centre on people's understanding - or rather misunderstanding - of pensions and investment, a natural response is to explore how to improve understanding.

This path has been trodden by NEST and several others before, although more with the intention of improving financial literacy or capacity rather than boosting consumer confidence[8]. While no one could reasonably question the good intention of improving consumer fluency with financial products and pensions in particular, evidence from the behavioural sciences and impact analysis of financial education projects suggest that gains in financial understanding don't necessarily improve financial decision making[9]. Put simply, more knowledge doesn't necessarily lead to better decisions.

This indicates that it may not be enough to just create communications that members can easily understand. We also need to be aware of the human capacity for cognitive bias and the tendency to adopt mental short-cuts[10]. If one of the communication goals is to lessen the possibility of poor financial decision making - because we aren't always rational decision makers - correcting our understanding won't always be enough to make a difference.

Furthermore, NEST research shows that learning about pensions doesn't necessarily give people peace of mind. Instead, in many cases it puts the spotlight on the features they didn't know about and would rather not see, namely risk. This requires us to think differently about how we deliver transparency and go beyond efforts to help people understand parts of the product and process that they may not fully approve of. In an automatic enrolment context, where the chief goal is to keep people contributing, the communications challenge involves balancing improved understanding with desired behaviour.

[8] de Meza, D., Irlenbusch, B. and Reyniers, D. (2008) 'Financial Capability: A behavioural economics perspective', Financial Services Authority.
[9] Choi, J., Laibson, D. and Madrian, B. (2010). 'Why does the law of one price fail? An experiment on index mutual funds' *Review of Financial Studies* 23(4): 1405-1432.
[10] Benartzi, S. and Thaler, R. (2001) 'Naive Diversification Strategies in Defined Contribution Saving Plans' *The American Economic Review*, Vol 91, No.1 79-98.

While the challenges are evident, our research indicates that communications can still play a role in mitigating the worst effects of attitudes to risk. Fundamentally, we can't alleviate all of the concerns people have about DC schemes through communications. Nor can we solve the confidence crisis in the financial sector through reassuring words alone. However, there are better and worse ways of talking about pensions, and doing it well is more conducive to building confidence and creating a dialogue with members. Where members do engage with scheme communications, we can be smart by being sensitive to the following challenges:

- It's not just what we say but how we say it. By framing information carefully we can make a difference to both comprehension and behaviour.
- People tend not to proactively engage with pension communications. When they do, it's often driven by concern. Communications need to be sympathetic to this.
- For most people, the starting point with pensions is negative. Communications need to reassure, not just inform.

This chapter sets out some high-level guidance on what works when talking to members about investment, risk, uncertainty and outcomes. It uses as its main evidence base two recent NEST research projects. One sought to identify ways in which to communicate investment to members. The other explored responses to deterministic and probabilistic retirement projections.

At NEST we're still exploring the best ways to talk to our members about investment. This is unlikely to be the final word on the subject. Now that debate is taking place about the quality of and confidence in workplace pensions, it's the right time to summarise what we've learned so far.

More knowledge doesn't necessarily lead to better decisions.

What members want to know

The best and most obvious place to start with member communications must undoubtedly be with what they want to know. Previous research[11] has identified a number of key information needs that new members have. These centre on workplace pension schemes and automatic enrolment generally. For example, 'When can I take my money out?', 'How much do I have to contribute' and 'What happens to my money if I die before I retire?' Few members will spontaneously say that they're interested in investment information. Most members don't understand pensions enough to know what questions to ask.

We undertook in-depth interviews with people who matched the demographic characteristics of the unpensioned. We asked them to imagine they'd been enrolled in a workplace pension scheme and what their first questions would be.

Almost everyone wanted to know:

- What happens to my money?
- Is my money safe?
- What will I get in the end?

While none of the people we interviewed said they were interested in investment, these three questions ultimately concern investment. The remainder of this chapter seeks to address these areas of interest and explores the challenges for all pension schemes seeking to deliver adequate responses.

Member communication journeys

Given the large amount of people eligible for automatic enrolment, it's not surprising that member communication needs differ. Like the working age population generally, the demographic make-up of the unpensioned is extremely diverse. It includes different levels of education, a wide range of life-stages and varying knowledge of pensions - around two-thirds have some experience of a pension. All this has an effect on where members start from, what they want to know and how much detail they're expecting. On the one hand, there's no one-size-fits-all communication response, but there are common elements in what people are most interested in and concerned about.

When presented with investment-related information that addresses these main concerns, four distinct groups emerge:

The 'cynical'

This group is the most distrusting of pension providers and the financial sector generally. They're aware that risk is taken and that outcomes aren't certain in DC pensions. This group is so negative that there's nothing you can say or do to change their view. People in this group tend to have been in a pension before or know a friend or family member who's been disappointed with their pension.

[11] DWP Communications (2011) 'Automatic Enrolment - information for workers qualitative research'. Available at www.gov.uk

The 'compliant'

This group is the least likely to show any interest in the scheme or any member communications. They share the lack of understanding of the 'curious' group but openly declare lack of interest in finding out more. Some in this group defer to the better judgement of professionals, even if they don't trust those in the financial sector. There's an implicit notion that they don't need to concern themselves with the product and that those running the scheme will know best. Although this group would appear to be fewer in number than the 'cynical' and 'cautious' groups, they present an interesting challenge through their deference. Like more traditional doctor-patient relationships, there's a sense here that the experts will take care of everything and so even though they're in the scheme, it isn't really their concern.

The 'cautious'

People in this group are keen to engage to get answers to their questions and are the most likely to become more positive in their view of workplace pensions on learning more. There's a sense here that the pension isn't as bad as they imagined based on, for example, the NEST proposition and outcome scenarios of a modelled member.

The 'curious'

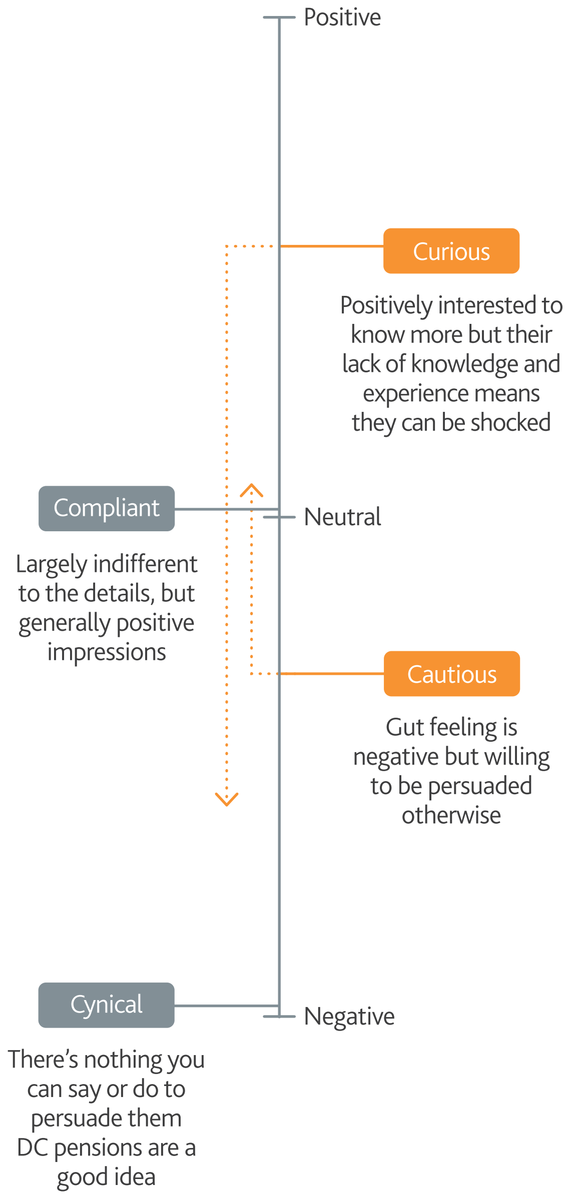
This group are the most likely to be shocked at what they find out from investment-related communications. They don't know how workplace schemes grow their money, they don't know about uncertainty and volatility, and they're shaken when they find out. This group tends to be younger and have the least experience of pensions, whether directly or indirectly through a family member, partner or friend.

Given the different starting positions of these groups, they each go on different communication journeys and they don't necessarily end up in the same place, despite being exposed to the same material. Some people will remain unconvinced by the DC proposition, no matter what's said about it or how this is framed.

The qualitative nature of our research means we can't say with confidence what percentage of the unpensioned will exhibit each of these characteristics. Our view is that communication strategies should focus on reaching the compliant, the cautious and the curious groups, while recognising the different journeys members are likely to go on.

Most members don't understand pensions enough to know what questions to ask.

Figure 5 - The member communication journeys displayed by the four groups in deliberative research



Answering the question 'What happens to my money?'

As set out in chapter 1, consumers generally have a poor understanding of investment. Even if they know that money contributed to a pension is invested, they struggle to create a mental picture of what happens to their money. In line with the common misconception about how money in a pension is grown, some believe that it goes into something like a savings account. That's why they're surprised and concerned when volatility becomes apparent. Consumers appear to feel far more disconnected from their money in a pension than they do in other commonly used savings vehicles, like a cash ISA or a building society account. For a typical member, once their contribution has been deducted something quite alien happens to it and some decades later they will see the result. Because this outcome is uncertain, this generates further fear.

NEST research has found that traditional approaches to talking about investment fail to help people understand what happens to their money, and can even make them more anxious about investment and their potential retirement income.

In our research we showed participants the statement below. It's a short description of what happens to their money in a pension, followed by a standard disclaimer for retail investment products:

> *A pension invests in things like equities, bonds and gilts.*
>
> *Investing your money can help it grow over time but also comes with risks. Investments can go down as well as up, and there is no guarantee you will get back all the money that you invest.*

Neither part of this statement strengthened understanding or fostered confidence. Few people really understood what 'equities, bonds and gilts' were. However, replacing these terms with something else didn't in itself help people's understanding. For many people, the following elements are missing from their understanding:

- Money invested differs from money in a savings account.
- Their contributions buy things and/or are lent out.
- Although the nominal value of their contribution stays the same, the value of what they've bought can change.

For most of the people we interviewed, the part of the statement that referred to volatility and capital-at-risk created anxiety where there was relative indifference before, and was the primary driver of lost confidence. The fact that this statement was made in such clear terms and upfront was taken to be a warning against the product. Rather than refreshing transparency this was seen as an alarming admission.

Making investment real

During the workshops several attempts were made to answer the question 'What happens to my money?' We worked with the participants to arrive at an approach that met the following criteria:

- They found the information accessible and straightforward.
- The content didn't make them feel more worried.
- The content addressed central unhelpful misunderstandings about investment and left participants with the correct understanding.

The communications solution to making investment real was, to our surprise, far simpler than we had anticipated. At the outset, we had expected co-producing a suite of infographics with participants, researchers and creative designers that would explain investment concepts and risk. What we came up with in the end was much simpler. Participants felt that this described and showed where their money went and what the pension provider was doing with their contributions. At NEST we've already started incorporating these findings into our website and other member facing communications.

Research stimulus

Produced in collaboration with research participants

Figure 6 - What happens to my money?

Where do my contributions go after they have been deducted from my pay?

Money from you, your employer and any tax relief you get is pooled with the contributions of other members due to retire in the same year as you. We call this a 'NEST Retirement Date Fund' and we'll have one for every year a member might retire. Each one is carefully managed and designed to help grow and protect members' money whether they're just starting out or getting ready to retire.

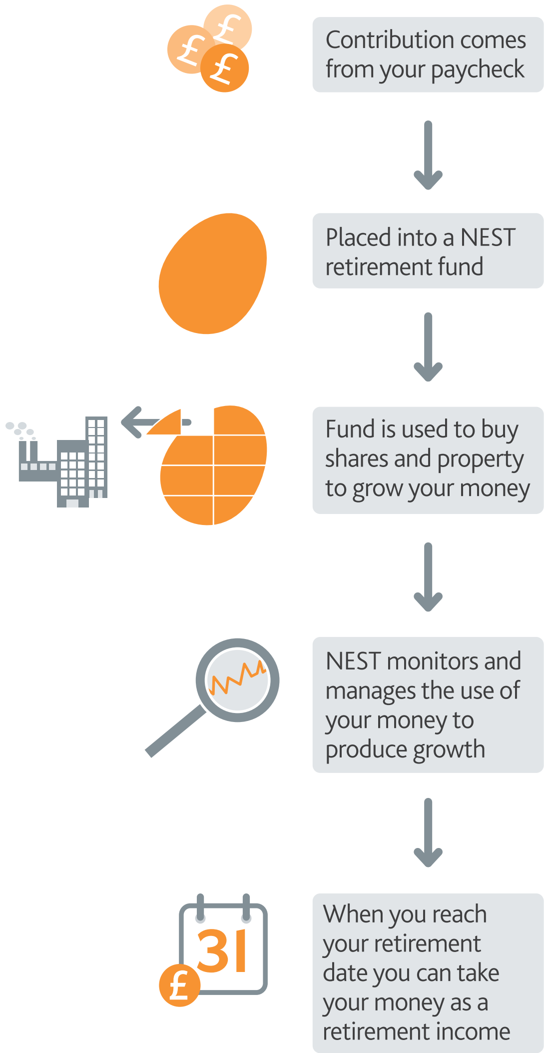


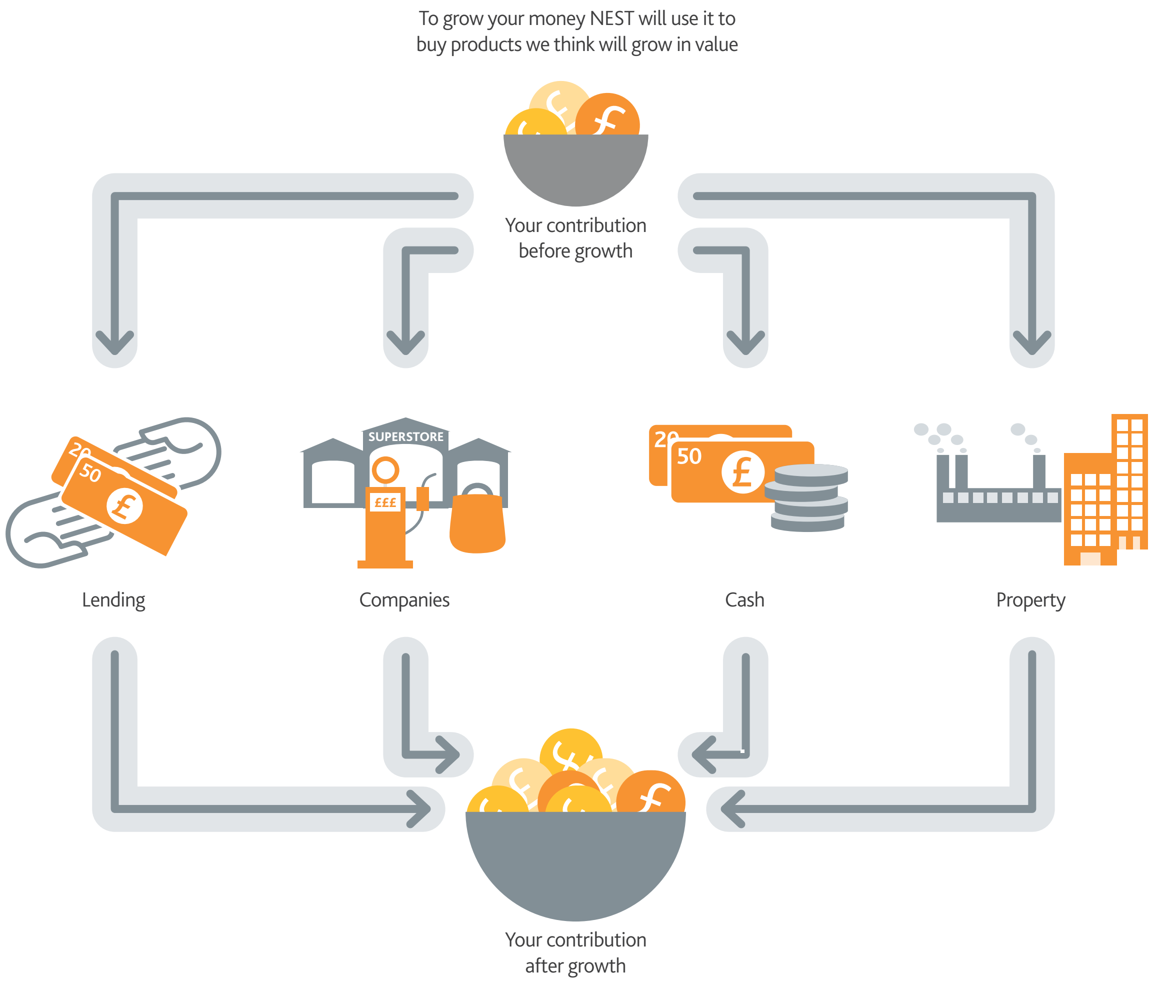
Figure 7 - Where does my money go?

What happens next?

With this pooled money, we buy things that our research suggests will increase in value over time. Because your money has been pooled with contributions of other members, we're able to buy things that it wouldn't be possible for you to buy with your contributions alone.

As the value of these things changes so does the value of your pot. If, for example, companies make profits and the value of the share goes up, the value of your retirement pot also goes up.

We also lend money to certain companies and governments, which they repay with interest, and we hold some of your pot in cash. We're careful not to put all your eggs in one basket. We spread your money across lots of these things to give us the best chance of growing it.



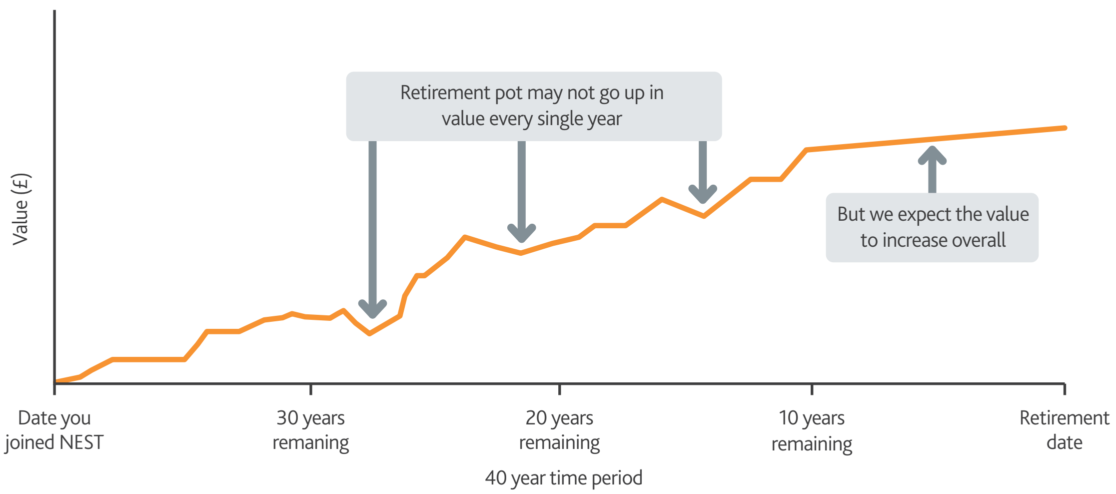
In addition the research stimulus shown in figure 8 aims to deal with the misunderstanding about pension performance and fund value volatility over time. In our research we found it helped people to understand that pensions don't perform like savings accounts and why outcomes are not certain.

Research stimulus

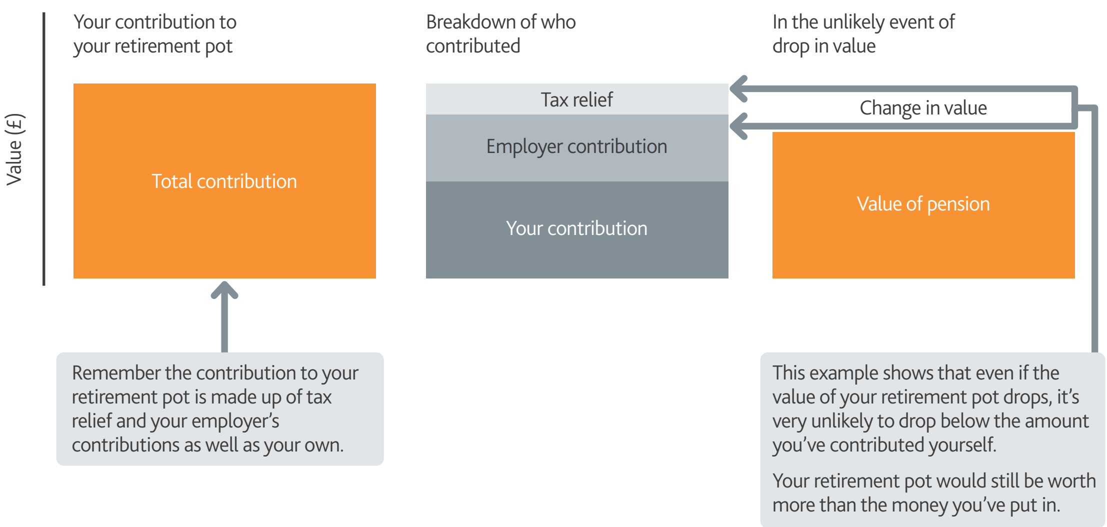
Fund volatility

Figure 8 - Research stimulus used to explain fund value volatility

Why is my pension worth less than last year?

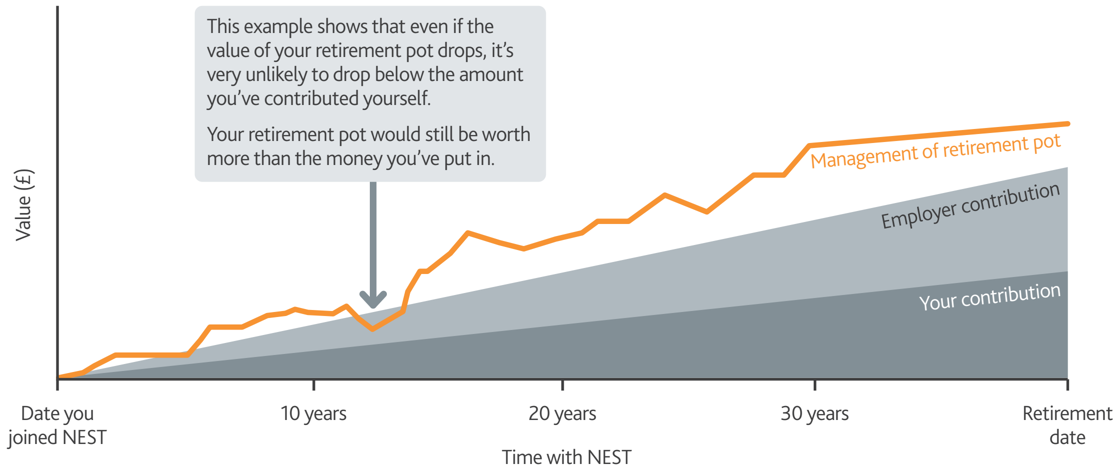


Why would I lose my money?

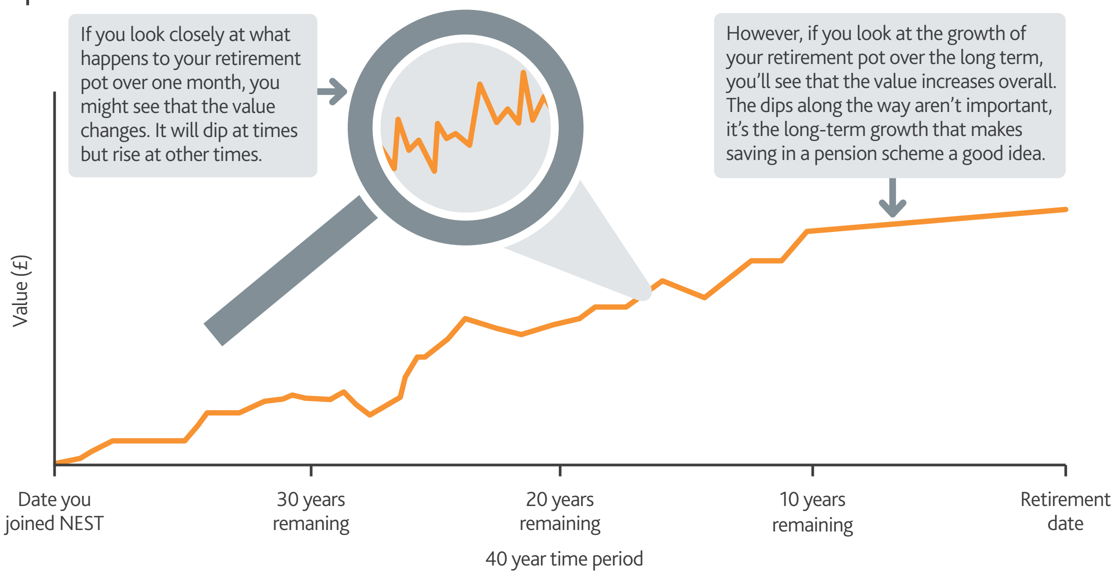


Would I lose my money?

Remember the contribution to your retirement pot is made up of tax relief and your employer's contributions as well as your own.



Ups and downs



The implications of making it real

Perhaps the most significant consequence of this approach was that it connected people to their money - previously they'd reported feeling estranged from it once it had left their pay packet. We can't know from this research whether this would affect people's level of engagement with their pension or their contribution levels. However, engagement or a conversation about contributing more would be difficult if members were left to feel disenfranchised from their contributions.

For the most part, learning what happens to their money is helpful. For those with the worst preconceptions about investment, it shows that thought is given to the management of their money.

It also shows diversification and giving examples of real businesses we invest in - supermarkets, for example - provides a better mental picture than that of an esoteric form of gambling that the term investment had for many.

For some people, finding out what happens to their money in a pension can be an education into the functioning of the economy generally. This is especially the case for those with the least prior knowledge and experience, most often young people. It's a lot to take in, for example, that governments are constantly borrowing money. This insight can give rise to concerns about why they're borrowing, for what purposes and how likely it is that governments, particularly foreign governments, will pay the loan back. Similarly, it can be eye-opening to learn that the quality of your retirement is affected by how profitable a wide range of companies are over many years.

Addressing concerns about 'safety'

We conducted additional customer experience research with volunteer members and employers in early 2012 and with dutied employers and automatically enrolled members in 2013. Among other things, this research reported on engagement with 'member welcome' communications and with the scheme online. We know from this that most members look at information they're sent when they're first enrolled in only a cursory way. We know too, as outlined in our *Member research brief* (2011) publication, that members can be prompted to look at their pension by external factors, like economic turbulence, and life events such as reaching a milestone birthday or having children.

Communications that deal with investment need to answer the questions that members bring. When they come to us they're more likely to be driven by concern than by curiosity, whether about the value of their pension, their contribution level or what they might get out at the end.

Demonstrating benevolence, integrity and ability

Answering the questions that matter to consumers has to be about more than education. Our research suggests that when people pose these questions, they do so out of concern. The answer they're looking for is therefore one of reassurance, not just explanation. Members don't have an appetite to become semi-experts. They want instead to be reassured that the people responsible for growing their retirement savings are doing so responsibly and sympathetically to their concerns.

Clearly, trust can't be built through words alone, it needs to be earned through consistent action. Given that consumers are generally unable to say what's different about the approach of one workplace pension to that of another, they don't really differentiate between one provider and the next. Therefore a step change is required in the perception of the sector altogether. Secondary evidence suggests that trustworthiness can be demonstrated through communicating:

- benevolence, by demonstrating shared values
- integrity, by demonstrating honesty and the intention of doing the right thing
- ability, by demonstrating expertise and a consistent track record.

Answering the question 'Is my money safe?'

As we've established when exploring what works to communicate risk, the word risk has an intrinsically negative connotation for the mainstream member. It seems that we should avoid using the word altogether. A more fruitful approach to talking about risk is possible without beginning with an explanation of risk. Our research suggests that what works best is describing how the downside of risk is managed. As with other aspects of communicating investment, the priority should be reassurance rather than boosting financial literacy[12].

In practice for NEST this means explaining the rationale for our particular investment approach, as we've done in our publication *Looking after our members' money* (2013). It also means clearly communicating the concepts of lifestyling and diversification, which implicitly deal with risk. These communications show that NEST understands concerns about losing money, and has a plan to both protect and grow members' pension pots. We used the stimulus set out in figure 9 to provide reassurance to members that their money was being carefully managed, without having to resort to complicated or technical concepts and language. This is now part of our web-based member communications at NEST.

They want instead to be reassured that the people responsible for growing their retirement savings are doing so responsibly and sympathetically to their concerns.

[12] de Meza, D. Irlenbusch, B and Reyniers, D. (2008) 'Financial Capability: A behavioural economics perspective', Financial Services Authority.

Research stimulus

Diversification and lifestyling

Figure 9 - Research stimulus we used to explain diversification and lifestyling

Diversification

Not putting all your eggs in one basket

We believe that using your money to buy into a wide variety of things instead of just one or two is the best way to grow and protect your pot. We do a combination of different things including buying into a wide variety of companies across the world, lending with interest and holding some of our members' money in cash.

We're not just banking on one thing to do well and our experts spend time finding a wide variety of opportunities to grow your pot without taking careless risks.

Because we don't just put all your money is one place, you are less likely to be hit hard because one thing may not be doing as well as another. This means our members can expect a smoother journey towards retirement with less dramatic ups and downs along the way, than if we were just buying into one thing with your money

Lifestyling

A different approach to growing and protecting your money

In your 20s - you are probably new to being in a pension scheme so we'll be concentrating on helping you establish your retirement pot and keeping the value steady while you get used to the idea of being in a pension.

In your 30s, 40s and early 50s - we focus on growing your retirement pot more quickly. During this time, because of the things we're buying into, it's possible that members could see more ups and downs in the total value of their retirement pot. But for the most part their retirement pot is likely to grow more quickly at this point.

10 years away from retirement - we focus on protecting the value of your retirement pot so it's ready for you to take out.

NEST experts look after your money carefully no matter which NEST Retirement Date Fund you're in, keeping a constant eye on the mix of things your money is buying to grow it more than the cost of living whether you're in the NEST 2020, 2030 or 2050 Retirement Date Fund.

Answering the question ‘What will I get in the end?’

What they will get in the end is the chief concern of all consumers. Some people want an answer to this at the outset to help them work out whether it’s worth contributing. Others want an answer when they get older and become more interested in what their retirement might look like. In either case, it’s the most important question consumers have and at the same time the most problematic.

There are a number of problems with providing an answer. Many people aren’t clear about what makes up the value of their pension and, in particular, what proportion of its value at any point is made up of their contributions. Most don’t fully understand the need to annuitise - although this becomes less relevant in light of Budget 2014 proposals - and what bearing their pension value has on their retirement income. They tend to find outcome projections demotivating, which can make communications on outcomes a concern for member behaviour and decisions about how much to contribute. Finally, consumers are looking for a level of certainty in the response that it isn’t possible to give.

Demystifying outcomes

There isn’t a perfect answer to the question ‘What will I get in the end?’ but NEST research suggests that there are a number of approaches that can boost member understanding and confidence.

Consumers don’t know what makes up their final outcome. When presented with a projection, some try to do their own arithmetic to establish what proportion of the projected outcome is made up of their nominal contributions and what portion is investment growth. Not knowing what makes up the outcome or how it can be influenced is another factor which leaves people feeling disconnected from their money.

During our research interviews we found that setting out first what makes up the projected outcome - in broad terms, contribution level, length of contribution, charges and growth - is more helpful than showing the projection alone. We did this by showing the research stimulus in figure 10. This approach helps to resolve some of the mystery of pension outcomes and implicitly sets out that the factors that make up their pension fund value aren’t fixed and can be influenced. Furthermore, it highlights that two of the key variables, namely how much and for how long they contribute, can be controlled by them.

> Consumers are looking for a level of certainty in the response that it isn’t possible to give.

Research stimulus

Paying in more and taking your money out

Figure 10 - Research stimulus shown for 'How much should I pay in?' and 'For how long should I contribute?'

How much should I pay in?

Paying in more

Jason is 35. He's been saving £40 a month in NEST for a few years. He also gets a £30 contribution from his employer each month and £10 tax relief from the goverment. The total contribution to his NEST pot is £80 a month. His retirement pot is now worth about £3,500. He plans to take his money out at age 67. By then his pot could be worth £55,800.

If Jason pays in £50 a month (an extra £10)
This means there's a total of £92.50 going into Jason's retirement pot every month, including the extra £2.50 tax relief he gets from the government. His retirement pot could be worth almost £63,100 when he reaches 67. This is an additional £7,300.

If Jason pays in £70 a month (an extra (£30)
This means there's a total of £117.50 going into his retirement pot every month. His retirement pot could be worth over £77,800 on his 67th birthday. This is an additional £22,000.

For how long should I contribute?

When to take your money out of NEST

Margaret is 55. She plans to take her money out when she's 66. She contributes £50 per month. Her employer also contributes £40 per month and she gets tax relief from the government of £12.50 per month. Her NEST retirement pot is now worth £20,000. When she's aged 66 her retirement pot is likely to be worth around £39,800.

If Margaret takes her money out of NEST at age 68
Contributing for those extra two years could raise the value of her retirement pot to around £44,500.

If Margaret takes her money out of NEST at age 70
Saving for four more years could raise the value of her retirement pot to around £49,700. This is almost £10,000 more than the value at age 66.

While the brief explanation given in figure 10 is helpful, fundamentally what people want to know is 'If my contribution amount and term is fixed, what will I get at the end?'

Initial research presented participants with deterministic projections to show illustrative examples of what the NEST scheme might deliver if a fixed amount is contributed for a fixed number of years. This was based on our investment objective of inflation plus 3 per cent growth after all charges have been deducted.

The benefits of using deterministic projections over projections that use probabilistic models continue to be discussed by experts, academics and regulators. Deterministic models are generally thought to be less difficult for people to understand because there's less information for them to take in. Because people are already broadly aware that the amount they'll get at the end of the pension isn't certain and they tend to think of uncertainty as intrinsically negative, we found that many considered a deterministic projection as a potential 'all or nothing' scenario. Furthermore, the perception of investment as entirely random and unpredictable drives the view that members are just as likely, or even more likely to get an outcome which is much worse than the one shown.

This preliminary insight was explored in further NEST research which looked in more detail at consumer responses to deterministic and probabilistic projections.

Figure 11 - Comparing deterministic and probablistic approaches to presenting information

Deterministic	Probablistic
Authoritative	More honest
Skirts issue of risk	Highlights risk
Easily understood	Challenging
Familiar	More informative
Taken 'as read'	Raises more questions
Presented traditionally	Presented creatively

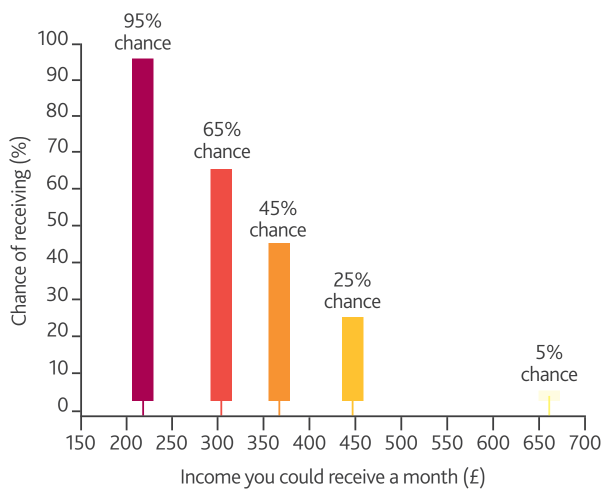
Deterministic projections, though more straightforward from a presentational view, aren't easier for people to understand. The opposite is true in the sense that they're easier to misunderstand. People certainly found deterministic projections easier to look at and it took them less time to digest the information that was being relayed. However, it was either taken to be a promise or as so indicative as to be meaningless. Earlier research, which explored this area in far less detail, suggested that consumers generally interpreted the outcome communicated by the deterministic projection to be just as likely as a very poor, and improbable, outcome. This research confirmed that this was the case for people with previous experience of pensions, who account for about half of the unpensioned.

Some consumers, especially those new to pensions, assumed that the deterministic projection was telling them what they'd get. When they realised that this outcome wasn't certain, they shared the emotive reaction of those who already knew.

In contrast, probabilistic projections are considered to be a lot more difficult to digest. But once people have taken in the information that there are a range of possible outcomes and that some outcomes are more likely than others, their understanding was much improved.

Probablistic projections were therefore seen as helpful for many in our focus groups. The preferred formats were simple bar charts, an example of which is shown in figure 12, rather than 'fans' or other methods that attempted to show probability of outcomes.

Figure 12 - Example of a probabilistic projection for monthly retirement income



By gaining an understanding of the different probabilities around investment returns, some learned things that disappointed them. Those who knew that pension outcomes are uncertain were pleased to see that the worst outcome is also the least likely. However, those who didn't know about uncertain outcomes were concerned at having the different probabilities spelled out for them by the probabilistic projection. In short, the deterministic model allowed this group to be content in their lack of understanding.

Putting it into practice

How NEST communicates to members

From the varied research that informs this report our evidence base suggests that we should communicate investment to members in a way that is clear, meaningful and reassuring. Essentially NEST members want to know that their money is safe and is being managed for their benefit.

The challenge is how to put this into practice. This has led NEST to some key principles for communicating to members.

Make it real

Members find it easier to understand investment if actual money amounts are used and specific examples of what NEST is doing with it are provided. Members respond positively when they understand that they are the beneficial owners of shares in global companies or real assets like property. Providers should avoid abstract expressions such as percentages and fractions and focus on showing what investment means in real terms. This makes it easier for members to picture what's happening to their money and feel confident that it's being looked after.

Speak their language

Through all scheme communications NEST applies plain language principles to ensure that messages are clear and simple. In addition, investment terms aren't well understood by large sections of our membership. NEST has worked hard to change the way investment is communicated to avoid jargon and outline the basic principles of investment clearly.

Be a safe pair of hands

Savers want to know that NEST is on their side. NEST can show this through appearing as a trustworthy actor by being transparent and displaying our integrity. As a trust-based scheme NEST is bound by legal duties that include acting in the best interests of members. Making this clear helps to reassure members that NEST is on their side.

Show you have a plan

Many savers are nervous about trusting their money to the financial markets. This problem has been made worse by recent economic history. 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.

It's not complicated

Many people never get around to saving for retirement because they're frightened of making the wrong choice. NEST communications to members emphasise that NEST Retirement Date Funds take care of the complicated decisions. This lets members save confidently in the knowledge that they're in the right place.

Members have choices

NEST research shows that members don't like to feel trapped. Members want to know that they can have a role in influencing what outcomes they achieve through saving. As well as offering fund choices to address specific preferences, NEST emphasises the difference that contributing more or saving for longer can make. This allows members to take more control of their saving activity if they want to.

Conclusions

Our research has revealed a profound information asymmetry between providers and members. Information asymmetry isn't particular to pensions and there are obviously other important areas in people's lives where they don't and often can't know what those acting on their behalf understand. But it would seem that in pensions this information imbalance distances members from their workplace pension scheme in a way that will eventually become unhelpful to both parties.

This detachment means that members feel little connection to their money in a pension and their pension outcome. The results of this distance can be seen in orphaned pension pots and previously sub-optimal annuity decision making. How this will look with an automatically enrolled group we can only speculate, but there isn't anything to suggest that it will be improved. The need to build symmetry between provider and member, then, isn't motivated by improving financial capability alone. There needs to be a more level playing field for engagement.

Our research indicates that historic disengagement shouldn't be interpreted as apathy. In fact, consumers are extremely passionate about building a retirement income, and what interests and concerns them the most is investment - though they are unlikely to put it in those terms. For them, what happens to their money, how 'safe' it is and what they can expect to get out at the end are of the utmost importance and together define the product.

The paradox is that these most vital issues are those that consumers, even those with previous experience of a pension, know the least about. This implies that member communications in the past have failed to provide useful or comprehensible information about the issues that matter most to members. These important questions are also perhaps the most difficult to answer clearly and definitively. Our research shows, however, that it is possible to boost members' understanding and situate them and their money in the picture that they previously felt outside of.

Outcomes would appear to be the most challenging to communicate. Neither deterministic nor probabilistic projections offer a complete solution, with each having benefits and drawbacks. The potential implications of different projection methodologies and presentations are not easily resolved by research and require a judgement to be made as to which is the best to adopt, or whether a mixture of the two could aid understanding. A similar judgement is required when considering whether to show a projected pot size or projected income in retirement. Both had drawbacks and advantages.

In light of the changes announced in the 2014 Budget, careful consideration by providers will need to be given to the presentation of pot sizes and incomes now that the requirement to annuitise will be removed. NEST will continue to work with the industry and consumer groups to improve the communication of the likely outcomes of pension saving. The fundamental problem with communicating outcomes in a defined contribution context is members' reactions to uncertainty. Whichever approach is taken to communicating outcomes, it pivots on addressing the desire for certainty in an uncertain product.

In the next chapter we discuss in more detail consumers' desire for certainty and what, if anything, they're prepared to give up to achieve it. Given that communication offers only part of the solution, we also consider what kind of pension product innovations, such as introducing guarantee-type elements, might provide members with more certainty.

Historic disengagement shouldn't be interpreted as apathy…consumers are extremely passionate about building a retirement income.

Chapter 3

Unpicking the appetite for certainty

A preference for certainty over uncertainty isn't surprising in any situation. Behavioural scientists and even neurologists have documented our predisposition towards certainty for some time[13].

But what does this mean for defined contribution (DC) pensions? These schemes are designed around the premise that the volatility of investments such as equities is compensated through significant outperformance of bank deposits over the longer term. They appeal to economic utility rather than the pervasive risk aversion of many of those wishing to build a retirement pot. As we've seen, communications alone can never fully reconcile this.

One response to this challenge might be to provide some form of 'guarantee'. However, this is problematic, perhaps more so than the communications conundrum for several reasons. These include the likelihood of much higher charges, the sacrifice of significant potential upside and, not least, the problem of how guarantees could be positioned to consumers - could they ever really be described in terms that would deliver the kind of certainty that consumers say they want?

Recent NEST research sought to shed some light on these issues and questions. We conducted 12 focus groups in which we discussed DC outcomes and guarantees with people who matched the demographic characteristics of the unpensioned. As part of this discussion, we explored the language of guarantees and discussed what this term means to people and whether it means the same thing in different consumer contexts. A key question for the research is whether a guarantee equates to 100 per cent certainty, or whether 99 per cent or 99.9 per cent, for example, would be considered good enough.

We also asked focus group participants to complete a questionnaire that aimed to identify how important they felt certainty is. We asked them to consider other key pension product features like final outcomes - based on a probabilistic spread - and cost - expressed as gross charges deducted over the course of a savings career. This chapter primarily discusses findings from this research.

[13] Crammer, C. (2005) 'Neural systems responding to degrees of uncertainty in human decision-making'. *Science* 9: Vol. 310, no. 5754: 1680-1683.

What consumers mean by 'guarantee'

Across a variety of NEST research projects we've heard requests for 'guarantees'. But what do consumers mean? And why is the word so persuasive in terms of changing hearts and minds about contributing to a pension?

In life we seek guarantees to give us some protection against unwanted, potentially damaging or inconvenient situations. Often the guarantee mitigates the worst case scenario, but doesn't prevent it altogether. With respect to DC pensions, what members are faced with at the moment are no promises to fulfil any conditions with respect to the value of their savings or indeed the retirement income it might be converted to. The only time a guarantee has been offered in a DC pension context is at the end of a savings career when most current savers had to annuitise their pot. The changes announced in Budget 2014 mean that savers are faced with greater freedom in terms of what to do with their pots, but are potentially faced with more complicated decisions and potentially less certainty in terms of a lifelong income.

As outlined in chapter 1, given members' view of pensions as a protectionist course of action, the absence of any kind of certainty whatsoever is seen as being against good sense. It's counter-intuitive and looks like bad judgement. A key driver of low participation levels has historically been decision anxiety and regret aversion[14] - the feeling that the decision is too important for them to take. It's important because the stakes are so high and, as such, mistakes simply aren't permissible. Or to put it in simple terms, when in doubt, do nothing.

In our research we asked focus group participants to think of other words that meant the same thing to them as guarantee or that they associated with certainty. The most commonly cited words across all focus groups were: safe, secure, certain, assurance, promise, commitment, peace of mind and gain. These words strongly suggest that members are looking for a guarantee as a response to the shortcomings and worst case scenarios they associate with the financial sector and with investment. They want pensions to be free of risk, at least in terms of the perception of risk as entirely negative, as we saw in chapter 1. Rather than a guarantee of delivering a specific outcome, guarantee is shown to be more about a having safety net.

[14] Loomes, G., and Sugden, R. (1982) 'Regret Theory: An Alternative Theory of Rational Choice Under Uncertainty' *The Economic Journal*, Vol. 92, No. 368: 805-824.

Money in the bank perceived to be guaranteed

Finance professionals are aware that nothing is truly certain in money management. Even in the absence of investment risk, liquidity and counterparty risk remain and so even a bank account can be compromised. Consumers don't share this view. While there's a distrust of banks as corporate entities, there's a firm belief that money in a bank account is guaranteed by virtue of a perception that the bank does not invest it. It can be mentally conceptualised as being in a container marked with the account holder's name. It therefore carries both the impression of security and permanence, unlike money that's invested, which is seen to fall victim to random and uncontrollable forces.

There's a certain contradiction here in consumers' perceptions. On the one hand, there's a general awareness about the role and impact of banks in the recent economic downturn and a feeling that banks are not to be trusted. On the other hand, money in a bank is considered safe. The Financial Services Compensation Scheme (FSCS) does protect savings - but only some pensions - up to £85,000, but the existence of this was not well known enough to explain member confidence. It seems that money which isn't invested is presumed to be guaranteed.

Guarantees and quality

Overall, things that are guaranteed are perceived to be of higher quality than things that aren't. We invited research participants to think of other products that carry guarantees. White goods were most commonly cited and some participants identified that the better the product, the stronger the guarantee. This was seen as a mark of the manufacturer's faith in the product they had produced.

Examples of guarantees tended to be warranties - discussed below - or insurance policies. Neither is seen as wholly positive. In both cases a formal agreement has been made that certain protections are in place, but often the conditions aren't seen to be good enough or fair. For example, a warranty that doesn't last for long enough or that requires an additional fee for it to be extended is perceived to be poor value.

Again, there is a quality aspect here. Free guarantees suggested a better product to participants than products that came with guarantees carrying an additional cost. The latter suggest that the manufacturer or provider has less faith in the reliability of their product. This insight is important in understanding consumer decision making when trading off pension products on features such as outcome, cost and protection.

Insurance policies that participants referred to as guarantees were, by nature of carrying a fee, viewed less positively than free warranties. A popular example of such a policy was payment protection insurance (PPI) which was widely considered a scam. Guarantees, it seems, aren't necessarily viewed positively. So while it's the case that uncertainty is undesirable, it shouldn't be assumed that providing any form of guarantee will improve confidence.

Guarantees as standard

In our research, participants saw a guarantee of getting back at least what they put in as a basic and essential product feature of pensions. In addition, a guarantee of retirement income would be desirable as it would help them plan for retirement. The assumption among participants was that a pension would have this feature and there was incredulity when it became apparent it would not.

For some members, it seems that it isn't until they realise their pension contributions are invested that they realise the pension doesn't carry a guarantee of them getting back at least what they put in. Language would seem to be a contributing factor to this misunderstanding. When focus group participants talk of saving in a pension they don't have investment at the front of their mind, and 'savings' are - de facto - guaranteed in members' minds.

Another factor contributing to this misunderstanding is 'common sense'. For consumers, a pension that doesn't definitely protect their contributions while seeking to grow them is simply foolish. By not taking into consideration the long-term benefits of investing in equities over a savings account, they struggle to understand why anyone would design a product this way. They're even surprised to find that such a product exists.

Guarantee as 100 per cent certainty

During the focus groups, we presented research participants with different creative executions of probabilistic projections, as shown in figure 13. The executions displayed the same data in a variety of ways using different visual presentations but also used different framing. Participants were invited to discuss the probability of getting back less than they put in. This was presented as a 'less than 1 per cent chance of getting less' and a 'more than 99 per cent of making more than you put in'.

Opinions on whether this degree of certainty was acceptable were polarised, irrespective of the framing. Some participants felt that this was reasonable and fair, and in some cases this probability was considered to be quite good. The majority, however, were less forgiving and felt strongly that any possibility, no matter how remote, of getting back less than was contributed is unacceptable.

'Savings' are - de facto - guaranteed in members' minds.

Figure 13 - Research stimulus showing different visual representations of 'What you might get'

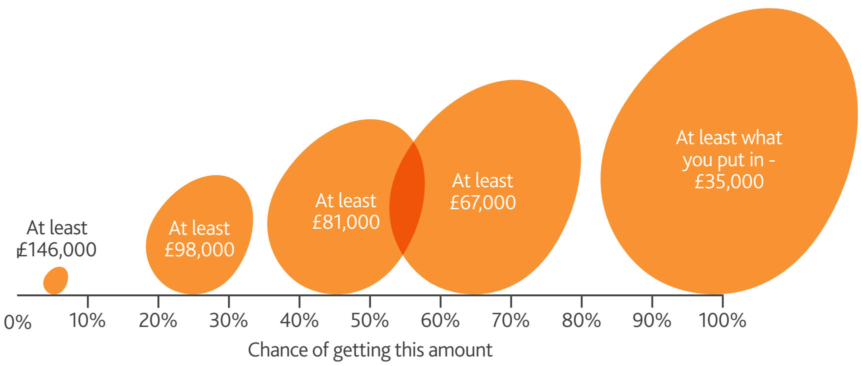
All these examples are based on someone earning £19,800 a year, saving for 30 years. We've assumed they have contributed only the minimum contribution of 8 per cent of their salary, including money from their employer, money from their pay and tax relief.

As set out in chapter 2, we tested a variety of different formats for indicating probability and degrees of certainty. The preferred representations were the simple bar charts.

1. What you might get: value of retirement pot

This chart shows that someone earning £19,800 a year, saving for 30 years has a:

- 99 per cent chance of getting a retirement pot that's at least more than they contributed
- 45 per cent chance of getting a pot worth more than £81,000
- 5 per cent chance of getting a pot worth more than £146,000.



2. What you might get: value of retirement pot

This chart shows that someone earning £19,800 a year, saving for 30 years has a:

- 99 per cent chance of getting a retirement pot that's more than they contributed
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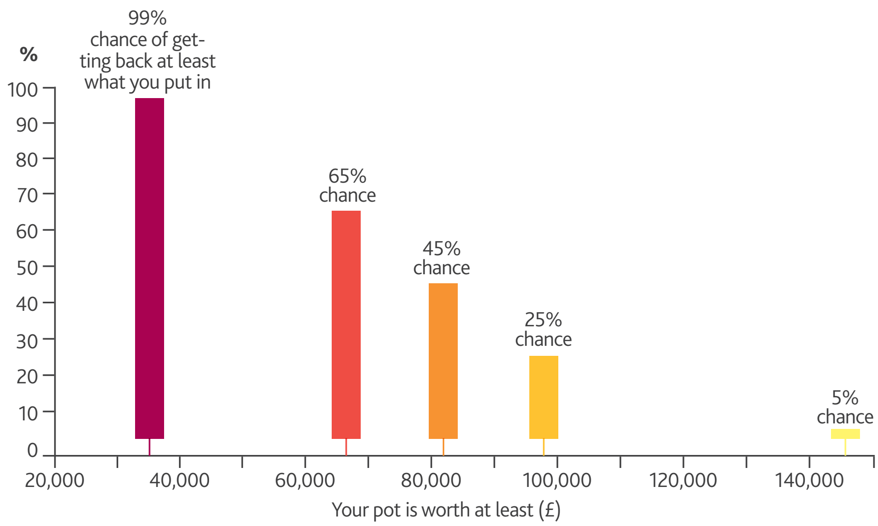
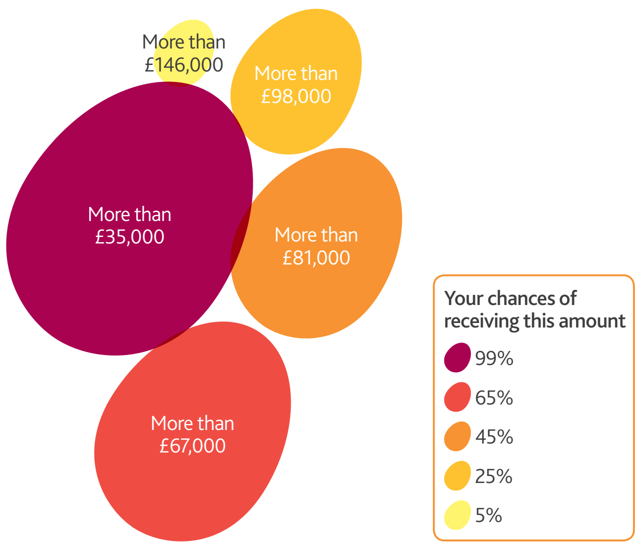


3. What you might get: value of retirement pot

This chart shows that someone earning £19,800 a year, saving for 30 years has a:

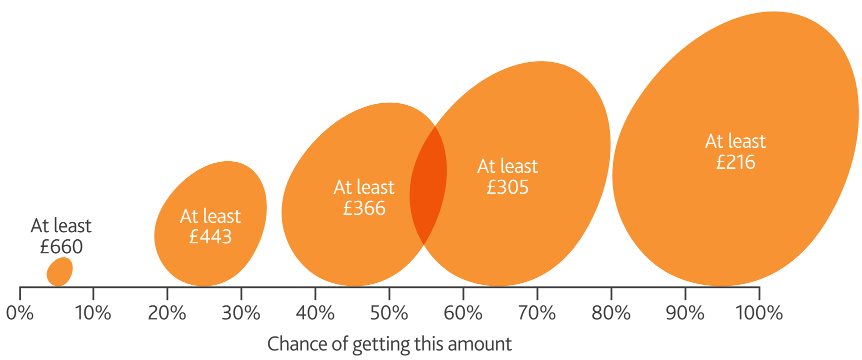
- 99 per cent chance of getting a retirement pot that's more than they contributed
- 45 per cent chance of getting a pot worth more than £81,000
- 5 per cent chance of getting a pot worth more than £146,000.



4. What you might get: monthly retirement income

This chart shows that someone earning £19,800 a year, saving for 30 years has a:

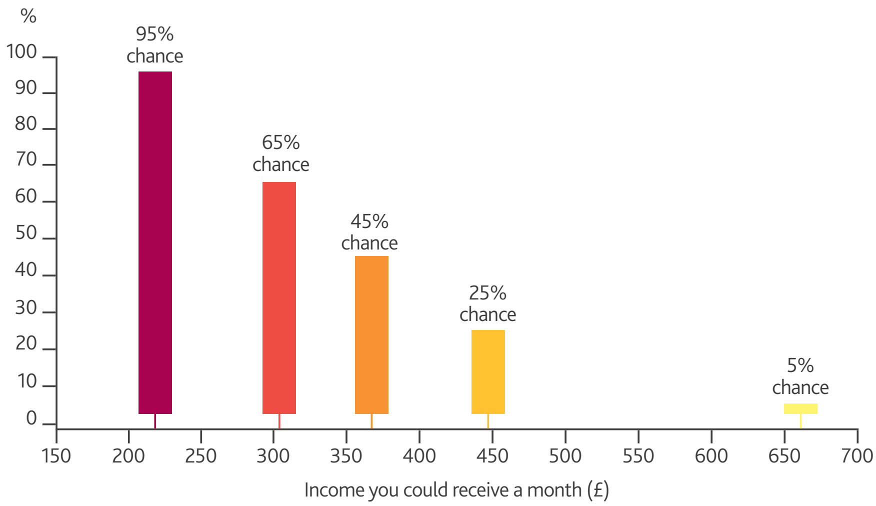
- 95 per cent chance of getting a monthly retirement income that's at least £216 a month
- 45 per cent chance of getting a monthly retirement income that's more than £366 a month
- 5 per cent chance of getting a monthly retirement income that's more than £660 a month.



5. What you might get: monthly retirement income

This chart shows that someone earning £19,800 a year, saving for 30 years has a:

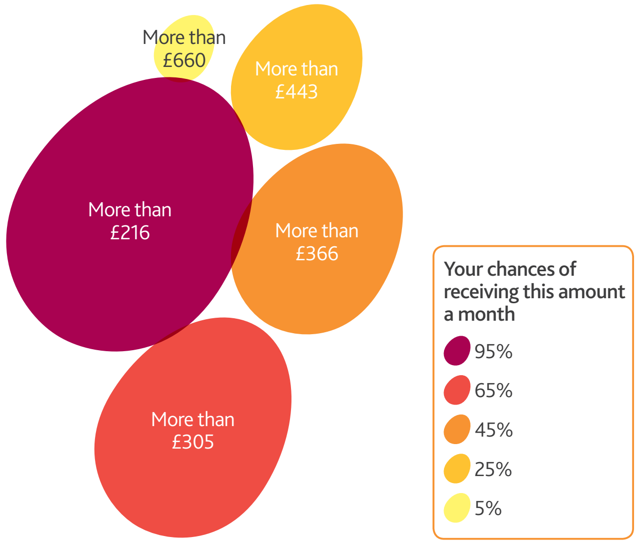
- 95 per cent chance of getting a monthly retirement income that's at least £216 a month
- 45 per cent chance of getting a monthly retirement income that's more than £366 a month
- 5 per cent chance of getting a monthly retirement income that's more than £660 a month.



6. What you might get: monthly retirement income

This chart shows that someone earning £19,800 a year, saving for 30 years has a:

- 95 per cent chance of getting a monthly retirement income that's at least £216 a month
- 45 per cent chance of getting a monthly retirement income that's more than £366 a month
- 5 per cent chance of getting a monthly retirement income that's more than £660 a month.



Almost all participants discussed light-heartedly that 'nothing in life is certain', with many citing the saying, 'in this world nothing can be said to be certain, except death and taxes'. Regardless of this, uncertainty - when it comes to money saved for the purpose of an income in retirement - is totally objectionable, and particularly so, it would seem, in the context of planning for retirement. Some participants pointed to other remote chances, including the likelihood of cleaning products to kill all germs. It would seem that while 99.9% chance of 'killing all known germs' is acceptable for a toilet detergent, the similar chance of getting back less than was contributed to a pension is not.

Arguably this is a problem with how people conceptualise certainty. The word 'guarantee' implies to members 'risk-free'. In contrast, the financial sector sees guarantees rather differently. Guarantees for those working in the financial sector reduce the risk of liabilities, they don't remove risk altogether. As such, while consumers are looking for a 100 per cent certain, risk-free scenario that means they can't lose the totality of contributions, financial experts would say that such a scenario is at best imprudent and at worst impossible. Even with underwriters and insurers, there's always a possibility, albeit remote, that safety measures might fail. For example, insurers do occasionally go bust.

> The majority assumed that the chance of getting back less than was put in was equivalent to the chance of losing everything.

Worst case scenario dominates

As mentioned in chapter 2, members respond emotionally to risk as entirely about the downside. Members' emotional response is evident again in their response to uncertainty, even when the feared scenario - losing money - is the least likely. We can see this in the language that they use to talk about uncertainty in pensions and in the way they apparently contradict themselves. For instance, many focus group participants were able to acknowledge and even understand why outcomes derived from investment performance can't be predicted exactly. But they still expected pension providers to be able to guarantee that people will at least make their money back or be able to tell them what they'd get at the end.

Perhaps the most significant emotional response is the tendency to focus on the worst case scenario - to 'catastrophise'. The majority of the respondents assumed that the chance of getting back less than was put in was equivalent to the chance of losing everything. In reality, it might mean getting back a number of pence less than was contributed and the chance of losing everything is to all extents and purposes nil. As outlined in chapter 1, when members think of uncertain outcomes they imagine poor outcomes first. Similarly, when members are confronted with the highly unlikely chance of getting back less than was put in, they imagine first the possibility of losing everything. Though this possibility is impossibly remote, the consequences are dire. As a result, for many people the chance of loss - particularly total loss - dominates and becomes all pervading, not because of its probability but because of its impact.

The relative importance of contribution protection

This section documents survey results gathered from a questionnaire we gave to focus group participants in the autumn of 2013. The survey was conducted to inform the following research questions:

- Are members able to weigh up pension products on key attributes?
- If members are forced to trade off these key attributes, which attributes are most important and which appear to be the least important?
- Are members prepared to pay higher charges for greater protection?
- What impact do members report that guarantees will have on their behaviour as a pension scheme member?

How we designed our survey

Identifying products to describe

We selected product choices to present to research participants on the basis of the following features:

- They're based on currently existing or realisable strategies within a defined contribution (DC) framework. However they have, to a degree, been idealised to address the second criterion.
- They're sufficiently different from each other. Those that were presented needed to be distinct to meet the objectives of the research. Products that weren't well differentiated would have made the task of trading-off even more difficult and perhaps even impossible.

The products we set out to research participants were as follows:

- **Product A - Typical DC**

  This is based on the familiar DC default model of a high equity proportion growth portfolio.

- **Product B - Balanced, risk-managed DC**

  This was based on the strategic asset allocation of the NEST growth default funds at the time the survey was undertaken.

- **Product C - Constant portfolio protection insurance (CPPI) - nominal guarantee**

  This used a form of *CPPI* based on known levels of future contributions to determine and execute an algorithm for rebalancing between risky and risk-free assets.

- **Product D - Cash**

  Based on historical performance of low risk money market instruments.

Presenting unbranded products

The products were presented unbranded and simply referred to as products A, B, C and D. This was to eliminate any bias that might have been introduced by brand resonance, and also because none of the products presented entirely resembled a branded product currently on the market.

Consistent contribution profile across all questions

Respondents were told at the beginning of the questionnaire, and reminded throughout, that *'All of the questions assume you have paid about £1,500 into a pension, every year for twenty years. In total the amount of money you have paid in is £30,000'*.

Striking a balance between level of detail and level of difficulty

We felt there was a limit to how many products it would be reasonable for research participants to weigh up at once. For this reason we presented only four products.

In addition, there are a number of other factors that ideally ought to be taken into account. For example, annuity rates and inflation can affect the final return offered by any individual. We made the choice not to include these and other factors in order to give participants the best chance at weighing up the products based on their core attributes. We didn't want to overcomplicate the exercise with details that weren't absolutely central to answering the research questions.

The attributes that matter

Based on previous research, we identified the attributes that are most valuable to members if they were in a position to choose a pension scheme for themselves. These were:

- cost
- protection
- outcome.

We acknowledge that this is a somewhat artificial exercise as members currently have no role in choosing a pension scheme and are reliant on the choices made by their employer. Employers are likely to have entirely different criteria. Indeed our research with employers, as outlined in *NEST insight 2013*, suggests that this is the case.

The attributes were presented as follows:

- Cost was shown as a value in pounds based on the reduction in yield intrinsic to the median final pot size. We only looked to compare the costs of offering different strategies, so other cost generators, such as profits and marketing, were not included.
- Protection was expressed as 'a chance in', for example one in 10 or one in 20, rather than as a percentage. In percentage terms the difference in level of protection between products can be less than 1 per cent, which would have appeared too marginal for many people to tell the difference. This approach, therefore, made it easier to set products apart.
- Outcome was based on a probabilistic spread. For each product respondents were shown the pot size at the 99th, 75th and 10th percentile probability.

Before any results had even come in, a key lesson of the research was how difficult it is to present pension products based on these attributes and in a way that consumers can easily digest.

Firstly, pension products simply aren't defined, by anyone, in this way. So consumers aren't able to compare and contrast one DC scheme over another in terms of the attributes they value because that information simply doesn't exist.

Secondly, technically it's extraordinarily difficult to equally compare products on the same attributes. Because of the different approaches that each scheme takes, attributes tend to be intrinsically linked with other aspects of the scheme structure. It's therefore impossible to compare one feature and hold all else equal.

Unlike mobile phone tariffs, computer specifications, loans or mortgages, pensions are not described in terms that allow consumers to distinguish between them. While this is in large part reflects that people don't actually choose workplace pension schemes for themselves, it's nevertheless a challenge from a member communications perspective. It makes brands and propositions hard to differentiate and potentially encourages the view that pensions and investment approaches are 'all the same'.

Trading off attributes

The questionnaire was designed to allow respondents time with the products and their attributes before we asked them to weigh up which they preferred. The questionnaire was presented in three sections.

The first section began by setting out the products' characteristics in an abstract way, using a star rating for each product's attributes, as set out in table 1. The aim was to mimic more familiar product differentiators, such as 'What Car?' ratings or film reviews.

In section two we asked respondents to look at each attribute on its own to allow them to understand the detail and have a chance to consider what they valued most about it.

Finally, in section three we presented respondents with the full product set again, this time with all of the attribute detail they had considered in isolation.

This last exercise is crucial for understanding what the respondents were prepared to trade off and, ultimately, which product they would, on balance, choose for themselves.

Section one of the questionnaire - pre-deliberation results

We asked respondents to rank the four products in order of preference based on how their attributes were described in table 1. While some products scored high on some attributes and low on others, the weightings were deliberately set so that all products were equal in terms of the total number of stars. The judgement as to which product's attributes achieved which ranking was taken by the NEST investment team. This was based on a 'financial expert' view that from a more rational economic standpoint, a typical DC scheme is more likely to offer a better final outcome than a cash-like fund, and that the outcomes achievable in a balanced DC and CPPI type product are broadly the same in aggregate. This ranking exercise was designed to elicit a snapshot of the attributes considered most important to respondents when information provided is deliberately high level and easy to weigh up. We wanted to understand at the emotional level which attribute was the most important.

Stimulus
Features review

Table 1 - Initial product stimulus

Pension product	What you could get at the end	Best protection of what you've paid in	Best price
A	★★★★	★	★★
B	★★	★★	★★★
C	★★	★★★★	★
D	★	★★★	★★★

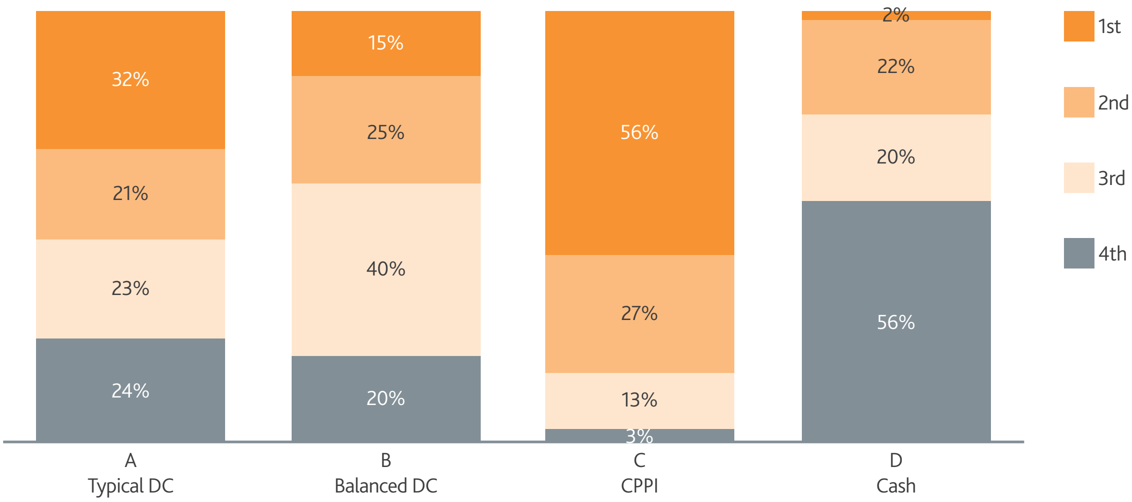
At this stage, participants ranked the products as follows:

- 1st - *CPPI* (Product C)
- 2nd - *Typical DC* (Product A)
- 3rd - *Balanced DC* (Product B)
- 4th - *Cash* (Product D)

The results suggest that most respondents tried to balance their appetite for the highest outcome with their desire for the best protection. The majority - 83 per cent - ranked the *CPPI* product in first or second place. *CPPI* offers the best protection and has the same star rating for outcome as *balanced DC*.

Typical DC came in second place overall, even though it offers the 'worst' level of protection. It seems then that without looking at the detail that sits behind the star rating, outcome is a significant driver of product choice. Although protection would appear to be the most important factor, fewer respondents were prepared to achieve best protection at the expense of best possible outcome. *Cash* was by far the least favoured with 56 per cent ranking it in fourth place and only 2 per cent ranking it in first place.

Figure 14: Pre-deliberation results



Section two of the questionnaire - the attributes in isolation

The second section of the questionnaire was largely intended to prepare respondents for the level of detail they would be asked to consider in aggregate at the end of the questionnaire. In effect the aim was to educate participants about what we meant by high level concepts such as 'best outcome'. Although not a direct intention of the design, the results to this section reveal that those completing the questionnaire were able to understand the information they were presented with. This is a key finding in terms of what kinds of information can be easily digested by the unpensioned. While respondents were able to understand the information, many of them did however find the exercise difficult.

The results from this second section also provide some insight as to what members may value most in pension attributes. Respondents were asked to rank the four pension products according to each individual attribute - cost, outcome and protection. This exercise may seem obvious for cost, and most respondents got this question 'right' in that the cheapest product came first when looked at in isolation. It was also a relatively simple task for the attribute of protection, with respondents placing the product offering the best protection in first place. However, ranking the attribute 'outcome' was not so straightforward.

For the outcome attribute, respondents were asked to make a value judgment about what constitutes 'good'. This could be seen as the product that offers the chance of the highest outcome - arguably a rational economic view - or it might be the product that offers the best protection of the downside.

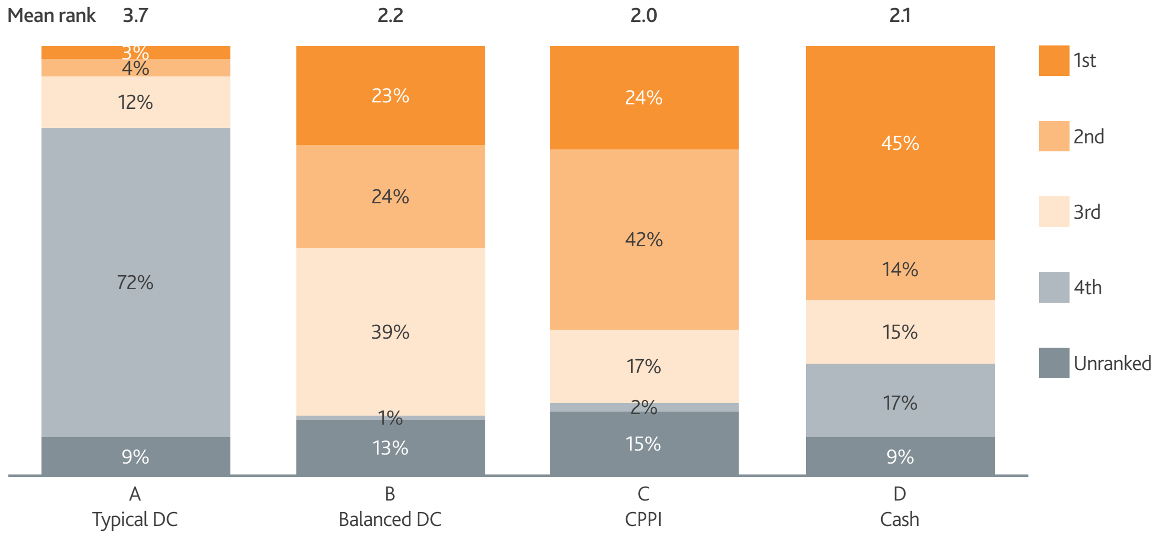
Figure 15 reveals that, in line with prospect theory, respondents were driven more by the desire to get back what they put in and build on this. As such, on the attribute of outcome alone, overall the respondents ranked the products as follows:

- 1st - *CPPI* (Product C)
- 2nd - *Cash* (Product D)
- 3rd - *Balanced DC* (Product B)
- 4th - *Typical DC* (Product A)

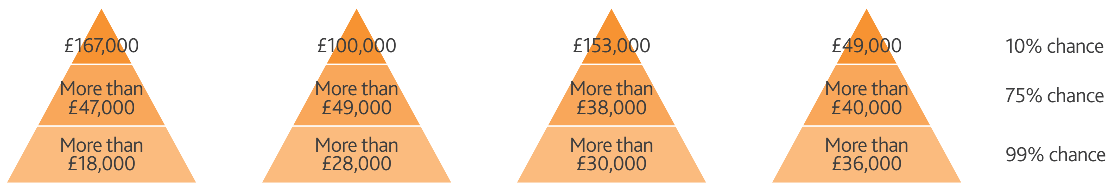
CPPI appears to 'offer it all'. It presented the chance of a high outcome - ranking second highest of all the products - while also offering a 99 per cent chance of making more than the £30,000 that was contributed. What is perhaps more interesting is that, based on mean rank, the *cash* product followed in very close second place, even though it offered the poorest outcome in terms of the possible gain on the contributions.

Despite offering the chance of the highest outcome compared to the other products, *typical DC* held the least appeal to the respondents, with 72 per cent ranking it in fourth place. This is completely at odds with how the NEST investment team had ranked this individual attribute. It was a surprising result and has significant implications for the traditional and common approach to DC investment design.

Figure 15: Order of preference based on outcome attribute only



What you could get out



Section three of the questionnaire - post-deliberation results

The final section of the questionnaire looked to understand how individuals would trade off the three different attributes once they were given more detail. Respondents were asked to weigh up the products once again, taking into account all of the attribute detail they had considered in isolation. In effect they were repeating the first exercise, but instead of looking at the product attributes in abstract, they were making a decision as an 'informed customer'.

Respondents were shown table 2 and asked to rank the products in order of preference once again and to give reasons for their choices.

Table 2 - Detailed product stimulus

Pension	Chance of getting back less than you paid in	What you could get out		How much does it cost
A Typical DC	1 in 20	£167,000 More than £47,000 More than £18,000	10% chance 75% chance 99% chance	£4,000
B Balanced DC	1 in 100	£100,000 More than £49,000 More than £28,000	10% chance 75% chance 99% chance	£3,000
C CPPI	1 in 1,000	£153,000 More than £38,000 More than £30,000	10% chance 75% chance 99% chance	£10,000
D Cash	1 in 500	£49,000 More than £40,000 More than £36,000	10% chance 75% chance 99% chance	£2,500

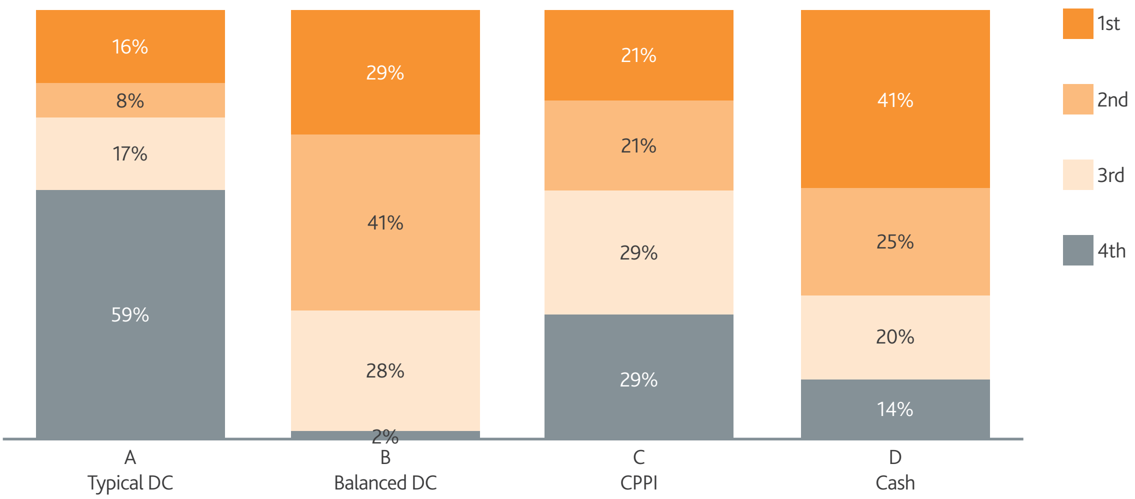
The overall ranking differed dramatically to that given at the beginning, when they considered the product attributes in abstract using the 'star rating'. Taking into account all of the attributes, post-deliberation the products ranked as follows:

Table 3 - Ranking of products pre- and post-deliberation

Ranking given pre-deliberation (beginning of questionnaire, based on star rating)	Mean rank	Ranking given post-deliberation (end of questionnaire, based on detail)	Mean rank
1st - CPPI (Product C)	1.6	1st - Balanced DC (Product B)	2.0
2nd - Typical DC (Product A)	2.4	2nd - Cash (Product D)	2.1
3rd - Balanced DC (Product B)	2.7	3rd - CPPI (Product C)	2.7
4th - Cash (Product D)	3.3	4th - Typical DC (Product A)	3.2

CPPI, which had ranked in first place at the abstract level in the first section of the questionnaire, now ranked in third place. *Cash*, which previously ranked in fourth place, jumped up to second place. Figure 16 below details the proportions ranking each product in first, second, third and fourth place.

Figure 16 - Post-deliberation results



The popularity of *cash* grew dramatically, with 41 per cent ranking it in first place compared with 2 per cent rating it first pre-deliberation. *Balanced DC* also gained more favour. Its appeal seemed to be broader with 70 per cent ranking it in their top two - 29 per cent placed it first, 41 per cent second. Although more people rank *cash* in first place, appeal is more polarised with 14 per cent ranking it in fourth place compared to 2 per cent ranking *balanced DC* in fourth place.

While *cash* and *balanced DC* both gained appeal, the attraction to *typical DC* fell dramatically following exposure to the detail. It ranked in second place pre-deliberation, but by the end of the questionnaire it was ranked in fourth place by nearly two-thirds of respondents.

Figure 17 below shows the top two and bottom two products pre- and post-deliberation. *Typical DC* dropped from second to fourth place, with 76 per cent ranking it in third or fourth place.

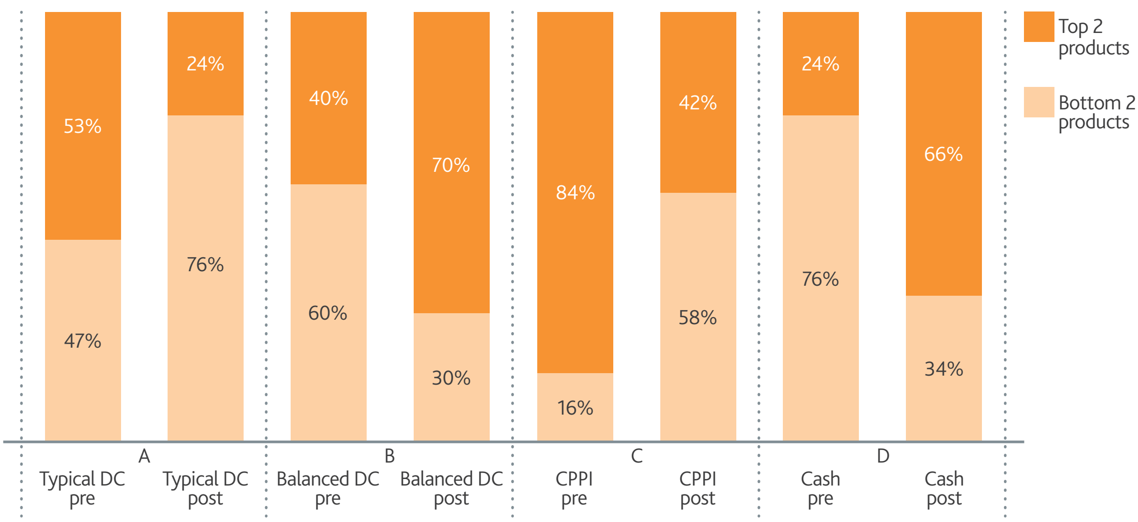
Understanding the post-deliberation results

So what might explain the dramatic change of heart? After respondents completed their questionnaire they briefly discussed their experience of completing the questionnaire and the choices they made.

Choosing *balanced DC*

Those who favoured the *balanced DC* product reported that this product offered the best mix of desirable attributes. While it wasn't able to satisfy the desire for best protection, it was cheaper than the product that did, so it was seen to offer comparably good protection at a relatively low cost. It also provided them with the chance of growing their money more than the lowest cost, better protection product. Respondents described this product as 'best value for money' and 'the best deal overall'.

Figure 17 - Summary results pre- and post-deliberation



Choosing *cash*

The large number favouring *cash* rationalised that they were seeking the best protection available at the lowest cost. This option, unlike the others, appeared to 'almost guarantee' that they would make more than their contributions - 99 per cent chance of making more than £36,000, compared with £30,000 with *CPPI*, £28,000 in *balanced DC* and £18,000 in *typical DC*. This group was more concerned with protecting their contributions and this was the product that best suggested 'low risk'. These respondents were more comfortable giving up significant amount of potential upside in order to gain more certainty at the lowest cost. Financial experts would see this as potentially the riskiest option for retirement savings because of its low return and strong likelihood of underperforming inflation. But for these research participants this is the most prudent option available in the choice set presented to them.

> *"I've chosen a relatively safe product."*

> *"I would be getting back at least what I put in."*

> *"Safe investment. Cheap cost, low risk and good return."*

> *"It will pay less than the others but with good protection and low cost."*

Choosing *CPPI*

Those who favoured the *CPPI* product were trying to give themselves the best protection without compromising on the chance of a return comparable with the *typical DC* product. They were prepared to pay the higher charge to achieve this, but weren't necessarily happy about doing so.

> *"I've chosen a plan where, even though I'm paying more for protection, I have an element of guarantee."*

> *"It's the safe option with an outside chance of good return."*

> *"I'm virtually guaranteed to get back what I paid in."*

For a CPPI type product to be reasonably effective, however, it's critical that contributions are fairly consistent and known in advance. Those who ranked *CPPI* in first place were asked whether an obligation to contribute consistently without any breaks would affect their choice.

Once that condition was explained as a critical feature of a CPPI type product, 30 per cent said they would no longer rank this product in first place. Concerns around employment uncertainty were often cited in their reasoning. However, surprisingly 60 per cent said they would still not change their product choice in that situation. Some of these respondents attributed their decision to having security in employment and their time of life, but for the majority the desire for a guarantee was the overriding factor.

Choosing *typical DC*

Of the 16 per cent who ranked *typical DC* in first place, a few had misunderstood the detail provided for the ‘level of protection’ attribute. It seems that some had interpreted ‘1 in 20’ as the best protection of their contributions rather than the worst. This level of misunderstanding is consistent with the number who apparently misunderstood the detail provided for this attribute in section two of the questionnaire, where respondents were asked to look at this attribute in isolation. For this reason, the 16 per cent who placed *typical DC* in first place would appear to be an unreliable result, and we can assume that the true result would likely be lower.

Others had chosen this product because it offered them the chance of the highest possible return - with a 10 per cent chance of providing more than £167,000 - in comparison to the other products. For this minority, this product wasn’t ‘a bad bet’ based on the probability of outcomes presented.

Summary of results

As is often the case with this kind of research, this survey can’t provide all the answers. However, the survey does provide a number of key insights which would seem to be consistent with other research and theory in this area.

Emotionally driven decision making

Based on the choice set presented, many respondents favoured the *cash* product which, from a rational economic perspective, is highly unlikely to be in their best interests. While this is the case, the survey results suggest that the majority of members who didn’t choose the *cash* option appear to balance their desire to protect themselves from downside risk with the need to build a retirement income that far exceeds what they contributed.

Members can weigh up pension products on key attributes

The lay consumer is able to size up products on key attributes of cost, outcome and protection. It’s clear, however, that many found the task of completing the questionnaire difficult. Simplifying retirement product descriptions does not necessarily increase the chance of members making informed product choices.

It’s clear from the change in results between the pre- and post-deliberation trade-off question that members would make different choices when they have more information. However, there’s likely to be a limit to what members can digest. Other NEST research suggests that individuals can take in information and become much more informed, but their memory of this information tends to be short-term. This is because engagement with pensions tends to be sporadic. Feedback about the questionnaire suggests that the type of information presented was reaching the limit for most, and was too much for a minority who fundamentally misunderstood some of the detail.

Members overall are more concerned with protecting against downside risk than they are with highest possible outcome

Consistent with theory on loss aversion and certainty bias, it seems that members are generally more concerned with protecting themselves against downside risk, even if this means giving up substantial possible upside.

To reduce downside risk members would rather accept a lower potential outcome than pay a higher charge for a 'guarantee'

Post-deliberation, the products that offered the highest possible outcomes were the least favoured. Choosing *balanced DC* or *cash* would appear to allow respondents to protect themselves from the highest chance of contribution loss without paying a comparatively higher cost. The cheapest protection means giving up the most upside and 41 per cent ranked this in first place.

Appetite for contribution protection at any cost is limited

Only 6 respondents ranked the *CPPI* product in first place after taking into account a requirement to contribute without breaks. Despite a strong desire for the best possible protection of their contributions, it seems clear that few people are prepared to pay high fees for it. With only one star out of a possible four, this product was presented in the first question as the most expensive, but was still the most favoured product in the abstract overall. However, when this cost was expressed as a figure, this product fell drastically out of favour.

While providing evidence to help answer the question 'Is there appetite for guarantees at any cost?', the research revealed further unexpected insights about members' willingness to pay for certainty. As outlined above, many think that contributions are already protected, or if they are aware that this isn't the case, they believe they ought to be. This helps to explain why those who are prepared to pay a comparably higher charge for greater certainty are very much the minority. Furthermore, those willing to pay are not happy about having to do so.

Those who are prepared to pay a comparably higher charge for greater certainty are very much the minority … and are not happy about having to do so.

Conclusions

Our research suggests that the key missing piece of the jigsaw isn't acquiring technical knowledge about how pensions work. Most providers already have key information within their member material for this, such as: 'What is a pension?', 'What is investment?', 'What happens if I die before retirement?' Instead, what's lacking is information that would allow consumers to weigh up pensions on the attributes that are important to them.

Perhaps one of the most telling findings of all is that the participants, when asked to list pension product features, struggled to think of any. As consumers, they could list attributes for almost anything. But when it comes to a product as important as a pension, they struggled to come up with any features at all.

And despite the fact that people will become members of several pension schemes in their working lifetime, the product landscape is entirely undifferentiated to them. They don't know the difference between one scheme and another and it isn't easy for them to find out. More importantly, consumers don't always understand that providers may treat the task of growing their money differently, and that there are different views about what the right approach is.

This research is not alone in suggesting that people make emotionally-based decisions. Even though this is the case, it's possible for consumers to weigh up pension products if given the right information. However, many find it difficult - even at a level of abstraction - with half of our participants saying that they would rather someone else took the decision on their behalf.

Members want the face of their pension provider to be radically different to their current perception of the industry. Their pension provider should have their best interests at heart and nothing else. As a trust-based scheme NEST has a legal duty to act in members' interests and has conducted research in order to develop a scheme around those interests. For NEST, best interests must be informed by members' characteristics, needs, attitudes and behaviour. Often our research into these areas has raised more challenges than final conclusions. It has given us an evidence base that doesn't point to a straightforward answer but instead gives us what we need to make an evidence-based judgement.

Making this judgement necessarily involves dealing with the tension between rational economic thinking and giving people what they want. Acting in people's best interests isn't a license to ignore what they are telling us they want, but it does mean sometimes making choices that members may not have chosen for themselves. According to the results of the survey on appetites for greater certainty, many of our members would choose a cash-based product or something that is effectively a savings account for their retirement. We're unlikely to share their view that this is the best way to build a retirement income.

We embarked on the survey expecting more people to favour the cash and CPPI based products. These products more obviously address the aversion to loss that we know is a key concern for members. However, overall many research participants favoured a balanced risk approach that resembles our current product. This suggests two things.

Firstly, in a choice set that means giving up substantial upside, high charges or poor protection of the downside, overall members will make a choice that balances the 'rational' thinking with their desire for certainty.

Secondly, in the absence of a product that offers greater protection at the same or lower cost, NEST's current approach is closest in a pure DC pensions world to what members would choose for themselves.

Despite a certain degree of validation for our approach to date - which has been based on significant research into members' needs and expectations - we know that fundamentally members wouldn't be evangelical supporters of any product unless it can give them what they really want - a good outcome with guaranteed protection at a low cost. This presents DC pension providers, including NEST, with an enormous challenge. At times pure DC schemes will be occupying the difficult position of disagreeing with some of their members about their best interests.

Current debates have talked about 'consumer need' for guarantees. Our evidence indicates that guarantees will not in themselves be a solution for the lost confidence in the pensions sector. Consumer need can't be just about giving people what they say they want on the back of fear, misconceptions and emotional bias. However, nor can these views or feelings be safely ignored.

Indeed there is no single solution - improving the situation is about changing several things together. A key element of this will be about bringing the pensions consumer into the discourse that has excluded them for years. It will be about trying to relate to their concerns and describe products in terms that are meaningful and matter to them. It is likely to also involve looking for innovative ways of product design to try and provide greater certainty, but without high charges, and without giving up the need for inflation-beating growth.

Annex A: NEST research

This report draws on a number of qualitative and quantitative research projects focusing on consumers with similar demographic characteristics to the unpensioned. These include:

- *Retirement projections research*, 2013

  Qualitative research that explored individuals' perceptions of pension outcomes and what they needed from communications about outcomes. We tested a number of different design concepts for probabilistic projections using in-depth interviews and group discussions with 105 individuals.

- *Communicating investment research*, 2012

  Qualitative research that looked at how to talk to potential members about investment and in particular about NEST's investment proposition. This project involved a combination of in-depth interviews and workshops with 175 people.

- *Attitudes toward trade-offs between retirement outcomes, certainty and cost,* 2013

  Focus group research that examined whether consumers can weigh up pension products on key attributes, what they're willing to trade off and their appetite for guarantees. A total of 105 participants were asked to complete a questionnaire to rate pension products following different levels of exposure to information.

- *Behaviour of existing savers in times of economic stress*, 2010

  Quantitative analysis of 25,000 members from a variety of defined contribution pension schemes in the UK. We observed their contributions and switching activity between December 2007 and September 2009 to identify any trends in the period immediately before and after the onset of the financial downturn.

- *Understanding Reactions to Volatility and Loss*, 2010

  Qualitative research into the attitudes of consumers in response to the value of their pension fund falling from time to time. Groups met between November 2009 and February 2010 in seven locations in England, Scotland and Wales. A total of 102 people took part.

Our published research reports are available at **nestpensions.org.uk/library**

Annex B: references and sources

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