Understanding our members' investment needs

Research to inform Nest's investment strategy

December 2021

nestpensions.org.uk

Contents

Executive summary

This report summarises how a range of evidence about our members and their investment needs influences the evolution of Nest's investment strategy.

It demonstrates Nest's commitment to invest our members' assets based on extensive and continuing research into members' characteristics, circumstances and attitudes as set out in our 'Statement of investment principles' (SIP). As such, the report is a core part of how we demonstrate and discharge our fiduciary duty to act in our members' best interests.

We consider research on member needs to be an ongoing process, and the conclusions presented in this report reflect this. Many describe how member evidence has shaped our funds and investment strategy to date. Many others point to how we might develop our approach in the future to match the changing needs of our membership.

Our key conclusions:

Members' characteristics

- Although our current membership is skewed towards younger workers, our modelling suggests that over the next two decades this will change, as the first large generation of workers enrolled in Nest ages. We'll need to focus increasingly on developing investment solutions like the Nest Guided Retirement Fund for our members approaching and living in retirement.[1]
- Our members have lower earnings, less earnings growth and higher job turnover than the average UK employee with a workplace pension. Many may have short or intermittent periods of contributing to their Nest pot and lower contribution levels. It's especially important that we aim to deliver consistent investment returns through a diversified investment strategy.
- For younger members, who have a longer time frame for realising investment returns, illiquidity should be embraced.
- While some of our members may be able to draw upon joint household income and cost savings in retirement, it's difficult to predict which members will reach retirement or spend retirement on their own. Our investment strategy should assume that our members only have their own savings and income at their disposal.

Members' capacity for investment risk

- The majority of our members will not have a defined benefit (DB) pension to supplement their State Pension income. Over time, converting their defined contribution (DC) pot with Nest into a post-retirement income that can last will become increasingly important.
- Based on member surveys, we believe more than half (55%) of our members have pots with other pension providers, but we can't confirm this. Even if our members do have other pots, we don't know how much savings they've accumulated in those pots or how the pots are invested. We therefore should invest their Nest pot as if it were their only pot.
- Debt levels in the UK have been rising consistently since the mid-1990s and an increasing proportion of people are carrying debt into retirement. Many of our members have little financial buffer against adverse events, with a greater proportion classified as 'struggling' (34%) or 'squeezed' (37%) financially compared with the adult population as a whole. We need to consider the likelihood that our members will have higher debt levels across their lifespan and consider this when determining appropriate targets for risk-adjusted returns in our default investment strategy, the Nest Retirement Date Fund series.[2]

1 More information about the Nest Guided Retirement Fund is available on our website at **nestpensions.org.uk/schemeweb/nest/aboutnest/investment-approach/other-fund-choices/nest-guided-retirement-fund.html**

2 More information about the Nest Retirement Date Fund series is available on our website at **nestpensions.org.uk/schemeweb/nest/aboutnest/investment-approach/nest-retirement-date-funds.html**

- Over the next decade, an increasing proportion of people in the UK are likely to reach retirement while living in rented accommodation, which tends to be more expensive than owning a home. Our members' housing tenure appears to mirror this wider trend. This may put more demand on the post-retirement income they receive from their Nest pot.

Members' preferences for investment risk

- Most of our members are very uncomfortable with volatility in their investment returns. This is in line with a lower capacity for investment risk. Our default investment strategy should target steady growth rather than outsized gains with high risk. We should maintain a diversified portfolio to reduce the impact of market volatility.
- If we're to act in our members' best interests, we will from time to time have to go against what our members say they want in surveys and other research. For example, while members don't seem to be overly concerned with inflation risk, we should protect their purchasing power in retirement.
- Risk aversion comes in different flavours depending on a person's life stage and financial resources. It's appropriate to design our default investment strategy to take different levels of risk at different phases in a member's saving journey.

Changing needs in later life

- While many of our members may retire later in life, we need to be aware that some will retire earlier than expected, and some of those retirements will be involuntary, due to ill health or other demands. Our investment approach should not assume that contributions to members' pots will rise all the way to their expected retirement age, even if they're saving persistently with us.
- The general trend is that people in the UK are increasingly retiring later and working beyond their State Pension age, with many transitioning gradually from full-time work to full retirement. Given the changing nature of retirement evident in economic data, we should continually reassess when we start to de-risk the retirement target-date funds in our default strategy, and the investment portfolios to which we move members' pots when they reach their State Pension age.
- Pot size at retirement is a means to delivering income replacement and not itself the ultimate objective. Even small pots can help our members to replace wages once they're in retirement. Our research has shown that our members still want to convert pot sizes of less than £10,000 into sustainable income. However, we should look to address the inevitability that many small pots are likely to go unclaimed at the member's retirement age. In addition to continuing to support work on the pensions dashboard being developed by the Money and Pensions Advice Service (MaPS)[3] and others, we should design our investment strategy to help protect the value of unclaimed pots for those members who eventually trace them.
- We anticipate that, for some of our members, their Nest pot will become their primary vehicle for pension saving. We should consider a range of post-retirement investment pathways to cater to members who are highly dependent on their savings with us versus those for whom their Nest pot represents one portion of their saving. Providing a solution which can support members in moving unspent pension savings into a growth-orientated vehicle might be attractive to some of our members.
- Understanding patterns in life expectancy and healthy life expectancy across our membership will help us to evolve retirement investment pathways for our members. As an increasing number of our members reach their retirement age in the future, we'll use observations of life expectancy across our membership to develop ways to better manage mortality risk for them.

3 Through MoneyHelper, MaPS provides impartial guidance about money and pensions that is free to use and backed up by the government. MoneyHelper can assist Nest members and members' beneficiaries if they experience problems related to Nest or any other pension scheme. Visit **moneyhelper.org.uk**

Our members' retirement expectations

- There is a significant communication challenge to make members aware of the realities of the income in retirement they might expect. This is compounded by their limited knowledge of how taking too much income too early in retirement can increase their 'risk of ruin', that is, their risk of running out of retirement savings during their lifetime. Such calculations are complicated by people's tendency to miscalculate their own tolerances for investment and income risk. We should explore how to reduce our members' risk of ruin, as well as their risk of not spending their savings, through the design of our investment approach and retirement pathways.
- We conducted stated-preference experiments with our members before launching our retirement solution, the Nest Guided Retirement Fund, in 2020. These experiments helped us to design the fund's guided investment pathways and understand our members' tolerance for some income uncertainty. It will be important for us to continue to evolve the Nest Guided Retirement Fund in light of future evidence as increasing numbers of members are automatically moved into it when their target-date fund closes.

Our other fund options for members

- About 99% of our members remain in our default investment strategy, the Nest Retirement Date Fund series, and the vast majority of them stay in the target-date fund in which they were automatically enrolled. We should continue to focus on building a diversified portfolio for our default strategy since this will serve most of our members over the long term.
- Our members currently seem broadly content with the range of other fund choices we make available to them.[4] This may change as pension saving and investing becomes increasingly normalised over time.
- In our surveys, only 14% of members in the Nest Higher Risk Fund feel the risk in the portfolio is too low. This suggests that careful consideration should be given before changing the risk profile of this fund.
- We should continue to regularly check that the Nest Ethical Fund's investment criteria align well with its members' stated priorities for excluding and including certain sectors or business practices.

The importance of responsible investing to our members

- Our member surveys strongly indicate that many of our members are encouraged by our responsible investing approach. It lines up with their expectations for a pension provider and gives them more reason to trust that Nest is investing in their best interests.
- Where possible we should also seek to engage our members in more of a dialogue on how we may want to prioritise particular stewardship activities, such as engagement with companies and voting on shares.

[4] More information about our other fund choices is available in Chapter 7 and on our website at **nestpensions.org.uk/schemeweb/nest/aboutnest/investment-approach/other-fund-choices.html**

Chapter 1

Introduction

As a trust-based pension scheme, Nest invests in the best interests of our members.

To be able to do this, Nest Corporation, as Trustee of the Nest scheme, needs to have a thorough understanding of the profile of our membership and our members' likely expectations and aspirations for long-term saving and retirement.

A member evidence–based investment approach

Research into the diverse characteristics and circumstances of our membership is always the starting point for our investment decisions, from before we enrolled our first member to today, when we have over 10 million people saving with us, and going forward.

We've conducted and consulted a range of research in shaping both our default investment strategy, the Nest Retirement Date Fund series, and the other fund choices available to our members.

We set out our evidence-based approach to investing members' assets in the governance section of our 'Statement of investment principles' (SIP).[5]

Governance of the Nest Trustee

Nest's assets, representing the balances on members' pension accounts, will be invested in the best interests of Nest's members and beneficiaries both for the default strategy and for any other investment choices members may make. In the event of a potential conflict of interest the assets will be invested in the sole interest of members and beneficiaries.

The Trustee's policy for securing that assets are invested in members' best interests is determined following extensive and continuing research into scheme member characteristics, circumstances and attitudes. This research is a mixture of quantitative data on socio-economic characteristics of the scheme's membership, qualitative research into members' attitudes and aspirations for their retirement savings, and, increasingly, management information about our members' savings patterns and behaviour.

Where significant changes to the scheme membership are detected the Trustee reviews the appropriateness of the default strategy and additional investment fund choices accordingly. Details of our member **investment research** can be found on our website.

The research referenced in our SIP is part of an ongoing process, not least because the profile and priorities of our membership, as well as the legislative, economic and market conditions within which our investment strategy operates, change over time. In the 10 years since our first member contributed to a Nest pension pot, our membership has grown to over 10 million.

[5] Our SIP as at December 2021, from which we're quoting, is available on our website at **nestpensions.org.uk/schemeweb/dam/nestlibrary/SIP-Mar20-Mar23.pdf**
The latest version of our SIP can be found at **nestpensions.org.uk/schemeweb/nest/aboutnest/investment-approach/statement-of-investment-principles.html**

As at 30 September 2021, the assets we're investing on behalf of our members totalled over £20 billion. We've used member research to make a variety of changes to our investment strategy over the past decade – from evolving our fund choices for members to providing them with new investment pathways beyond their expected retirement date.

This report brings together and summarises a wealth of research that has implications for how we invest for our members. By publishing it we hope to provide insight into how Nest makes decisions about investing for a large and diverse membership – many of whom are relying on Nest to make good investment decisions on their behalf – as well as for those members who want support in making investment decisions for themselves.

From theory to practice

Our understanding of Nest members and the employers registered with Nest has evolved over the years.

We started from a position of theory, relying upon external data and research and surveys conducted prior to the launch of auto enrolment in 2012.

Prior to the launch of auto enrolment, we published our first member research brief.[6] This sat alongside our first SIP. The research brief provided a comprehensive and public evidence base describing who Nest's future members were likely to be, how much they were likely to be earning, where they were likely to be working, their experiences with various financial products and their attitudes towards investing, long-term saving and pensions.

Working in the absence of actual members, assumptions were made as to who our members were likely to be. A term often used, at the time, to describe the group from which Nest members were likely to be drawn was the 'target group'. These were individuals who were eligible for auto enrolment based on the age and earnings thresholds set out in the legislation. They were employed predominantly in the private sector. Many were not currently contributing to a qualifying pension scheme. To centre our analysis on those individuals whom the auto enrolment policy was primarily set up to serve, we focused on a 'target market' of low and moderate earners whose earnings were £35,000 or less per year.

Once workers began to be enrolled in Nest, we gained access to transactional records reflecting actual saving behaviour and attitudes. We also began to design bespoke surveys of our members and employers through our in-house research programme. Today, Nest's membership stands at more than 10 million savers, with over 800,000 employers registered with us.

We now have a huge wealth of actual data on our members. After 10 years of investing, it's worth comparing this with our original member research brief to see how our membership has developed over time.

6 Nest Corporation, 'Member research brief: Research to support the investment strategy' (2012), **nestpensions.org.uk/schemeweb/dam/nestlibrary/member-research-brief.pdf**

Our evidence base

In our investment research to understand our members, we combine analysis of Nest scheme data with results from member surveys.

This allows us to consider a range of information about our members beyond their Nest pension pot, from the assets they might hold in other pensions and non-pension wealth, to their attitudes towards responsible investment. It also helps us to see how members' actual behaviour may differ from their intentions.

The 'Retirement saving in the UK' series of reports[7], and their precursors 'How the UK saves', both published by our in-house research unit, Nest Insight, have served as a foundation for our understanding of our members. These reports provide significantly more detail on member characteristics, including discussion of such factors as sector of working, level of educational attainment, gender and ethnicity. In this report we summarise those points most pertinent to our current and future strategic investment decision-making.

To gain the richest possible picture of our members' experience of and expectations for their pension saving, we supplement analysis of our own scheme and survey data with analysis of external data. Much of this external data comes from official data sources such as the Office for National Statistics (ONS). Public data has either been accessed and analysed directly by Nest or Nest Insight analysts, or bespoke data has been provided to Nest for analysis.

Wherever possible the most up-to-date data has been cited in this report. However, in some cases, new data may have become available soon before or soon after this report's publication. For example, with respect to ONS's Wealth and Assets Survey, we've used the latest round of data (round 6) released at the time of writing this report. That data covers the period April 2016 to March 2018 and was released in December 2019. Data for round 7, covering April 2018 to March 2020, is expected to become available in November 2021. Based on the trend in data over the past decade, and the fact that this data round only covers the first three weeks of the global coronavirus pandemic, we do not anticipate that analysis of round 7 will materially change the conclusions we make in this report.

[7] This series is available on the Nest Insight website at **nestinsight.org.uk/research-projects/retirement-saving-in-the-uk**

Purpose and structure of the report

The purpose of this report is to provide a summary of our ongoing member research looking at a variety of socio-economic and attitudinal member evidence which we're using to inform decision-making about our investment strategy and member investment outcomes. This decision-making encompasses topics such as:

- investment return objectives
- investment risk tolerances, including the types of investment risk taken on our members' behalf
- how we should change return objectives and risk tolerances at different stages of our members' working lives
- members' expectations around what happens to their savings and investments as they approach and enter retirement
- investment fund choices available to members beyond our default investment strategy
- members' interest and involvement in how their money is invested

Over 99% of our members are in our default investment strategy, the Nest Retirement Date Funds, a series of target-date funds which are life-styled based on each year in which our members aged 22 to 65 might retire. For this reason, much of the evidence in this report considers what conclusions we should draw about the design of that default strategy.

In Chapter 2, we review the characteristics of members in our default target-date funds, focusing on the age profile, earnings potential and career patterns of our members as compared with the broader population of UK workers eligible for auto enrolment. As expected, our membership has been skewed towards younger workers during our first 10 years, but we anticipate that our membership age distribution will even out by 2050. This shapes how we develop investment approaches for people nearing and in retirement.

In Chapter 3, we explore our members' capacity for risk, considering the other assets they may hold as well as their debt levels. Of special note are UK-wide trends which suggest that younger workers will be less likely to own their home at retirement.

In Chapter 4, we look at what our members tell us about their risk preferences, and how they behave when faced with risk in the form of market volatility. We've presented members with choices in surveys which suggest they prefer certainty over risk, but we've seen that they rarely change their investment fund choice in response to market volatility. This has informed our decision-making around extending the diversity of our investment portfolio.

In Chapter 5, we turn to the question of how retirement, and people's financial needs in retirement, are changing as people live longer. We also consider how ill health may influence retirement age and income needs. While many people are continuing in work longer and retiring later, some are using the 'freedom and choice in pensions' reforms to access their pension savings early. Understanding our members' changing needs in later life will be key in developing an appropriate range of retirement pathways in the future.

In Chapter 6, we review what our members tell us about their retirement planning, including what sort of income they're expecting to get from their pension savings. We describe the research we commissioned while we were designing and refining the Nest Guided Retirement Fund.

In Chapter 7, we look at our other fund choices for members and explore the characteristics and attitudes of those members who make more active decisions about how their savings are invested. While the proportion of our membership making active fund switches is very small, we anticipate that this may increase as pension saving becomes more normalised.

Finally, in Chapter 8, we discuss our approach to responsible investment and our members' attitudes towards it. We are responsible investors of our members' money because we believe this is in their best interests financially, but we also see that this approach may help to get our members more engaged with their pension.

Appendix A describes the main data sources we've used as evidence. Appendix B provides technical notes regarding the methodology for the survey we conducted when designing the Nest Guided Retirement Fund.

Compared with our first member brief, this report is more focused on our members' retirement needs and expectations. This reflects the considerable changes in pensions regulations over the past 10 years as well as the demographics of our membership. Going forward, we expect that our members' attitudes and behaviour will continue to change, particularly as an increasing proportion near retirement as compared with the relatively young membership which marked our first decade. As Nest matures, our aim is to share summaries of our investment research on a regular basis.

Because our members are likely saving with other pension providers in addition to Nest, and because they're representative of the overall population eligible for auto enrolment, we believe being transparent about the rationale for our investment approach and decision-making is important.

Chapter 2

Our membership demographics

How persistently people contribute to a pension pot, how much they can contribute and for how long they save, are key drivers of financial outcomes at retirement.

Age profile

Nest's membership, like the hypothesised target group we identified before the launch of auto enrolment, has a higher proportion of younger workers. As at 31 March 2021, 28% of our members were 30 or younger.

These younger workers are more likely to be in less settled employment and have had far less chance of being members of a traditional pension scheme prior to the introduction of auto enrolment. So we believe this cohort is quite likely to be almost entirely reliant on the assets they've accumulated through auto enrolment schemes when they reach retirement.

Over time Nest's membership profile will skew older. New members being enrolled because they've reached the age or earnings eligibility threshold for the first time will be much less numerous than the existing membership enrolled between the start of auto enrolment in 2012 and the time of this paper's publication in 2021. As a result, younger workers will become a less dominant group in the overall demographic profile of Nest's membership.

Figure 1, Figure 2 and Figure 3 show how we predict Nest's membership will evolve over the next few decades.

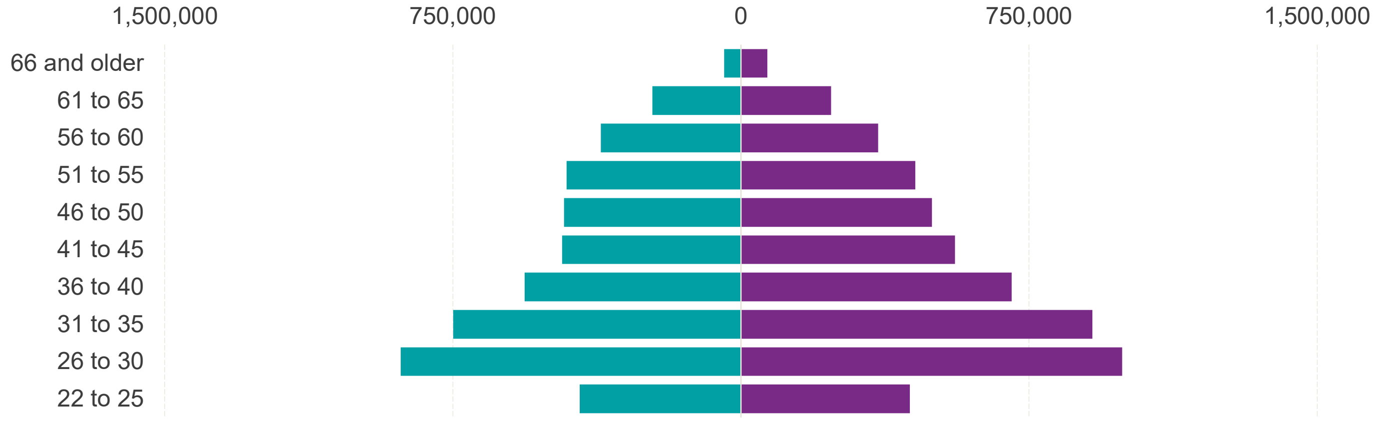
28%

of Nest members were 30 or younger

(as at 31 March 2021)

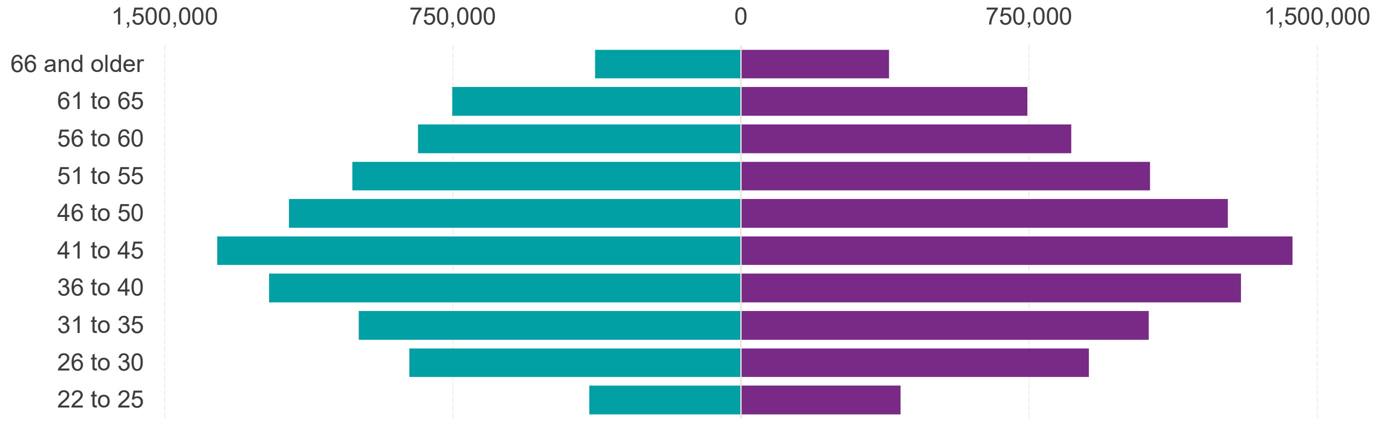
Women Men

Figure 1. Age and gender distribution of Nest membership as at 31 March 2021



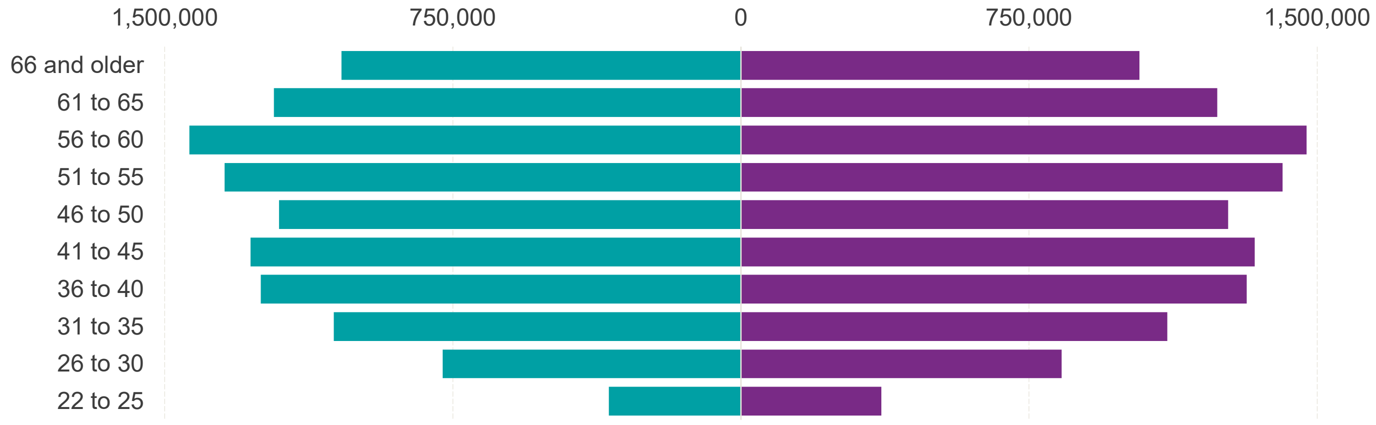
Source: Nest Corporation, scheme data, 2021

Figure 2. Nest membership, projected 2034/35



Source: Nest Corporation, simulation modelling, 2021

Figure 3. Nest membership, projected 2049/50



Source: Nest Corporation, simulation modelling, 2021

Age profile: What does this mean for our investment approach?

- The Nest scheme currently has a large cohort of young members who may be contributing to their Nest pension pot for decades. This would suggest that liquidity considerations – that is, the need to realise member investments in the short term – are much lower than if the scheme had an older membership. We should feel confident in exposing large parts of our membership to illiquidity risk in order to seek higher investment returns over time for them.
- While there's a definite skew towards younger age groups in our membership, we do have significant numbers of members who are already approaching retirement. As shown in Figure 2 and Figure 3, these groups will be growing, both in volume and as a proportion of our membership, over the next 25 to 40 years. Having suitable investment solutions for our members up to and in retirement will become increasingly crucial over time.
- Our investment approach should recognise the changes in people's investment return objectives and risk tolerances in different phases of life. Having the flexibility to implement different investment return objectives and risk tolerances based on members' ages will continue to be an important feature of our investment approach. Having 50 retirement target-date funds provides an efficient way to deliver on different risk and return objectives while members are saving towards a retirement income. Different approaches are more suitable for members taking life-long income.
- As the scheme matures, our membership's age distribution 'bulge', representing the large cohort of younger workers who were first enrolled when auto enrolment was introduced, will move through our membership profile. This means that in future years we'll likely have an over-representation of people approaching retirement. We should continue to regularly review our membership's age demographics to ensure that our investment approach reflects such potentially significant shifts.
- We recognise that many of our younger members today will be nearing or in retirement by 2050. This has been an important consideration in developing our climate change policy to halve our carbon emissions by 2030 and be a net-zero investor by 2050 or earlier.

Earnings

One of the main goals of the government's workplace pension reforms was to ensure and increase access to quality pension saving among low and moderate earners. It was understood that the target group for auto enrolment would have lower earnings on average than those already saving in traditional pension schemes. In 2011 it was estimated that mean (average) earnings for those already saving in a pension were around £31,000 per year, which at the time was roughly equivalent to being in the top 25% of the earnings distribution for all workers in the UK.

When considering Nest members' earnings, we look at median (middle of the distribution) rather than mean figures, since this helps us to focus on the significant number of scheme members who are at the lower end of the earnings distribution. To see how our members compare to the wider UK labour market, we've analysed Nest scheme data against a population drawn from the Office for National Statistics' (ONS) Annual Survey of Hours and Earnings (ASHE), specifically those workers who were members of a workplace pension scheme. We refer to this population from ASHE as 'UK eligible employees', although it should be noted that membership of a pension scheme does not necessarily mean the worker is eligible for auto enrolment.[8]

8 See Nest Insight, 'Retirement saving in the UK 2021: Member experience from Nest, the National Employment Savings Trust' (September 2021), **nestinsight.org.uk/wp-content/uploads/2021/09/Retirement-saving-in-the-UK-2021.pdf**

As at 31 March 2021 the median annual earnings for all Nest members was around £19,300. Among active Nest members – that is, those members who were currently employed by an employer using Nest – the figure was slightly higher, at £19,600. This is around 31% less than median earnings for all UK employees who are saving into a workplace pension (£28,200).

Nest members differ from the larger population of all UK eligible employees in other ways. Most interestingly, there is relatively little variation in earnings by age for our members. In contrast, median earnings for UK eligible employees rise consistently until they reach their early 40s, and then decline.

Among our members, median earnings are lower than those of UK eligible employees at the same respective points along the overall earnings distribution, and the gap widens through the distribution. As we can see in Figure 4, our members in the bottom 10% of earners are paid, on average, around 15% less than UK eligible employees. At the middle of the distribution this gap widens to roughly 32%. In the top 10% of earners, the gap is over 38%.

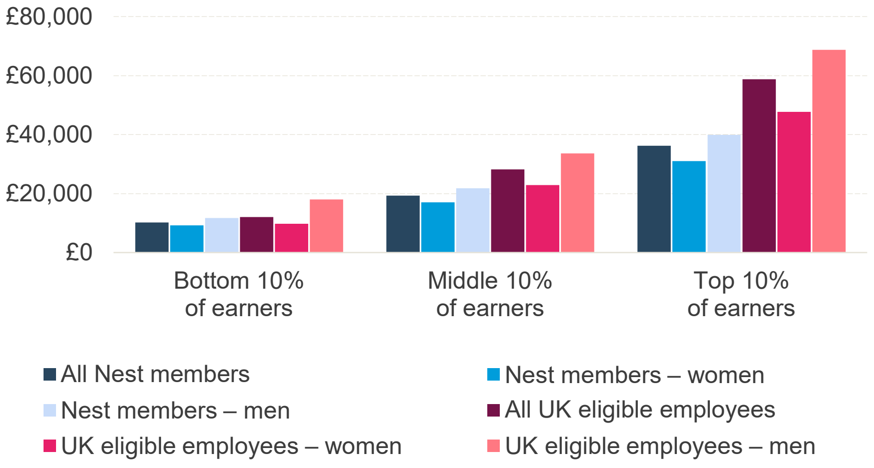
This gap between our members and their equivalent counterparts in the distribution of all UK eligible employees is wider for men than women. Men who are Nest members appear to be lower-earning compared to all men who are eligible for auto enrolment, across the entire earnings distribution. In contrast, women who are Nest members appear to earn about the same as all women who are eligible for auto enrolment except at the top end of the distribution.

£19,300

median annual earnings for Nest members

(as at 31 March 2021)

Figure 4. Distribution of earnings for Nest members and UK eligible employees



Source: Nest Corporation, scheme data, 2021, and Office for National Statistics (ONS), Annual Survey of Hours and Earnings, ad-hoc data service (2021), **ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/adhocs/13317annualsurveyofhoursandearningsashestimatesofgrossannualearningsofallemployeesandthosewithaworkplacepensionbyspecifiedagebandsapril2020**

Our members are more likely to be employed in roles with more precarious employment and to have less job security. So they're likely to have less scope to reduce their household spending in favour of saving.

In addition, some workers' earnings are bond-like – that is, their earnings increase rather steadily and predictably over time. Other workers' earnings are more equity-like – that is, their earnings are subject to more volatility.

The orthodoxy prior to the start of auto enrolment was that the human capital[9] of higher earners, who were then more likely to be saving in a workplace pension, is more bond-like and less equity-like. In other words, their earnings and earnings potential across their working life tend to be similar to the profile of a bond – low risk with predictable outcomes. It was argued that because of these features it was appropriate for defined contribution (DC) pensions designed for this group to consider approaches with more equity holdings and investment risk to diversify their members' bond-like human capital.

Our members are likely to see less earnings growth, and to have lower earnings potential, than the wider population of all UK eligible employees. Combined with the qualifying earnings threshold for auto enrolment, this means pension contribution rates for our members will be relatively lower than the overall rate across the UK.

Earnings: What does this mean for our investment approach?

- Given their low to moderate earnings, careful investment risk management will continue to be important for our members. By default we should seek high probabilities of achieving good outcomes rather than low probabilities of achieving the highest outcomes.
- Because many of our members' earnings and earnings potential are more variable across their working life, their human capital is likely to be less bond-like and more equity-like. So we need to consider that dominating our investment portfolio with equity risk may be less suitable for them because of their exposure to risk through their labour market participation in the UK economy. Diversification away from very high equity allocations should continue to be a key element of our investment approach.
- Because our members are less likely to be able to trade off spending with saving, they may have less scope to increase their pension contributions. This means diversification away from one particular asset class or risk premium is especially important, since they're likely to have less capacity to increase their contributions if their investments perform poorly over long periods.
- Risk does not have a single definition. Different types of risk will have different relative importance and consequences at different stages in a member's saving journey. Members' current and anticipated lifetime earnings are also a factor. Our investment approach should reflect how our members' appetite for risk may change over their working career.

Career patterns

Nest members are employed across a wide range of sectors in the UK, with no sector employing more than 12% of our active membership.[10]

9 Human capital is the value of individuals' skills, knowledge, abilities, social attributes, personality and health attributes. These factors enable individuals to work, and therefore produce something of economic value. It is measured as the sum of the total potential future earnings of everyone in the labour market.

10 Nest Insight, 'Retirement saving in the UK 2020: Member experience from Nest, the National Employment Savings Trust' (February 2021), **nestinsight.org.uk/wp-content/uploads/2021/02/Retirement-saving-in-the-UK-2020.pdf**

In member surveys, around 14% of our members describe themselves as part-time workers, compared with 24% of UK workers in the Labour Force Survey.[11] However, because part-time workers typically earn less than full-time workers, a significant proportion of part-time workers at employers using Nest may not meet the earnings eligibility threshold for auto enrolment.

We've observed that our members move jobs more frequently than employees on average across the UK labour market. We also recognise that, due to Nest's scale, many workers are likely to be enrolled in Nest multiple times over their working life, due to moving jobs.

In the financial year ending 31 March 2021, around 40% of enrolments made into Nest each month were of returning members. Given that around 10% of workers enrolled each month ended up opting out of pension contributions, this means that more than 40% of enrolments in 2020/21 were workers who had previously been enrolled in Nest. As the number of workers across the labour market who have ever been enrolled in Nest grows, this proportion will increase. We estimate that by the mid-2030s the proportion of returning members each month will be around 2 in 3.

We believe that many of our members will likely be enrolled in another workplace pension when they're not actively saving with Nest. However, we currently only have data about the contributions made into our own members' pots and the assets they accumulate with us.

We anticipate that some of our members will regularly return to Nest through subsequent employments and so will spend a significant portion of their working life contributing to their Nest pot. Other members, however, may not have this employment and contribution pattern. For this reason, we expect there will be a vast spread of pot accumulations across our membership when members reach retirement.

Career patterns: What does this mean for our investment approach?

- We need to remain aware of the fact that our investment strategy will not be the only investment strategy that our members have their retirement savings exposed to. We should encourage high standards across the pensions industry.
- For members who cease contributing, we should, at the very least, safeguard their accumulated assets against inflation as best we can.
- For most people, the principal objective of saving for retirement is to deliver a post-retirement income. Pot size at retirement is a means to this end, not the ultimate objective. We also need to provide suitable investment pathways for those members who don't want a retirement income from Nest but do want to remain invested beyond their State Pension age or another notional retirement age.

[11] ONS, 'Full-time, part-time and temporary workers (seasonally adjusted)' (September 2021), **ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/datasets/fulltimeparttimeandtemporaryworkersseasonallyadjustedemp01sa**

Living circumstances

We understand that many Nest members will be pooling their financial resources with other members of their household. They'll do this to facilitate both day-to-day spending as well as longer-term saving. Yet, at the same time, pensions are mainly regarded as an individual asset, linked to the jobs a person holds rather than the money they earn.

The relationship between the individual accumulation phase of pension saving and the potentially joint drawdown of these savings in retirement is complex. It can, of course, be disturbed by life events, such as the breakdown of a marriage or civil partnership.

We know from surveys that nearly one third of our members describe themselves as single (never married or in a civil partnership). This is perhaps unsurprising given the higher proportion of younger workers in our membership today. As younger workers become a less dominant proportion of our membership, we may see an increase in the proportion of members who say they're currently sharing their household with a partner. While rates of cohabitation have changed in a relatively steady and predictable way in recent decades, it's not currently possible or prudent to model likely changes in our members' households.

It's clear that cohabiting brings about an overall increase in financial capacity. Almost one quarter of Nest members who are cohabiting report they have a joint household income of £50,000 or more. Households with greater financial resources typically find it easier to save. Where individuals remain in a relationship through their retirement, they'll likely benefit from this increased capacity for saving. However, living circumstances can change suddenly.

Household composition: What does this mean for our investment approach?

› If we could feel confident that our members are likely to be part of a joint household in retirement, we might assess overall investment risk capacity profiles differently. However, in the absence of reliable data to predict how members' household circumstances may evolve over time, we believe it's prudent to base our investment strategy on the premise that our members will require an individual income in retirement.

The big picture

Nest's membership is diverse. The demographic profile of our members will also continue to evolve as the auto enrolment system matures.

Notably, as the first, large generation of workers enrolled in Nest ages, we'll need to focus increasingly on investment solutions for our members approaching and entering retirement, including those of our members looking to access their accumulated pension savings while they keep working.

Nest members have lower median earnings than UK employees with a workplace pension. We expect our members to have less earnings growth over their working life than their peers in their decile of earnings in the overall labour market.

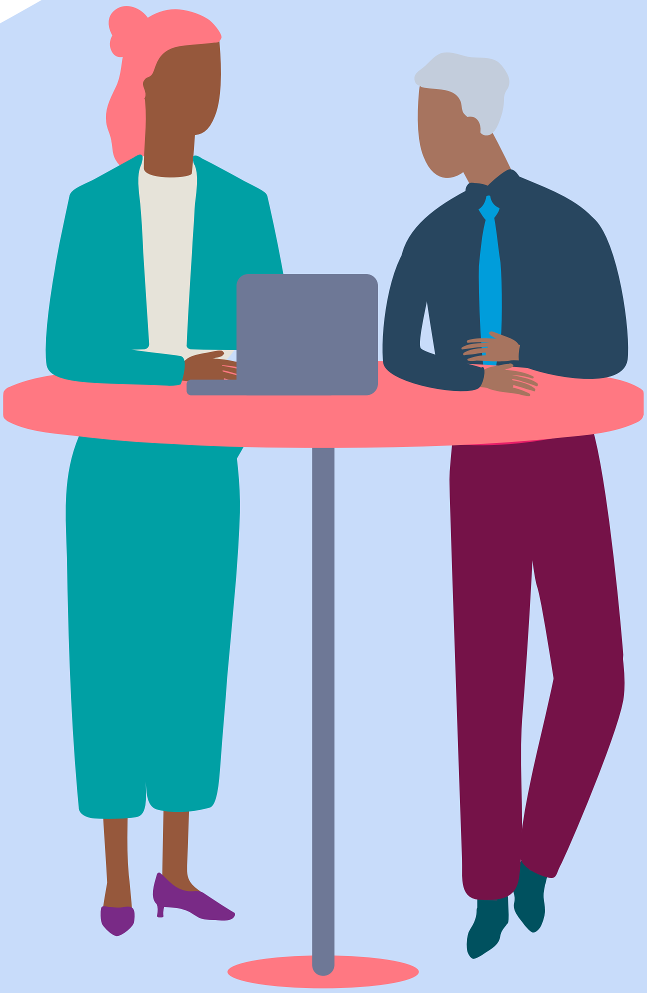
Our members also appear to have higher job turnover. This is likely to lead to many having short or intermittent pension pot contribution histories with Nest. Many of our members may be saving in other schemes when they're not saving with us. We should aim to deliver consistent investment returns for our members across their lifetime of saving by employing a diversified investment strategy and encouraging high standards in the pensions market. In addition, we should support tools to give our members a view of the combined potential retirement income they might expect from their State Pension and workplace pensions and provide counsel on developing industry-wide approaches for the consolidation of small pots based on observed member behaviour.

For younger members, who have a longer time frame for realising investment returns, illiquidity should be embraced.

While investing for a household retirement rather than an individual retirement might be a more efficient way to deliver income replacement, we lack information on our members' non-Nest savings, and people's family circumstances can change.

Chapter 3

Investment risk capacity



People exhibit a range of capacity to take on investment risk. In part, their risk capacity reflects their ability to deal with the consequences of losses.

Risk capacity is largely a function of a person's particular situation or characteristics, mainly those related to their earnings, wealth, assets and debt.

As we've seen in analysis conducted by our in-house research unit, Nest Insight, for its series 'Retirement saving in the UK'[12], the group eligible for auto enrolment prior to the government's workplace pension reforms is broadly similar to Nest's membership today. We can therefore consider surveys of all UK eligible employees and be confident that any conclusions as to where their investment risk capacity may naturally fall would also describe our members.

For many UK eligible employees, defined contribution (DC) pots accumulated because of auto enrolment, be these through Nest or other pension schemes, will comprise a small part of their overall retirement saving. For some eligible employees, however, these pots will be their sole or primary retirement asset.

DB versus DC saving

Prior to the launch of auto enrolment in 2012, evidence suggested that around half of the original target group of low to moderate earners had previously saved into a pension. A person's probability of having a previous pension was, of course, highly correlated with their age. For many younger workers, auto enrolment saw them saving into a pension for the first time.

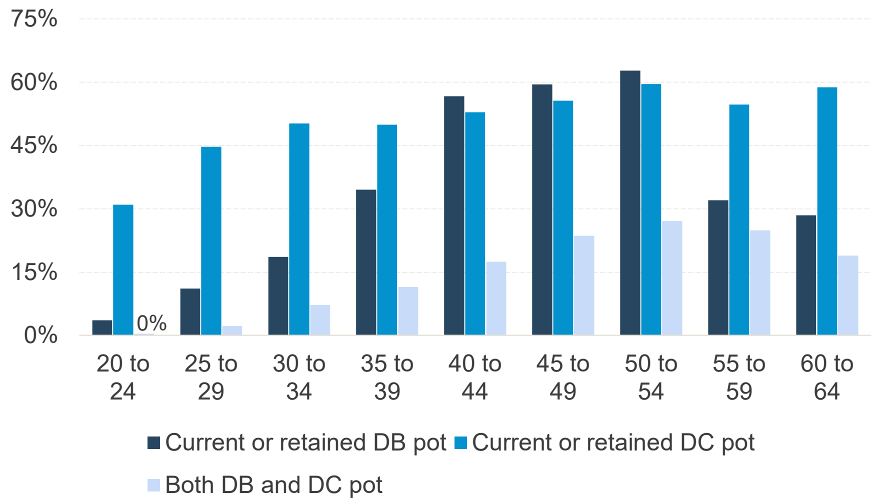
Historically, a significant proportion of workplace retirement saving in the UK had been made through defined benefit (DB) pensions. According to the Occupational Pensions Scheme Survey (OPSS), as recently as 2004 the ratio of active membership in DB to DC pensions was almost 9 to 1.[13] Around 60% of active DB savers at that time were working or had worked in the public sector. Discounting these savers, the DB to DC ratio was around 4 to 1.

A gradual shift towards the DC market meant that by 2012, the active-member ratio of occupational DB to DC schemes in the private sector was 5 to 2.

The Office for National Statistics' (ONS) Wealth and Assets Survey is an extremely robust data source when it comes to understanding individuals' financial resources. Data from the survey's latest round, as at the time of writing, suggests that almost 90% of eligible employees have either a current or retained pension of some description.[14] Drilling down further by pension type, we found that just over half of eligible employees had either a current or retained DB pension. It's estimated that up to as many as half of these, or about one quarter of eligible employers, were public sector workers at some point in their career.

There's a clear age divide in DB pension holdings among eligible employees. Figure 5 shows how people aged 40 and older are far more likely to have a current or retained DB pension than those under 40. This is unsurprising. However, a majority of older workers also have either a current or retained DC pension or both a DC and a DB pension.

Figure 5. UK eligible employees with current or retained pension pot, by age



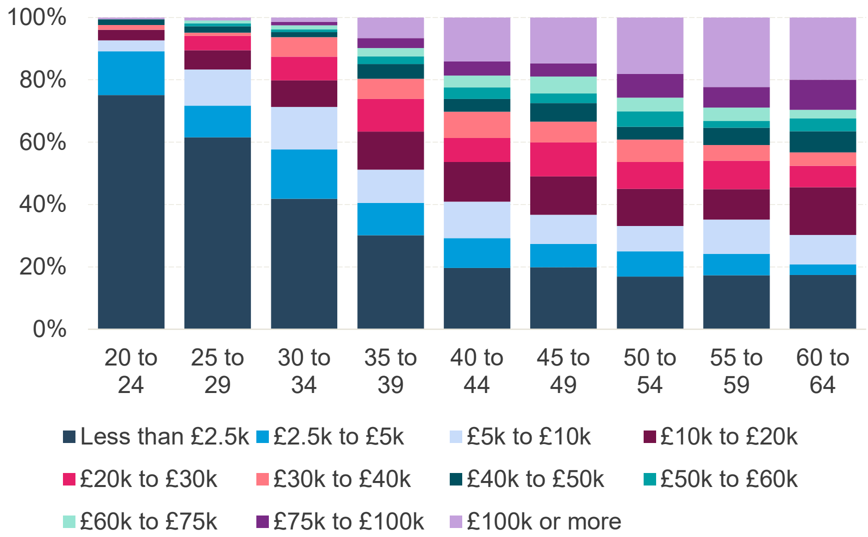
Source: ONS, Wealth and Assets Survey, round 6, April 2016 to March 2018, **ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/totalwealthingreatbritain/latest**

13 ONS, 'Occupational Pension Schemes Survey, UK: 2018' (June 2019), **ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/pensionssavingsandinvestments/bulletins/occupationalpensionschemessurvey/2018**

14 ONS, 'Total wealth in Great Britain: April 2016 to March 2018' (December 2019), **ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/totalwealthingreatbritain/latest**

Although retained or current DC saving rates are well over 50% for those aged 40 and older, these DC pot values are relatively low. Over half (55%) of people 40 to 44, and nearly half (47%) of people 45 to 54, who have one or more DC or personal pensions, have less than £20,000 in them (Figure 6).

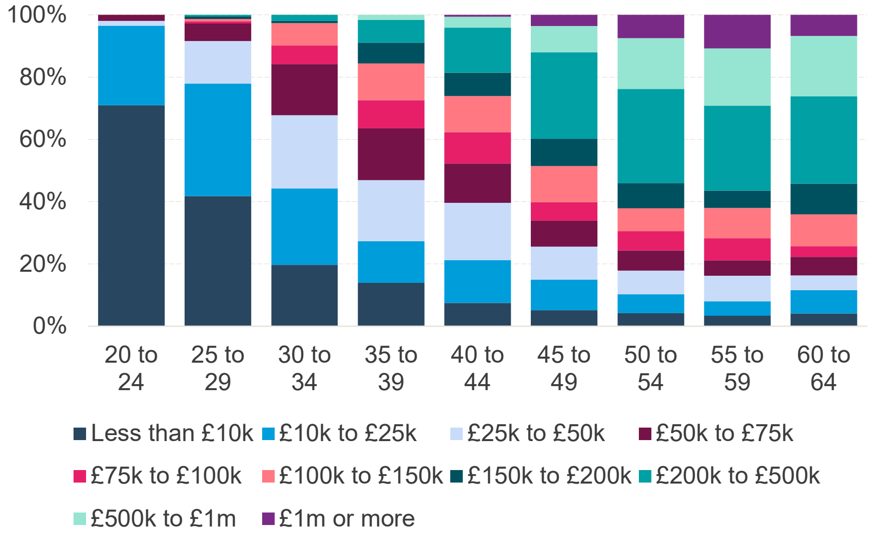
Figure 6. UK eligible employees' DC or personal pension pot holdings, by age



Source: ONS, Wealth and Assets Survey, round 6, April 2016 to March 2018
Note: Pension pot bands are up to but not including the top figure, so, for example, £2.5k to £5k includes pots with a value of £2,500 to £4,999.

When we look at the DB holdings for individuals by age, we see a clear generational difference (Figure 7). Those aged 40 and older may have low DC pot values but a significant proportion of them have relatively high DB pension balances. About 60% of those 40 and older with some DB pension have balances totalling £100,000 or more. Among those 50 and older, over 80% do. A person aged 40 today may have another 25 years or more of working ahead of them. Those with a relatively high DB balance already have a solid base of savings for retirement. Those who changed jobs between establishing their DB pension and their retirement are likely to top up their DB balance with DC saving because of auto enrolment.

Figure 7. UK eligible employees' DB pension holdings, by age



Source: ONS, Wealth and Assets Survey, round 6, April 2016 to March 2018
Note: Pension pot bands are up to but not including the top figure, so, for example, £10k to £25k includes pots with a value of £10,000 to £24,999.

The picture is very different for those aged under 40. These younger workers are far less likely to have had access to a DB pension through their workplaces. Those with a DB pension have secured a smaller balance. Just over 40% of people under 40 have some DB saving, but only 13% of them have DB balances of more than £100,000.

For younger generations, success in retirement will very much be dictated by their accumulation of savings in DC pension pots.

Auto enrolment and pension participation rates

When auto enrolment was launched, most eligible employees had had some previous experience saving into a pension, but only around 55% of them were then saving into a workplace pension.

Auto enrolment has boosted the proportion of people who are currently contributing to a pension pot, with a UK-wide pension participation rate of 88% in 2019.[15] Furthermore, 70% of eligible employees saving into any pension in 2019 had been persistently saving into their pot over the past three years. Auto enrolment has not only brought more people into retirement saving; it has also brought more people into saving on a consistent basis.

Almost all of the schemes being used for auto enrolment – about 98% – provide DC saving.[16] So younger workers who are mainly saving through auto enrolment will primarily have DC pots to draw upon in retirement.

[15] Department for Work and Pensions (DWP), 'Workplace pension participation and savings trends of eligible employees official statistics: 2009 to 2019' (June 2020), **assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/892841/workplace-pension-participation-and-saving-trends-2009-2019.pdf**

[16] The Pensions Regulator (TPR), 'Automatic enrolment commentary and analysis: April 2018–March 2019' (October 2019), **thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/automatic-enrolment-commentary-analysis-2019.ashx**

Our members' other pots

We haven't been able to directly replicate the detail of the Wealth and Assets Survey with our members to assess the range of pension savings they hold beyond Nest. But in our member surveys we have posed questions about their pension holdings to get a snapshot of the assets they might have available in retirement.

Over time, as auto enrolment has become the norm, the proportion of our members saying they only have a pension pot with Nest has decreased, as shown in Figure 8. In 2016 around half of our members said that Nest was their only pension pot. Three years later this had dropped to just over one third, with a similar proportion saying they now have at least two other pots apart from Nest.

It's notable that, for the first time, members' response to our 2020 survey did not indicate a continued reduction in the proportion saying Nest is their only pension pot. We'll be monitoring this trend going forward.

Members who are not currently contributing to their Nest pot are more likely to report having another pot. In 2017, 43% of our inactive members said Nest was their only pension pot, compared with 30% in 2020. Since workers are now automatically enrolled in a workplace pension scheme, each time they change jobs they may be enrolled in a scheme other than Nest.

48%

of members under 30 said Nest was their only pot

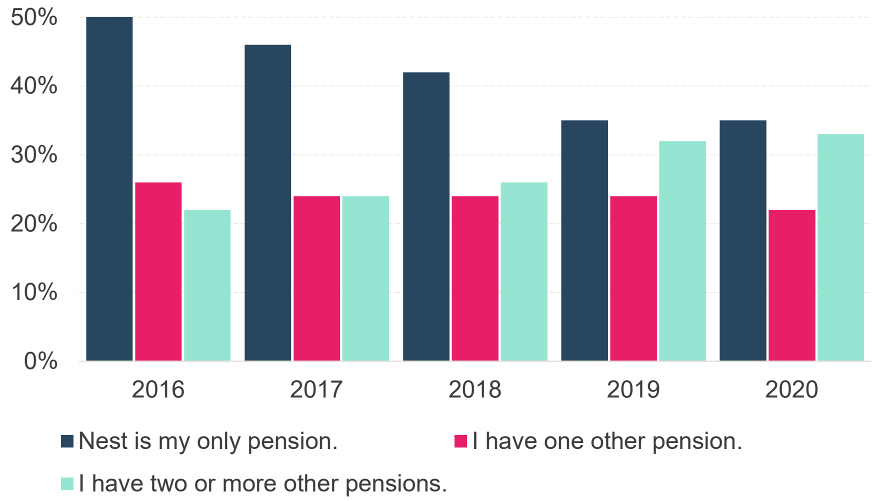
(2020 member survey)

23%

of members 50 and older said Nest was their only pot

(2020 member survey)

Figure 8. Nest members whose only pension pot is with Nest

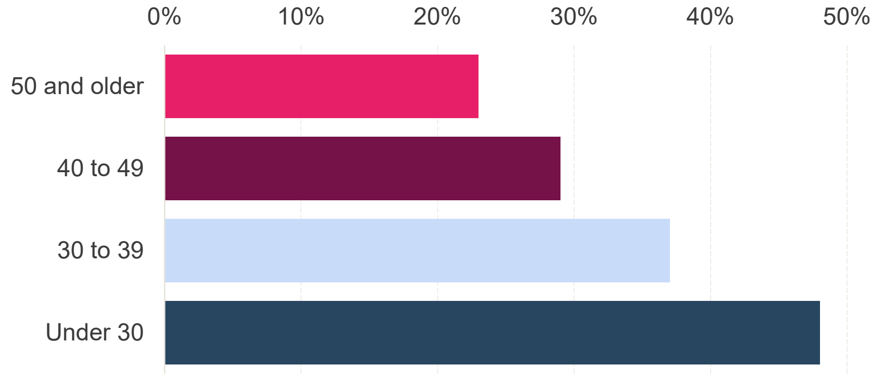


Source: Nest Corporation, member surveys, 2016, 2017, 2018, 2019 and 2020
Base: All respondents – 2016 (2,172), 2017 (3,535), 2018 (3,152), 2019 (2,994) and 2020 (7,116)
Question: How many UK pension schemes, if any, do you have in addition to your Nest pension? This can include any pension schemes you have with previous employers and/or any personal pension schemes you may have set up yourself.
Note: Figure excludes respondents who answered 'Don't know'.

The likelihood that a member will report that Nest is their only pot decreases with age. In 2020, 48% of our members aged under 30 said Nest was their only pot compared with 23% of those aged 50 and older (Figure 9). As auto enrolment has become established, this difference between our younger and our older members has become less marked.

In 2017 there was a 39-percentage point difference between those under 30 and those 50 and older saying Nest was their only pot. By 2020 the difference had dropped to 25 points.

Figure 9. Nest members in 2020 whose only pension pot is with Nest, by age



Source: Nest Corporation, member survey, 2020
Base: All respondents (7,116)
Question: How many UK pension schemes, if any, do you have in addition to your Nest pension?

In our 2016 survey we not only asked members how many pensions they had but also whether their other holdings were DB or DC pensions. In Figure 10 we can see that our members' responses mirrored the responses to the Wealth and Assets Survey representing all eligible employees. While we haven't repeated the exact question in our more recent surveys, we would expect the pattern to remain similar to the Wealth and Assets Survey findings.

In 2016 the likelihood that a Nest member reported also having a workplace DB pension substantially increased with age. Over one third of our members aged 50 and older said they had DB assets, compared with 1 in 20 of our members under 35. A substantial proportion of our members 45 and older said they have a personal pension in addition to their other pension holdings.

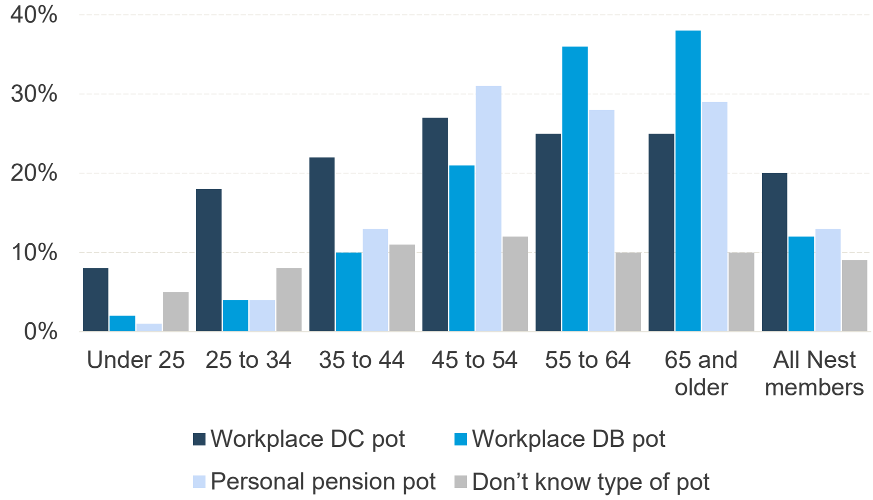
We went on to ask members how long they had been saving in different forms of pension provision.

About one fifth (19%) of those aged 45 and older said they'd saved in a workplace DB scheme for 10 or more years. So while our older members are more likely to have DB assets, only a minority have saved in a DB scheme for a prolonged period.

A similar proportion (18%) of these older members said they'd been saving in a personal pension for 10 or more years. Only 12% said they'd saved in a workplace DC scheme for that much time.

Hardly anyone aged under 45 said they'd been saving for 10 or more years in any type of pension, whether a workplace DB scheme, workplace DC scheme or personal pension.

Figure 10. Type of other pension held by Nest members, by age



Source: Nest Corporation, member survey, 2016
Base: All respondents (3,535)
Question: Other than your Nest pension pot, which of the following types of UK pension schemes do you have?
Note: Figure excludes respondents who said they only had a Nest pot.

Reliance on DC saving: What does this mean for our investment approach?

- The majority of our members, even at older ages, will not have a DB pension scheme to supplement their State Pension income. Converting DC savings into meaningful retirement income will become increasingly important over time as fewer of our members have any DB assets at their disposal.
- We believe many of our members may have pots with other pension providers, but we don't **know** this. Nor do we know how large their other pots are, or how those pots are invested. We should invest their Nest pot as if it were their only pot unless or until we can improve our understanding of our members' total pension assets.
- We should encourage higher investment standards across the pensions industry, so that the pots our members hold beyond Nest are invested as well as possible.

Non-pension assets

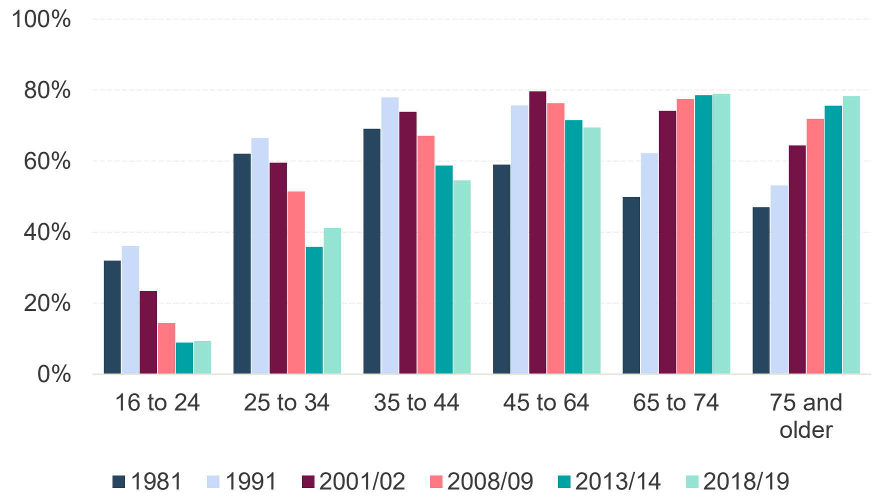
Pension holdings are only one aspect of an individual's preparedness for retirement. Some people have savings that aren't earmarked specifically for retirement. Others have debt levels that make saving more difficult or decreases their capacity for risk. Surveys often highlight that people consider the property they own to be the main or an important asset for financing their retirement. Changing patterns of home ownership, debt levels and non-pension saving should influence our investment approach, including whether investing in certain asset types either spreads or compounds risk on an individual level.

Home ownership

As reported in 'Retirement saving in the UK 2021'[17], Nest members are less likely to own their home, whether outright or with a mortgage, than the general public.

It's been widely reported that rising house prices in recent years have affected home ownership rates. In particular, higher house prices have led to people getting on the housing ladder later in life. Figure 11 shows how home ownership rates have changed on an age-cohort basis from the early 1980s through to 2018/19.

Figure 11. UK home ownership rates by age, 1981 to 2018/19



Source: English Housing Survey (EHS), **gov.uk/government/statistical-data-sets/owner-occupiers-recent-first-time-buyers-and-second-homes**

In general, as generational cohorts have got older, the propensity to own their home has increased. For people aged 65 and older, this pattern has held in every survey period. For people 45 to 64, it has largely held until around the time of the global financial crisis in 2008/09, when home ownership began to decline slightly. Among those aged under 45, the prospect of owning one's own home has been slipping away. In the early 1990s, around 67% of 25- to 34-year-olds were homeowners, while in 2018/19 only 41% were.

This trend is unlikely to reverse to such an extent that today's younger generations will have home ownership outcomes similar to previous generations when they're older. The aspiration that people might rely on their home to finance or partly finance retirement is becoming ever less realistic for most. In addition, the extent to which homes could be used to fund retirement has been questioned since the Pensions Commission reports in 2004[18], as well as before.

More importantly, however, if these trends in home ownership continue, the proportion of people retiring who are renters rather than homeowners is likely to increase substantially. Because renting a home tends to be more expensive than owning one, particularly in a period of low interest

17 **nestinsight.org.uk/wp-content/uploads/2021/09/Retirement-saving-in-the-UK-2021.pdf**

18 Pensions Commission, 'Pensions challenges and choices: The first report of the Pensions Commission' (October 2004)

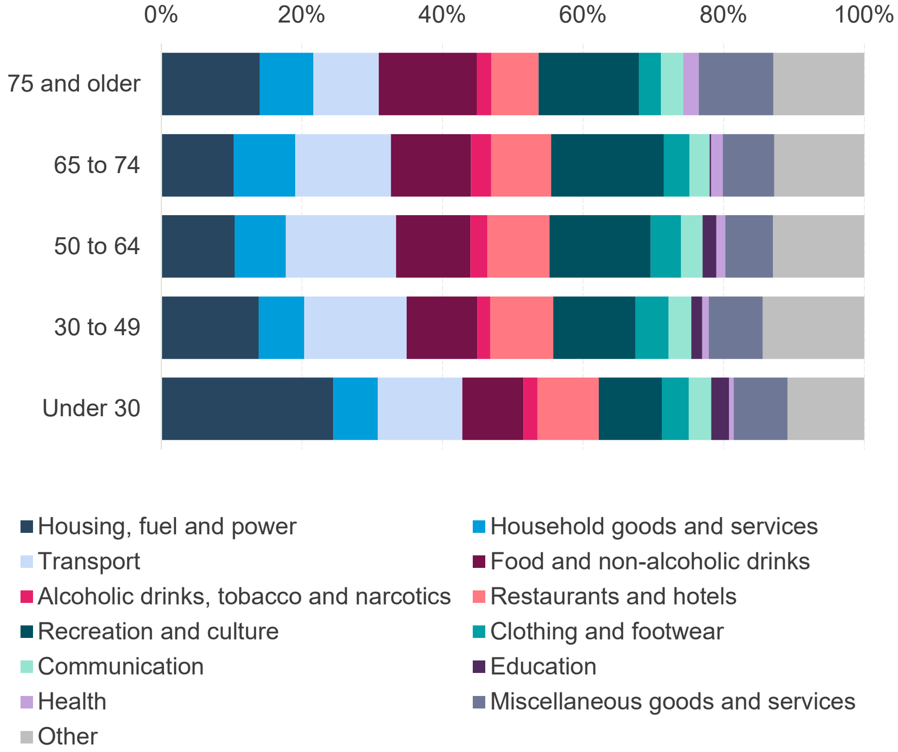
rates, this could have a profound effect on the income members need in retirement.

In Figure 12, we consider in more detail how renting a home affects household expenditure compared to owning a home.

The higher propensity for people aged under 30 to be renters rather than homeowners means they spend proportionally far more of their income on housing costs than other age groups. Among those 30 to 49, transport costs account for their largest category of expenditure, while those 65 and older spend more on recreation.

It should be noted that housing costs still form a large part of household expenditure for those 65 and older. Based on trends in home ownership, this is likely to go up significantly, squeezing out other spending categories unless income in retirement can be increased.

Figure 12. What UK households spend their money on, by age



Source: ONS, Wealth and Assets Survey, round 6, April 2016 to March 2018
Note: Housing costs exclude mortgage interest payments.

Home ownership: What does this mean for our investment approach?

- Our members are less likely to own their own home than the general public. Among those who own their home, more of our members are likely to be continuing to contribute towards a mortgage in retirement. They'll likely need a stable post-retirement income to help cover the cost of their housing without making significant cuts to other categories of expenditure.
- Our members, particularly our younger members, have less diversified asset wealth overall than older generations, with less personal holdings in illiquid assets such as real estate. We should provide access to illiquid assets, including both real estate and infrastructure investment, to help diversify their retirement saving and spread their investment risk across more asset types.

Other financial assets

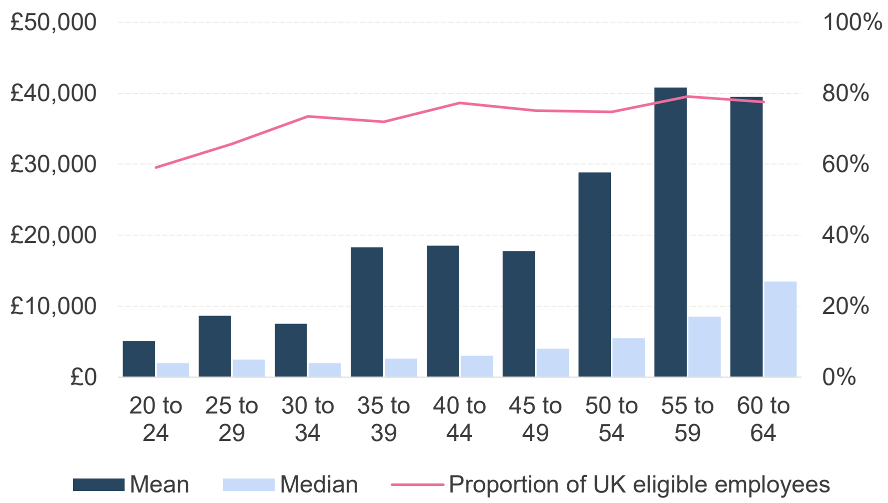
Most employees eligible for auto enrolment have some other form of financial assets beyond their pension or a home – for example, more liquid assets such as cash savings or savings products such as ISAs, bonds, trusts or gilts. Although these liquid holdings are unlikely to have been specifically put aside as savings for retirement, they give an indication as to how financially aware people are and how resilient they may be when faced with financial pressures either now or in retirement.

Figure 13 shows the mean and median level of liquid financial assets held by UK eligible employees and the proportion of those with at least one of these assets.

Across all age bands, the proportion holding some form of liquid financial asset is relatively high. At least two thirds of those aged 25 and older have some sort of non-pension savings of this type. For younger people, ISAs are the dominant non-pension savings vehicle. Those 45 and older tend to prefer ordinary savings accounts.

Median saving levels are relatively low across all ages. However, mean values rise considerably with age, clearly demonstrating that within older cohorts, some individuals have much higher levels of saving.

Figure 13. UK eligible employees who have financial assets, by age



Source: ONS, Wealth and Assets Survey, round 6, April 2016 to March 2018

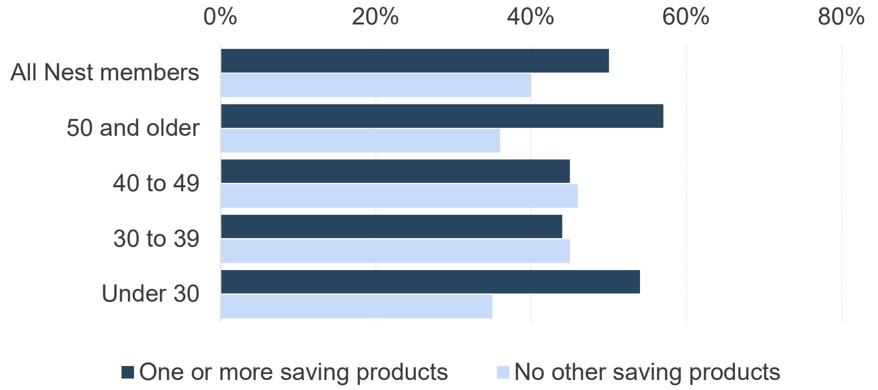
Our own surveys suggest that our members are slightly less likely than eligible employees overall to have non-pension savings of one form or another (Figure 14). In our 2020 annual member survey, half of our members said they had some savings. Those aged 30 to 39 (45%) and 40 to 49 (46%) were slightly more likely than younger or older members to say they had no savings.

The most common type of saving across all age groups of our members is a standard savings account (37%), followed by a cash ISA (18%) and premium bonds (10%).

Lower proportions of our members have a stocks and shares ISA (6%), stocks and shares invested directly in individual companies (6%) or other investment products such as bonds, investment trusts or unit trusts (4%).

Only around 3% have a lifetime ISA. These are concentrated among members aged under 40. Older members are more likely to have other, less common forms of saving. For example, 18% of those 50 and older have premium bonds, compared with less than 10% of those under 50.

Figure 14. Nest members who are saving, by age

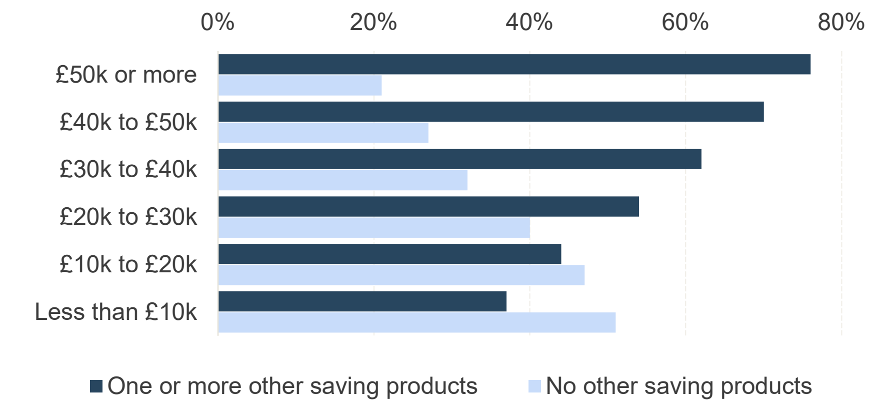


Source: Nest Corporation, member survey, 2020
Base: All respondents (7,116)
Question: Do you currently have any the following investments/savings?
Note: Figure excludes respondents who answered 'Don't know'.

Personal income has a significant impact on an individual's ability to save. This is evident in the member survey data shown in Figure 15. Those reporting a personal annual income of less than £10,000 were most likely to say they didn't have any form of non-pension savings (51%). In contrast, more than half of our members with an annual income of £20,000 or more say they have non-pension savings, with the proportion reporting they have savings rising significantly with income.

Not only are higher earners more likely to have some form of savings, they're also more likely to have money invested in the stock market than lower earners. Almost one quarter (23%) of those earning £50,000 or more say they have a stocks and shares ISA, compared with 6% of our overall membership.

Figure 15. Nest members who are saving, by annual personal income

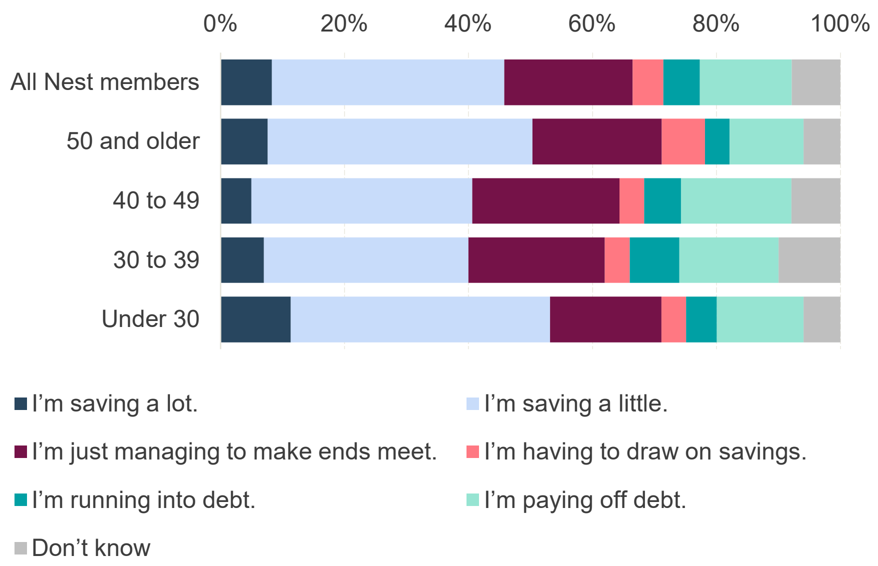


Source: Nest Corporation, member survey, 2020
Base: All respondents (7,116)
Question: Do you currently have any the following investments/savings?
Note: Figure excludes respondents who answered 'Don't know'. Income bands are up to but not including the top figure.

Figure 16 looks at how our members rate their financial situation with respect to their saving and spending. Roughly mirroring the proportion who said they had some form of non-pension savings, 46% of our members said that they were either saving a lot (8%) or a little (38%). Around one fifth (21%) felt they were just getting by, with a further 5% saying they were having to draw on savings to pay for daily expenditures. Around 6% felt they were getting into debt and a further 15% said they were paying off debt – an issue we'll return to later in this chapter.

While perceptions of members' financial situation were relatively similar across age groups, it's notable that those aged 30 to 49 were less likely to be saving and more likely to feel they're just managing or living with debt.

Figure 16. Nest members' perception of their financial situation, by age



Source: Nest Corporation, member survey, 2020
Base: All respondents (7,116)
Question: Which one describes your current financial situation best?

> Our members aged 30 to 49 were less likely to be saving and more likely to feel they're just managing or living with debt.

Other financial assets: What does this mean for our investment approach?

- Our members have low levels of cash savings, with median savings only exceeding £5,000 among members aged 50 and older. Almost half of our members report that they have no savings beyond their pension pot. This low saving rate means our members have little capacity to absorb unexpected rises in expenditure or falls in income.
- Delivering a high level of predictability with respect to expected retirement income is likely to be more valuable to our members than achieving a potentially higher but more volatile investment outcome. We should emphasise an investment approach that aims to deliver sustainable, steady growth in pot value, which in turn will likely encourage continued and persistent saving among our members.

Debt

Virtually all individuals and households in the UK carry some form of debt and our members are no exception to this. Among homeowners the largest debt held is almost always their mortgage. For younger people it is likely to be their student loan debt.

Household debt can be beneficial. It allows people to borrow money to purchase things that can improve their standard of living. It can also help to smooth their spending over their lifetime, reducing the financial shock of large, infrequent purchases like a car. This in turn can benefit the wider economy, as households smooth their consumption of goods and services during any temporary falls in income.

However, high levels of household debt can also be problematic, both for individuals and the economy. A sudden change in a person's circumstances, such as the loss of a job, can make it difficult to make payments towards debts. When higher levels of debt are held over lengthier periods by a significant proportion of the population, spending tends to fall, leading to reduced company revenues. Sustained over a prolonged period, this can contribute to economic recession.

While household debt levels in the UK have been rising consistently since the mid-1990s, historically low interest rates since the global financial crisis of 2008/09 have meant that the relative affordability of servicing this debt has increased.

Figure 17 shows the level of various forms of debt for employees eligible for auto enrolment and the proportion of each form of debt held. We've grouped debt into three categories: formal and informal loans, hire purchase agreements and instalment plans, and credit or store card debt used to pay for purchases over time.

In this figure, we've excluded formal student loan debt issued by the Student Loans Company (SLC), since the level of this debt skews down with age. Despite student loan debt being excluded from this analysis, other loan debt is still the highest form of debt among those aged 20 to 24. This form of debt has another peak among those aged 35 to 39. Between these two peaks, the proportion of people holding loan debt is relatively consistent at around 17%. From age 45, loan debt is held less often.

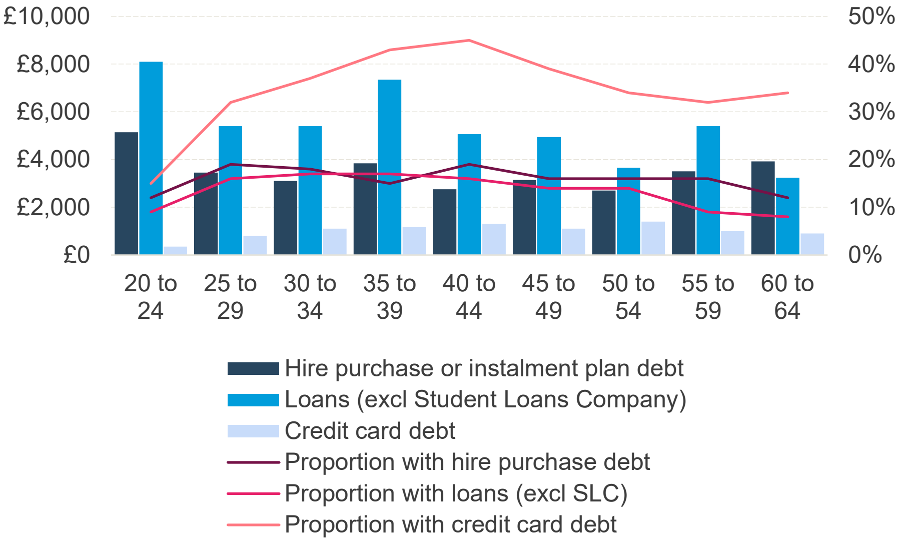
Credit card debt is far more common across all age groups, peaking at around 45% for those aged 40 to 44. As with loan debt, above this age band, credit card debt is held less often, but with a curious uptick among those 60 to 64. This might be explained by people using short-term debt products to finance early retirement.

Hire purchase agreement debt follows a similar pattern to credit card debt but the amounts of debt held are far higher. Although it could be assumed that hire purchase would be used more frequently by older workers in established, secure jobs, the proportion and value of these agreements is high among younger people.

Despite the general reduction in the proportion holding various forms of debt with age, the value of this debt does not fall among older age groups. In fact, both loan and hire purchase debt levels increase for those aged 55 to 59. This suggests that people approaching retirement may hold potentially high levels of debt and may need to finance these debts from their retirement income.

"People approaching retirement may hold potentially high levels of debt and may need to finance these debts from their retirement income."

Figure 17. Median debt, by age



Source: ONS, Wealth and Assets Survey, round 6, April 2016 to March 2018

Debt levels

While it's useful to look at the level of debt held to see how debt is distributed across age groups, many people do consider their debt to be serving a purpose. So it's helpful to consider the extent to which households consider their debt to be a 'burden'.

Round 6 of the Wealth and Assets Survey, covering April 2016 to March 2018, asked households with property debt about the burden of their debt on them. Around 7% considered their property debt to be a 'heavy burden' while another 30% considered it to be 'somewhat of a burden'. Importantly, the Wealth and Assets Survey only captures this measure of property debt burden for households which are not in arrears on their mortgage. If those households were also included, then these percentages would almost certainly be higher.

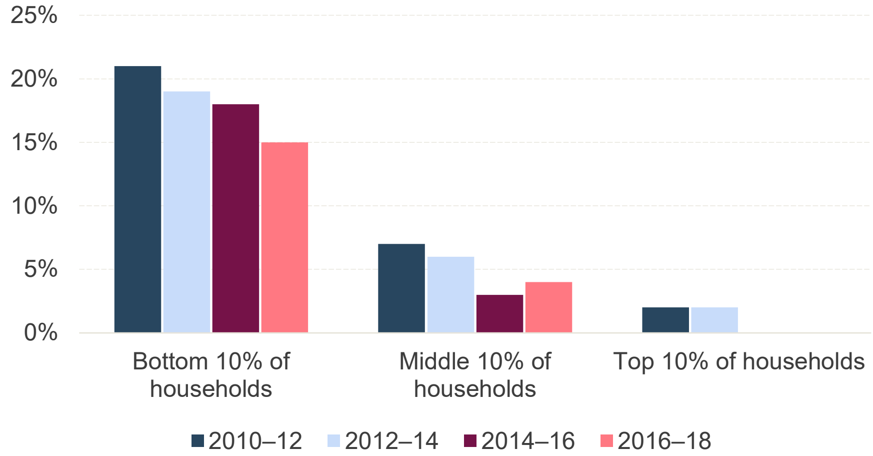
As financial debt is typically held by individuals, data on this debt burden is collected at the individual rather than the household level. Over the same period, the Wealth and Assets Survey found that, of all adults with financial debt, 14% considered financial debt to be a 'heavy burden' while another 30% considered it to be 'somewhat of a burden'.

For some households, debt may be more than just a burden. Their debt may be a problem that could adversely affect their household finances. It could determine their family's living standard and impact their family stability.

The level of debt that is considered a problem is difficult to define as this differs between households. For our purposes, a household is defined as being in 'problem debt' if it has liquidity problems, solvency problems or both.

Among all households in the Wealth and Values Survey, 4% were identified as having problem debt in the period 2016–18, compared with 6% in 2014–16 and 7% in both 2010–12 and 2012–14. In Figure 18 we can see that, although problem debt has generally fallen in each surveyed period, those households with the highest proportion of problem debt are at the lower end of the wealth distribution.[19]

Figure 18. UK households in problem debt, by household wealth deciles, 2010 to 2018



Source: ONS, Wealth and Assets Survey, waves 3 and 4 and rounds 5 and 6, 2010 to 2018

Student loans

Among most of Nest's younger members, we anticipated that the largest form of debt holding would be their student loan debt.

To understand student loan debt among our membership, we looked at the proportion of UK eligible employees with formal student loan debt from the Student Loans Company (SLC). This formal student loan debt peaks at 18% among those aged 25 to 29 (Figure 19). Median debt held is highest among those under 25, at around £25,000. Given that a proportion of this age band is likely to still be studying, their debt level may rise as they age.

The large discrepancy in the level of formal student loan debt between those under 30 and those 30 and older may largely be a function of time. Older people have had more years to repay or reduce their student loan debt. However, it should be noted that the student loans taken out by older cohorts were generally much lower.

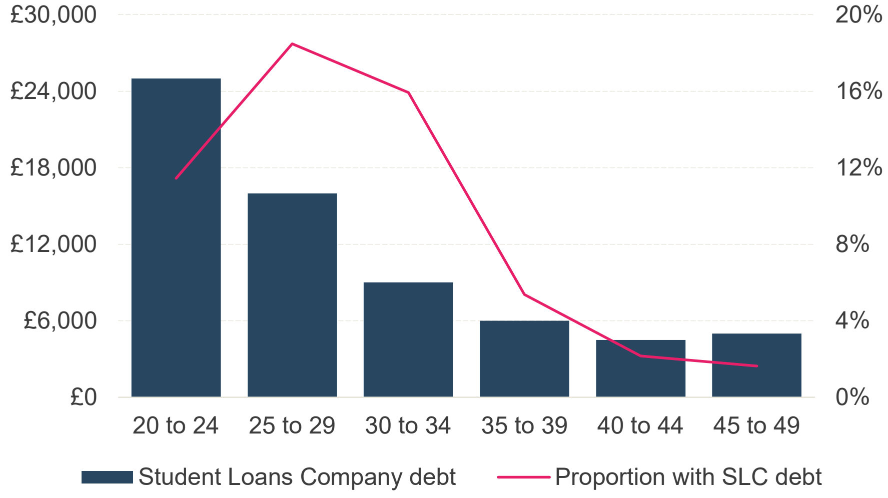
[19] Households were ranked by their total wealth and split into 10 equal (by number of households) groups, or 'deciles'. The 10% of households with the highest amount of total wealth were in the top 10% while the 10% of households with the lowest amount of total wealth were in the bottom 10%.

Our surveys of members present a slightly different picture to this analysis of the Wealth and Assets Survey. We've found that just over one third (35%) of our members aged under 30 have formal student loan debt. Among those 30 to 39, around one fifth (22%) continue to hold a student loan. Women are slightly more likely to be degree-educated, so it's not surprising to see they're slightly more likely (21%) than men (15%) to have student loan debt.

Because repayment of formal student debt is made as a proportion of income over a set amount, the effect of higher levels of this debt should be somewhat dampened. However, the perception of the much higher levels of debt held by younger workers could affect their likelihood of getting into the habit of saving.

Of course, some people may have also taken on other forms of formal and informal to finance studying.

Figure 19. Median student loan debt, by age



Source: ONS, Wealth and Assets Survey, round 6, April 2016 to March 2018

Our members' exposure to debt

In our surveys we haven't asked our members to explore their debt situation in significant detail. Instead, we've asked them about their perceptions of their financial situation with respect to saving or spending (see Figure 16 on page 35). Around one fifth either describe themselves as getting into debt or paying off debt.

We've also asked members about the specific types of loans and credit they've accessed, excluding mortgages. About 54% say they have one or more different forms of this debt. Most common is a credit card used to pay for purchases over time (28%), as shown in Figure 20. After credit card debt, the next most common is a student loan (18%), although this is largely reported by our members in their 20s (35%) and 30s (22%).

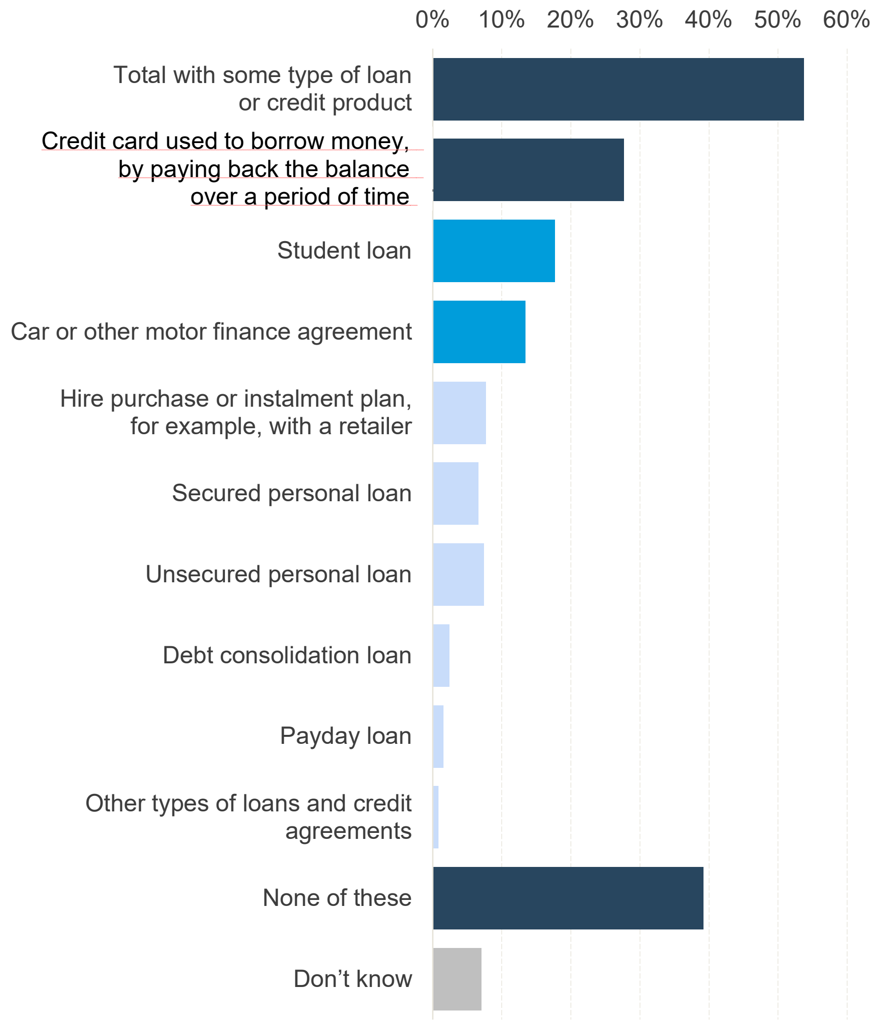
Our members aged 50 and older are more likely to say they don't have any form of loans or credit (51%) compared to members under 50 (39%). Those 30 to 49 appear a little more likely to be using credit cards than members younger (32%) or older (25%) than them.

54%

of Nest members hold one or more types of financial debt

(2020 member survey)

Figure 20. Nest members' debt



Source: Nest Corporation, member survey, 2020
Base: All respondents (7,116)
Question: Do you currently have any the following…?

To further understand our members' financial situation, we've utilised the Money Advice Service (now the Money and Pensions Service, or MaPS[20]) market segmentation tool for assessing people's financial resilience.[21] We applied this segmentation to a random sample of Nest's membership to see how our members' financial resilience compares to the adult population of the UK.

As shown in Figure 21, our membership has a greater proportion of households that fall into the struggling and squeezed segments of the MaPS financial resilience segmentation than the overall UK population.

To help understand people's financial needs, MaPS identified three major consumer groups in the UK:

❶ Struggling

the least financially resilient, who struggle to pay bills and build up savings, and are likely to be over-indebted

❷ Squeezed

who have significant financial commitments and are working, but don't have much to help them through income shocks

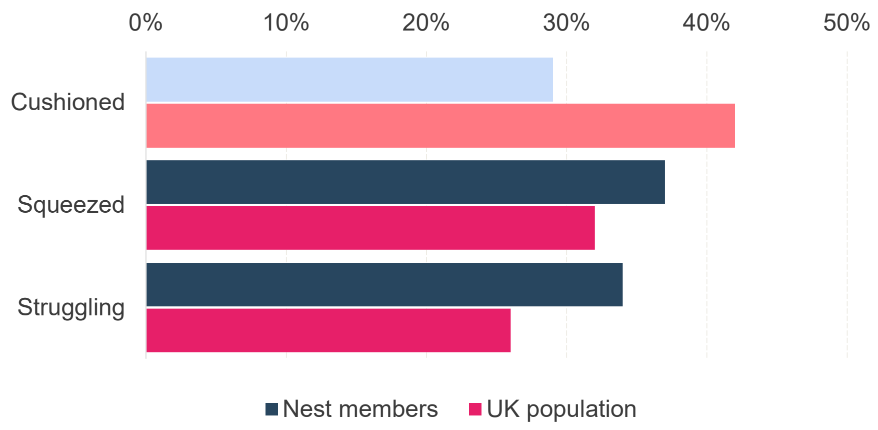
❸ Cushioned

the most financially resilient, who have higher levels of income and savings, and are highly engaged with their finances

[20] Through MoneyHelper, MaPS provides impartial guidance about money and pensions that is free to use and backed by the government. MoneyHelper can assist Nest members and members' beneficiaries if they experience problems related to Nest or any other pension scheme. Visit **moneyhelper.org.uk**

[21] Money Advice Service, 'Market segmentation: An overview' (March 2016), **masassets.blob.core.windows.net/cms/files/000/000/568/original/Market_Segmentation_report_An_overview.PDF**

Figure 21. Nest members' financial situation, by Money Advice Service market segmentation



Source: Nest Corporation, analysis of a random sample of 100,000 Nest members compared to UK population, 2021

Exposure to debt: What does this mean for our investment approach?

› A higher proportion of our members are struggling or squeezed financially compared to the population of UK eligible employees as a whole. They're in households with lower wealth, which tend to have higher incidence of problem debt. Adding leverage and volatility to their investment portfolio offers some opportunity to break out of their debt because they may feel they have more resources available to service their debt in the short term. This must be balanced against the evidence that they have less capacity to withstand poor investment outcomes. For many of our members, regularly adding significant additional leverage outside that which is naturally embedded in investment strategies – for example, the debt on company balance sheets – is unlikely to be appropriate in our default investment strategy.

› Many members continue to hold debt such as credit card debt, hire purchase agreements or car financing as they approach retirement. For those who are unable to buy items outright, it will be vital that their retirement income allows them the means to reliably service this debt.

› Given people's debt levels, post-retirement expenditures may not fall as quickly as has been the case in the past. Again, having reliable income in retirement that can help to replace pre-retirement income will be important.

The big picture

The majority of our members, even among those who are older, will not have a DB pension to supplement their State Pension income. Converting DC savings into a post-retirement income that can last is already important and will become increasingly so over time as access to DB pensions continues to dwindle.

We believe that many of our members have pots with other pension providers, but we don't know this. Even if we're correct in our assumptions, we don't know how much savings our members have accumulated in their other pots or how those pots are invested. We therefore should invest their Nest pot as if it were their only pot.

A stable post-retirement income will become more important as a number of trends converge. These include the increasing proportion of people approaching retirement while living in rented accommodation, the later age at which people in the UK are getting on the housing ladder and the increasing level of debt carried by individuals. In all of these areas, our members may feel the effects more acutely because they tend to earn less than the average UK worker.

Our members also have less diversified and less overall asset wealth, in part because our membership is skewed towards younger workers. They also tend to have low or no non-pension savings.

Chapter 4

Investment risk preferences

People's ability to take risk is not the same as their willingness to take risk. The difference is important to understand not only for how we engage our members in their pension saving but also in how we evolve our investment approach.

For example, if members do not change their pension saving habits in response to actual investment market volatility despite having said in surveys that they would, we might believe we can take additional investment risk for them. Previously, evidence has suggested that at times of market stress, people's tendency to stick with the status quo would be overcome and many of our members might start to make active decisions about their pot, by either changing their contribution levels or where their money is invested.

In this chapter we consider evidence from several quantitative and qualitative research studies conducted with our members as well as the wider population of employees eligible for auto enrolment to further understand our members' stated risk preferences.

Attitudes towards pensions

When we published our first member research brief in 2012[22], the 2008/09 global financial crisis was still very much at the forefront of people's minds. This shaped how much trust people had in financial institutions and different vehicles for investment.

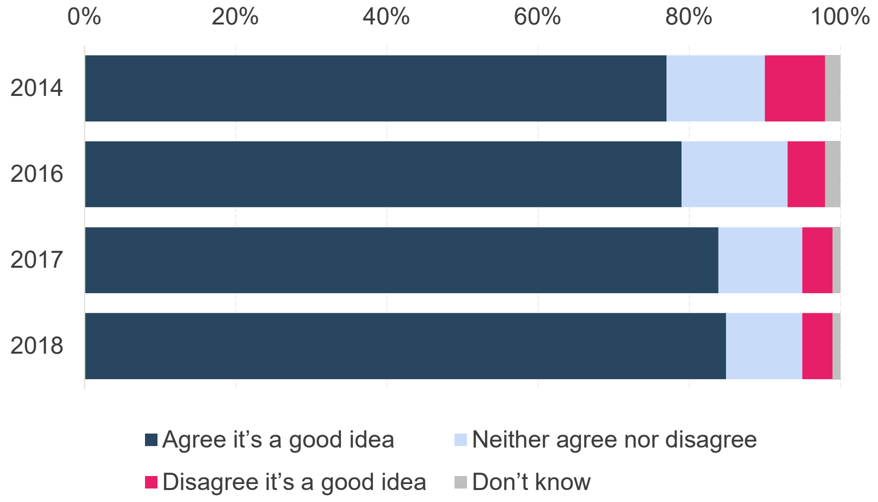
Then, during the process of staging employers into the auto enrolment system, we tracked how people's attitudes to pensions and saving were changing with greater exposure to workplace pension schemes.[23] As the proportion of eligible employees has increased, we've observed some degree of 'social norming' taking place, with saving in a pension becoming more the expectation rather than the exception.

22 **nestpensions.org.uk/schemeweb/dam/nestlibrary/member-research-brief.pdf**

23 We tracked surveys focused on private sector workers, since a much higher proportion of public sector workers were already saving in a defined benefit (DB) pension when auto enrolment was introduced.

Support for auto enrolment has always been high, but as more people were enrolled in pensions, this support increased. Even among those who opt out of their workplace pension, 74% agree that auto enrolment is ‘a good idea’ (Figure 22).

Figure 22. Private sector workers’ attitudes towards auto enrolment

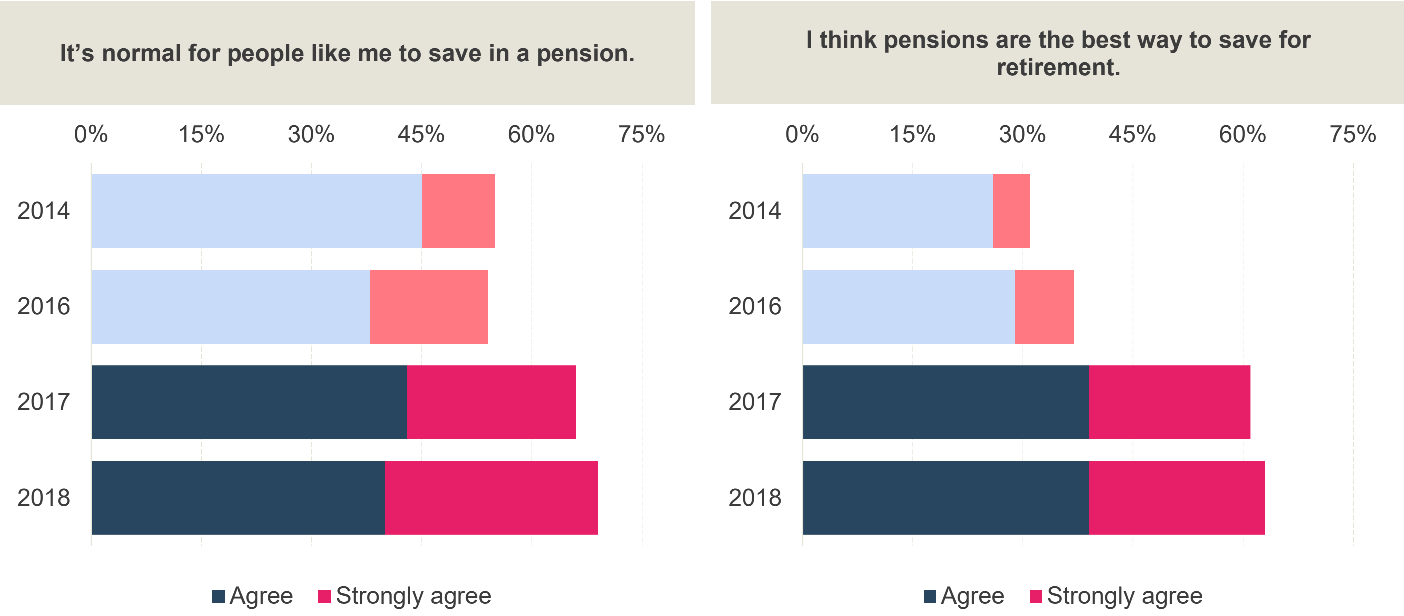


Source: Nest Corporation, consumer survey, 2014, 2016, 2017 and 2018
Base: All respondents – 2014 (2,000), 2016 (1,020), 2017 (1,030) and 2018 (1,014)
Question: Please say whether you agree or disagree that it is a good idea for people to be automatically enrolled in this way.
Note: Respondents were asked to answer on a 10-point scale from 1 for completely disagree to 10 for completely agree. We classified answers 1–4 as disagreeing, 5–6 as neither agreeing nor disagreeing and 7–10 as agreeing.

This normalising of pensions is also seen in the increased proportions agreeing (answering 7 to 10 on a 10-point scale) that it’s normal for people like them to save in a pension and that pensions are the best way to save (Figure 23). The proportion saying that it’s normal for people like them to save rose from 55% in 2014 to 69% in 2018, while the proportion saying pensions are the best way to save for retirement rose from 31% to 63%.

What’s particularly striking is the substantial increase in those that strongly agree with these statements (answering 9 to 10 on the 10-point scale). Between 2014 and 2018, the proportion strongly agreeing it was normal to save almost tripled while the proportion strongly agreeing pensions are the best way to save for retirement rose from 5% to 24%.

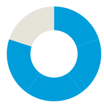
Figure 23. Private sector workers' attitudes towards pensions



Source: Nest Corporation consumer surveys, 2014, 2016, 2017 and 2018
Base: All respondents, 2014 (2,000), 2016 (1,020), 2017 (1,030) and 2018 (1,014)
Question: Please say how much you agree with these statements using a scale of 1 to 10 where 1 is completely disagree with that statement and 10 means you completely agree…
Note: We classified answers 7–8 as agreeing and 9–10 as strongly agreeing.

These positive trends among eligible employees are mirrored in our membership. In a 2019 member survey, we found that 4 in 5 agreed that saving in a pension is a good idea, with 57% saying they strongly agreed (Figure 24). This might seem like an obvious response, given that these members had not opted out of Nest. However, these results shouldn't be discounted since much of the design of auto enrolment has been predicated on, and its success credited to, the power of defaults and people's inertia. Indeed, only about 8% of all workers enrolled in Nest across the life of the scheme to date have opted out of their Nest pension pot.[24]

While being enrolled in a workplace pension may have much to do with people's inertia, and it's largely true that our members often have little interaction with the scheme, it would be wrong to assume that people don't care about their pots. Among our members, that clearly isn't the case. They may have 'allowed' themselves to be defaulted into Nest because in the main they think pension saving is a good idea, and auto enrolment has simply made it easier for them to save in a pension for retirement.



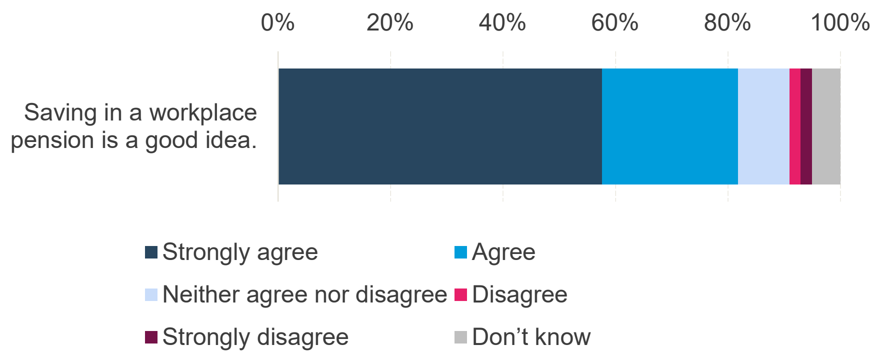
4 in 5

Nest members agree that saving in a pension is a good idea.

(2019 member survey)

[24] nestinsight.org.uk/wp-content/uploads/2021/09/Retirement-saving-in-the-UK-2021.pdf

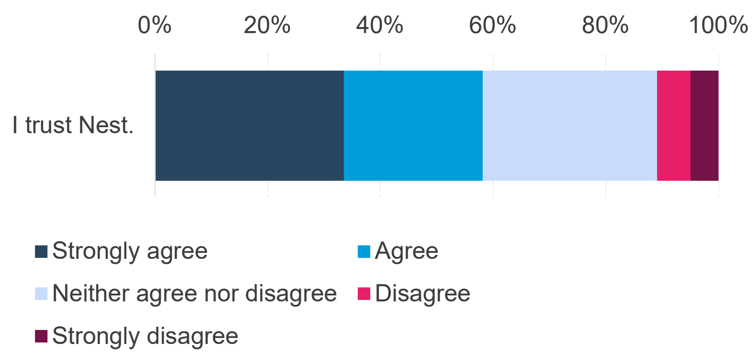
Figure 24. Nest members' attitudes towards saving in a workplace pension scheme



Source: Nest Corporation, member survey, 2019
Base: All respondents aware of Nest (2,775)
Question: Please say how much you agree with these statements using a scale of 1 to 10 where 1 is completely disagree with that statement and 10 means you completely agree…
Note: We classified answers 1–2 as strongly disagreeing, 3–4 as disagreeing, 5–6 as neither agreeing nor disagreeing, 7–8 as agreeing and 9–10 as strongly agreeing.

We should however be careful not to overstate either the general public's or our members' positivity towards pensions. For example, just over one third of our members who are aware of Nest strongly agreed that they trust Nest, in contrast with over half who strongly agreed that it's a good idea to save in a pension (Figure 25). This is not because a greater proportion distrust Nest but rather a reflection of more members being uncertain about how to answer the question, with 31% answering in the middle (5 or 6) of the 10-point scale. This quantitative survey result lines up with what we've repeatedly found when we conduct in-depth qualitative research with our members.

Figure 25. Nest members' trust in Nest



Source: Nest Corporation, member survey, 2020
Base: All respondents aware of Nest (3,454)
Question: Please say how much you agree with these statements using a scale of 1 to 10 where 1 is completely disagree with that statement and 10 means you completely agree….
Note: We classified answers 1–2 as strongly disagreeing, 3–4 as disagreeing, 5–6 as neither agreeing nor disagreeing, 7–8 as agreeing and 9–10 as strongly agreeing.

In the main, most of our members feel that it makes sense to save for retirement, but they may lack confidence around any decisions they've actively made, and their knowledge about what happens with the money contributed to their pot is extremely limited. Their lack of interaction with their workplace pensions also means there are limited opportunities for them to build confidence and trust in Nest. We recognise that there clearly remains much to be done to help our members, and eligible employees more generally, to better understand and feel more connected to their pension saving.

Attitudes towards pensions: What does this mean for our investment approach?

- Inertia is even more powerful in pension saving than we previously expected, with saving for retirement now seen to be the norm. With about 99% of our members remaining in the default fund in which they were originally enrolled, and contribution rates typically lining up with the minimum mandatory levels set in the auto enrolment legislation, reactions to market volatility appear to be muted, with few members making an active decision to change their contribution levels or fund choice in response. We should consider different types of investment risk for different member cohorts within our default Nest Retirement Date Fund series.
- Connecting our members with their pots will be important to build more confidence and trust in long-term saving. So too will an investment approach that provides steady growth in pot values and a sense that members can expect a reliable income in retirement to be delivered.

Knowledge of DC pensions

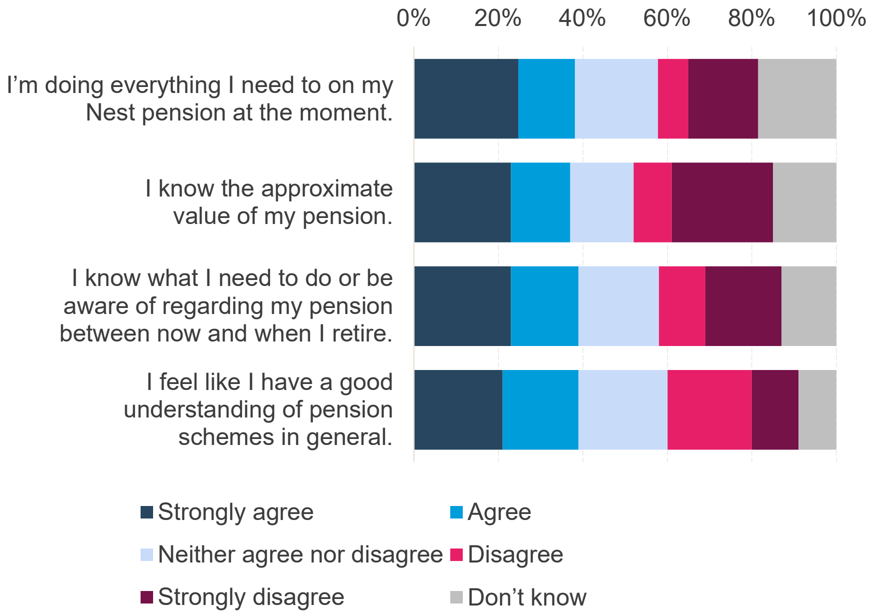
In our original member evidence brief[25], we noted a mixed picture when it came to individuals' level of knowledge of how DC pensions operate. While survey responses indicated that many people understood there is a link between DC pension performance and the stock market, people appeared to have little grasp of the specifics. In fact, when surveyed individuals were told how investment worked, they often expressed surprise. Many said that investment risk seemed to run counter to their belief that pensions should be designed to deliver safety and security in later life.

Nothing in our more recent qualitative and quantitative research leads us to think that our membership has become substantially more knowledgeable about pensions since the introduction of auto enrolment. We consistently find that our members as well as the public in general are not familiar with pensions and the underlying concepts of investment return and risk. For most, pensions are about prudence and planning for the future. People may have a vague idea that the contributions to their pot are being invested, but the majority do not fully understand what happens to their money.

[25] **nestpensions.org.uk/schemeweb/dam/nestlibrary/member-research-brief.pdf**

Figure 26 shows our members' responses in a 2020 survey to questions about their understanding of pensions in general, their knowledge of the value of their Nest pot, whether they felt they understood what they should do or be aware of in terms of their pot and if they felt they were doing everything they needed to for their Nest pension. For all of these questions, no more than one quarter strongly agreed that they were knowledgeable or clear on what they should be doing, either now or in the future. Around one third answered with uncertainty, either giving a neutral score (5 or 6 on a 10-point scale) or saying they didn't know. Another third disagreed that they were knowledgeable or clear about what they should be doing.

Figure 26. Nest members' knowledge about their pension



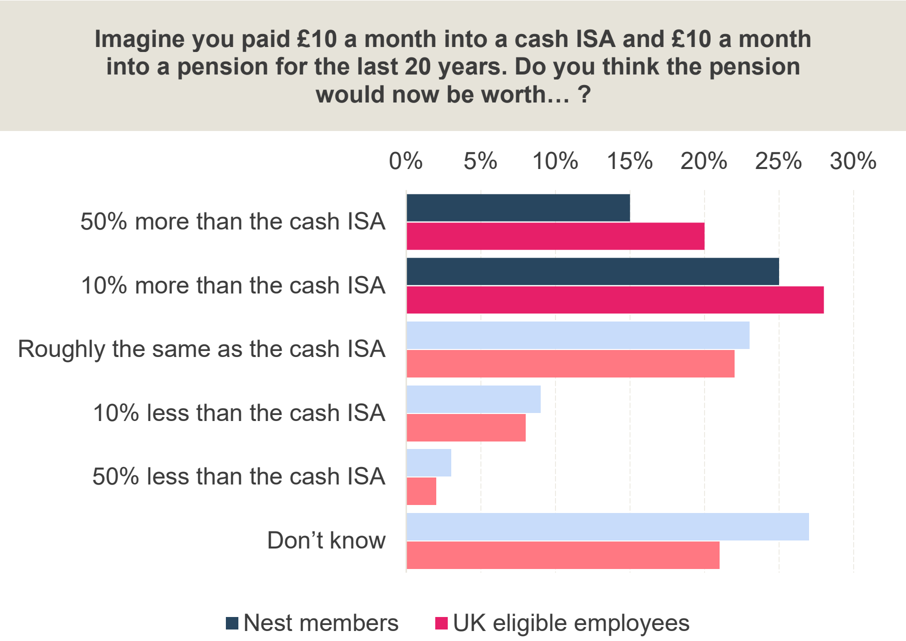
Source: Nest Corporation, member survey, 2020
Base: All respondents aware of Nest (3,454)
Question: Please say how much you agree with these statements using a scale of 1 to 10 where 1 is completely disagree with that statement and 10 means you completely agree…
Note: We classified answers 1–2 as strongly disagreeing, 3–4 as disagreeing, 5–6 as neither agreeing nor disagreeing, 7–8 as agreeing and 9–10 as strongly agreeing.

A previous member survey, done in 2017, explored the baseline financial literacy among our members around long-term investing.

In our 2017 survey we were interested in people's understanding of the different outcomes an investor would likely achieve by putting their retirement saving in a pension versus cash savings. To do this, we asked our members and a broader group of eligible employees to estimate the performance of a pension in comparison to a cash ISA.

Only 40% of our members believed that if you invested the same amount in both of these investment vehicles, a pension would be worth more than the cash ISA 20 years later (Figure 27). Just 15% of surveyed members said they thought the pension would be worth 50% more. Our members were slightly less likely than the wider population to believe this, largely because a higher proportion of our members didn't feel able to express a view on the question.

Figure 27. Expectations for saving in a cash ISA versus a workplace pension



Source: Nest Corporation, member survey, 2017
Base: All respondents (3,535)
Source: Nest Corporation, consumer survey, 2017
Base: All respondents (1,030)

Attitudes towards risk

In our original member research brief[26], we also shared evidence that our future members were, on average, more likely to be risk- and loss-averse than people who had previously saved in a pension.

For example, a Department for Work and Pensions (DWP) survey found that 76% of the target group for auto enrolment agreed that it was better to play it safe with investments even if higher-risk investments could make them more money.[27]

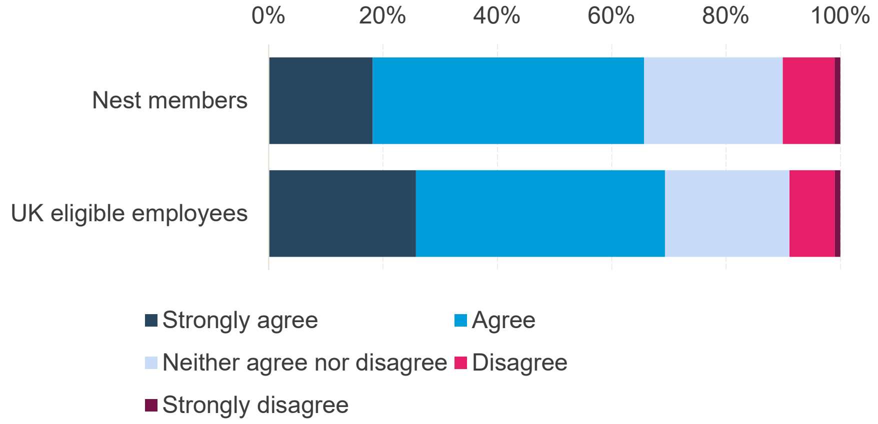
We've reprised this question in our own surveys over the years and seen a similar pattern of responses. The likelihood that a member will strongly agree that it's better to play it safe with retirement savings trends up with age and down with income, as we can see in Figure 28.

[26] **nestpensions.org.uk/schemeweb/dam/nestlibrary/member-research-brief.pdf**

[27] DWP, 'Attitudes to pensions: The 2009 survey' (2010), **assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/214476/rrep701.pdf**

Figure 28. Nest members' attitudes towards risk

It is better to play safe with your retirement savings, even if investing in higher-risk investments could make you more money.

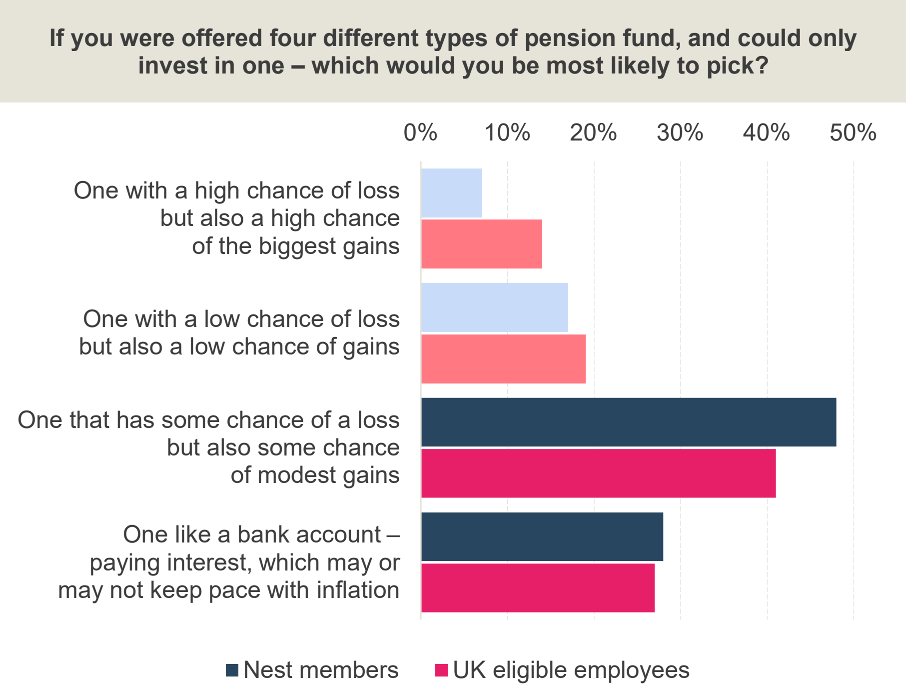


Source: Nest Corporation, member survey, 2017
Base: All respondents (3,535)
Source: Nest Corporation consumer survey, 2017
Base: All respondents (1,030)
Note: Respondents were asked to answer on a 10-point scale from 1 for completely disagree to 10 for completely agree. We classified answers 1–2 as strongly disagreeing, 3–4 as disagreeing, 5–6 as neither agreeing nor disagreeing, 7–8 as agreeing and 9–10 as strongly agreeing.

We've also explored members' risk appetite in another way, by asking them to choose among four different types of pension funds. Given our members' tendency to agree it's better to play it safe, it may not be surprising that the majority chose options they perceived to be lower risk. Only 7% chose the option offering a high chance of the biggest gains but also a high chance of loss (Figure 29). In fact, just over one quarter (28%) preferred the option that was described as being just like a bank account paying interest.

From behavioural economics we know that people tend to weigh losses as being greater than the same scale of gains. Our members' attitudes line up with this academic research. They also indicate that many of our members have a relatively low risk appetite. However, these instinctive preferences may need to be balanced against the fact that many members have a very limited understanding of how investment risk can be managed to help grow their pot over the long term.

Figure 29. People's risk appetite for their pension pot



Source: Nest Corporation, member survey, 2017
Base: All respondents (3,535)
Source: Nest Corporation consumer survey, 2017
Base: All respondents (1,030)

Attitudes towards risk: What does this mean for our investment approach?

- Our members dislike hearing about the potential for dramatic fluctuations in their pension pot value and investment fund returns. We should maintain a diversified investment portfolio to help reduce the impact of market volatility on their pots. Investing more in illiquid assets which are not marked-to-market daily will also reduce the volatility in reported fund performance and pot values.
- While our members may not be comfortable with traditional ways of communicating pension and investment risk and return objectives, they're able to articulate what they expect from their pension and what they would regard as a failure. Reframing our investment objectives to line up with our members' objectives – for example, a reliable income and a low risk of running out of money in retirement – may help to bridge the gap and ensure our members continue to feel our investment approach is serving their interests.
- Our members may not be overly concerned with protecting against inflation risk, given how they estimate the relative performance expectations for a pension compared with a bank account. However, we should do this on their behalf, to help protect their purchasing power in retirement.

Reactions to volatility and loss

We've been investing our members' money for retirement for a relatively short period of time. During the past 10 years, up to March 2020 when the global coronavirus pandemic started, the financial markets have been relatively benign, typically delivering higher than projected growth with little investment volatility. So it's hardly surprising that we haven't observed much if any obvious loss avoidance behaviour among our members. Indeed, they have in large part remained inactive when it comes to investment decision-making.

However, attitudinal evidence does point towards a significant proportion of our membership being risk- and loss-averse as we expected. And we've designed our investment approach with a view that periods of market volatility are inevitable, whether these are due to a pandemic or risks associated with other causes of economic or market turmoil.

For example, in our 2012 member research brief[28] we discussed a large-scale qualitative research project we conducted prior to the start of auto enrolment. Through it we aimed to understand our target group's loss and risk aversion and the extent to which these might drive their pension and investment behaviours. We concluded that people in our original target group of low and moderate earners, many of whom were not then saving in a pension, were strongly loss-averse. Their responses to hypothetical pension losses were often quite emotional. They commonly felt that pensions were supposed to grow steadily in value, and a loss was seen as an anomaly or a fault.

We haven't directly replicated this research with our membership, but we have conducted other quantitative and qualitative research to see if these findings continue to hold true among people who have been automatically enrolled in a workplace pension. As described on page 51, when we've asked our members to choose among four different types of pensions, they tend to prefer an investment approach that would limit the chance of losses. About 45% of our members would choose either a fund with a low chance of loss even though it had a low chance of gains or one like a bank account paying interest (see Figure 29 on page 52).

In our original qualitative research, we found that people on lower incomes and younger people were more likely to be very loss-averse. Our more recent quantitative survey research supports those findings. When we asked members about their preference among the four different pension types, those aged 22 to 29 were slightly more likely (31%) than older members to choose the bank account paying interest, the option least likely to incur losses. There was an even more noticeable difference by income – 30% of members with an annual personal income of less than £30,000 said they would choose the bank account option compared with 21% of members with an income between £30,000 and £39,999 and 15% with an income of £40,000 or more.

[28] nestpensions.org.uk/schemeweb/dam/nestlibrary/member-research-brief.pdf

Our qualitative research has identified that different types of loss result in different strengths of feeling. Participants felt more negatively about a loss of the contributions paid into their pot than they felt about a loss of investment gains on contributions. They only appreciated the risk of inflationary loss after prompting and tended to see it as less concerning than a loss in absolute value. A run of losses over several years was more alarming than an equally large loss experienced in a single year or losses experienced intermittently (in three out of five years).

In 2017 we surveyed our members to see which types of loss individuals found most and least acceptable. We again found that members expressed a strong loss aversion but, interestingly, the results slightly contradicted the results of our previous qualitative research. In the more recent quantitative survey, members had the most negative reaction when presented with a large immediate loss rather than consistent losses over a period of time. The difference between these qualitative and quantitative findings might largely be a function of the research methods.

In other qualitative research that we've conducted, our members have been most alarmed by the prospect of consistent losses over a number of years. For example, we revisited our members' reactions to market volatility and loss in 2021 in a smaller-scale qualitative research project. Here we found that our members continued to have an emotional response to loss and a preference for a 'middle of the road' approach to balancing the chance of gains against the chance of losses. However, in contrast to the findings of our original research, now members appear to be more tempered in how they anticipate they would act in response to losses.

> Our members have an emotional response to loss and a preference for a 'middle of the road' approach to balancing the chance of gains against the chance of losses.

In our original research, many of the participants had said they would take action to prevent further losses from occurring. Most often they said they'd stop their contributions, perhaps following the admonition not to throw good money after bad. Some said they'd monitor the situation to see if losses continued in a consistent pattern and then, if the losses did, they'd take action. Others said they were keen to seek information and advice. Because this was before the launch of auto enrolment, these were purely intentions. Some of the participants may have felt emboldened to take action after spending time discussing pensions during the in-depth research itself – what is called a 'research effect'.

In our more recent research, our members expressed weaker emotional responses to losses and they were less strong in asserting that they'd take action in response to losses in their pot value. And we observed very few members switching fund choices or stopping contributions in response to the market volatility at the start of the pandemic, as reported in 'Retirement saving in the UK 2020'.[29]

Indeed, with most of our members paying limited attention to their pension pot, investment losses would need to be very significant before they might be moved to react. This is particularly the case in the context of the demands of day-to-day life, which may get in the way between the member's intention to act and their actual behaviour. In our latest research, our members said they'd likely continue to be largely hands-off with their pension, even if they experienced short-term losses.

[29] nestinsight.org.uk/wp-content/uploads/2021/02/Retirement-saving-in-the-UK-2020.pdf

Reactions to volatility and loss: What does this mean for our investment approach?

- Our members are loss averse, potentially reacting negatively to different forms of loss presented to them in research experiments. We should continue to target investments with lower risk of sharp falls in valuation in our default investment strategy, the Nest Retirement Date Fund series.
- The form of loss most disliked differed across research projects. When we presented different forms of loss during in-depth qualitative research, cumulative losses over several years were most negatively received. This is subtly different to a general aversion to risk.
- Our members continue to think pensions should be about safety and stability in retirement and are unsure how DC pensions traditionally operate. Their reaction to hypothetical losses is emotional, in keeping with research in behavioural economics. We should continue to balance the need to give the highest possible income in retirement with our members' very real concerns around losses and insecurity. Finding ways to meet members' preferences without giving up investment returns will be a key challenge in developing our investment approach in the coming years.
- Our members do not have inflation 'front of mind' as a significant risk or a type of loss. Protecting purchasing power on their behalf should remain a key tenet of our approach. We should also strengthen our communication efforts to improve understanding of the corrosive effects of inflation over time.

The big picture

Most of our members prefer certainty. This is consistent with their having a lower capacity for risk, because they have a low or no buffer to cushion against adverse outcomes.

Maintaining and increasing confidence and trust in Nest as an organisation will be important to encourage our members to save persistently for retirement. Our investment strategy should target steady growth rather than outsized gains with high risk. We should maintain a diversified portfolio to reduce the impact of market volatility and the likelihood of extreme outcomes. We should also explore ways of rebalancing portfolios to both enhance returns and reduce volatility.

If we're to act in our members' best interests, we will from time to time have to go against what our members say they want. For example, while members don't seem to be overly concerned with inflation risk, we should protect their purchasing power in retirement.

Risk aversion, like risk capacity, comes in different flavours, depending on a person's life stage and financial resources. It continues to be appropriate to design the investment strategy for our default Nest Retirement Date Fund series to take different levels of risk at different phases in a member's saving journey.

Chapter 5

Changing needs in later life

We've considered what our current members' characteristics may mean for the future of our investment approach. Here we consider the changing nature of retirement and how this should influence our decision-making.

In 'Retirement saving in the UK 2021'[30], Nest Insight has provided evidence of how retirement has evolved over the past 40 years. This analysis includes an exploration of people's actual and expected retirement age, why many may be delaying retirement, how people are participating in the labour market and whether they're retired, partly retired or continuing to work full-time. This data is critical to forming a robust understanding of how our members will approach retirement, including how to develop our default investment strategy, which is based on retirement target-date funds, to take into account uncertain or variable retirement ages.

In addition, since the 'freedom and choice in pensions' reforms in 2015, it has been possible for defined contribution (DC) savers to access some or all of their pension pot from age 55. We now have enough years of data to confirm that a portion of our membership are taking advantage of this.

We should consider both earlier access and later retirement when making any changes to the life-styling of the Nest Retirement Date Fund series and the timing of the transition from our growth phase into the pre-retirement consolidation phase for members approaching their expected retirement age. We should also explore the composition of our portfolios for 'post-retirement' investments given that retirement may, now and in the future, be less an occasion celebrated on a single day, with the purchase of a single retirement income product, and more a gradual process stretching over months or years, involving a mixture of investment and insurance strategies.

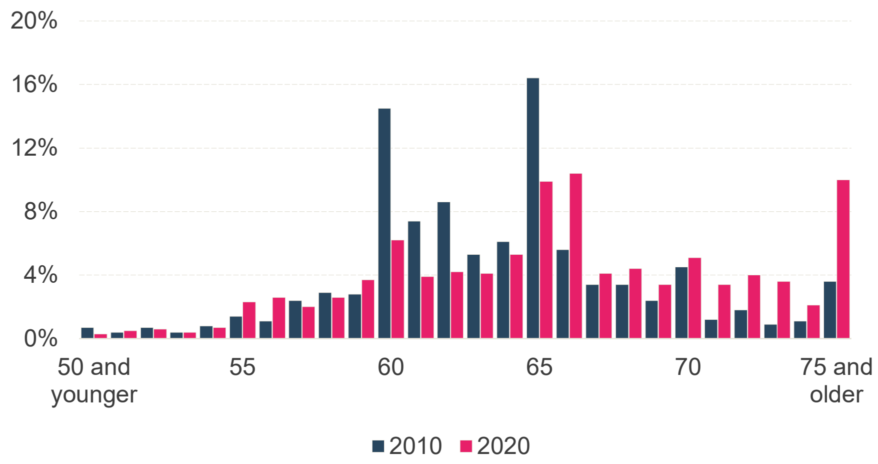
30 **nestinsight.org.uk/wp-content/uploads/2021/09/Retirement-saving-in-the-UK-2021.pdf**

The changing nature of retirement

First and foremost, people in the UK are retiring later in life, as shown in Figure 30. The significant spikes in retirements at age 65 for men and at age 60 for women that could be seen in 2010 have shifted up the age scale as a result of the equalisation in State Pension age for men and women and the increase in the State Pension age from 65 to 66.

But there has also been a clear increase in the proportion of people retiring beyond their State Pension age. In 2010, roughly 4 in 5 people said they'd retired at or before their State Pension age, whereas in 2020 only around 3 in 5 did. This is a massive shift in people's life choices over a relatively short period. It means that income solutions that made sense for people approaching retirement a decade ago are likely to need a significant rethink across the pensions industry, leaving aside the significant changes associated with the ending of compulsory annuitisation.

Figure 30. Retirement age in 2010 and 2020



Source: Labour Force Survey, April to June 2010 and April to June 2020

Although the proportion of people working beyond their State Pension age is increasing, this doesn't necessarily mean they're continuing in the same type of employment in their later years. Workers in their late 60s and in their 70s may be undertaking different jobs, different patterns of working or have different goals or ambitions for working than they had earlier in their careers. We know, for example, that the proportion of people working part-time increases from around age 55, an indication that, for some, the route into retirement is one of reducing how much they work rather than stopping work abruptly.

And of course, not all workers have the luxury of being able to stop working, or work less, in older age. As shown in the analysis in 'Retirement saving in the UK 2021', some people continue working voluntarily, while others say they do so involuntarily, citing reasons such as not being able to afford the cost of living without income from employment. Among those currently working beyond State Pension age, however, the majority report that they've done so voluntarily, with not being ready to give up working as their main reason.

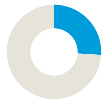
Our members' expected retirement age

In surveys we've asked our members about when they expect to retire. Many people may have no idea what they might do in several decades' time, so we should be careful in not over-interpreting their responses, particularly when surveying our younger members.

Regardless of these caveats, the State Pension age remains an anchor point for many of our members, although significant numbers expect to stop working before or after this date. In a 2017 member survey, only one third (33%) of our members said they expected to retire at their State Pension age, whereas one quarter (26%) expected to work past it and one fifth (18%) expected to retire earlier. Nearly a quarter (23%) were unsure when they expected to retire.

Members aged 60 and older are more likely than any other age group to say they expect to retire after they reach their State Pension age. These members, being closer to this age, may simply have formed a strong sense that they want to continue working or have perhaps realised that they'll be unable to afford to stop working then.

In a 2018 survey (Figure 31), we asked our members who were considering delaying their retirement beyond State Pension age why they were thinking of doing this. Older members were more likely to say they weren't ready to stop working. In contrast, our members 40 to 59 were more likely to say they'd need to work past their State Pension age to pay for essential items. This was particularly the case among women in our membership. We hypothesise that these members are concerned that, earlier in their working life, they under-saved for retirement.

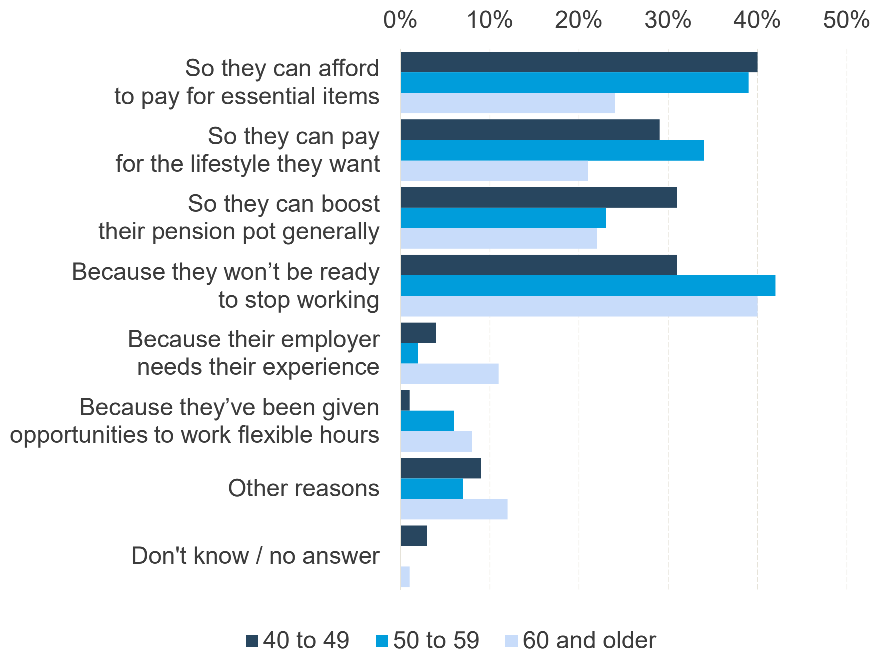


1 in 4

Nest members expect to retire after their State Pension age

(2017 member survey)

Figure 31. Nest members' reasons for planning to delay retirement beyond State Pension age



Source: Nest Corporation, member survey, 2018
Base: All respondents considering delaying retirement past State Pension age who were 40 and older (321)
Question: Why are you considering delaying your retirement beyond the State Pension age?

We've also observed that some of our members have reached their expected retirement date and have not decumulated their Nest pot. We automatically move the pots of members whose pot totals less than £10,000 and who have not yet accessed their savings when their target-date fund closes into the Nest Post Retirement Fund. As at 31 March 2021, the Nest Post Retirement Fund had around 80,000 members, with 30% of these members actively employed at that date. To put the membership of the Nest Post Retirement Fund into context, since the start of the scheme around 250,000 members have decumulated their pot.

With pot values being low, on average, it's unsurprising that over 80% of members who have decumulated their pot have chosen a trivial commutation, which is available only for pots with a value of £10,000 or less.

Retirement age: What does this mean for our investment approach?

- Our members are likely to have more variation in their actual retirement ages, and less of a 'cliff edge' between work and retirement. This suggests that some traditional approaches to de-risking investments close to a person's 'retirement date' may need to be rethought.
- We should work to ensure that our members are aware of how to change their target-date fund, should they already be anticipating that they'll delay their retirement beyond their State Pension age.
- One-size-fits-all approaches for life-styling investment strategies and strategies for investing into retirement need to take into account the increasingly large proportion of people retiring later (or earlier) than their State Pension age.
- Within the scope of pensions regulations, we should look to develop retirement solutions that allow greater flexibility for people who wish to continue working and contributing to their pension pot while being able to access their savings when needed. Importantly, we should aim to ensure that our members continue to benefit from investment returns well into their later life.

Life expectancy and ill health

The government's changes to the State Pension age since the early 1990s have been based upon the significant increase in people's life expectancy since the Second World War. People are living much longer and, for many, that means spending a greater proportion of their life in retirement. Thankfully, many of these extra years will be also be spent in good health. But for some people, their later years will be characterised by ill health, perhaps even before they reach retirement age.

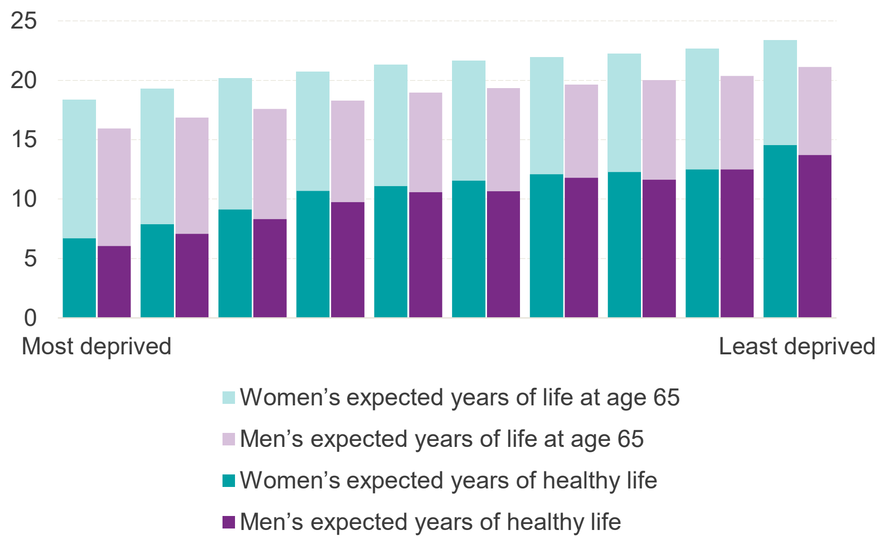
Lower life expectancy is associated with higher levels of socio-economic deprivation. ONS statistics released in 2021 show that those in the top 10% of the Indices of Multiple Deprivation (IMD) have five additional years of life expectancy on average than those in the bottom 10%.[31]

[31] ONS, 'Health state life expectancies by national deprivation deciles, England: 2017 to 2019' (March 2021), **ons.gov.uk/peoplepopulationandcommunity/healthandsocialcare/healthinequalities/bulletins/healthstatelifeexpectanciesbyindexofmultipledeprivationimd/2017to2019**. For information on the life factors used to create the IMD, see Appendix A starting on page 102.

We can consider healthy life expectancy against total life expectancy based on either life expectancy from birth or from age 65. To understand the experience of people living in retirement, and tailor our investment approach to their needs, we've used healthy life expectancy from age 65.

As Figure 32 shows, the proportion of total life expectancy that is in good health increases rapidly as the IMD decile increases. This is true for both women and men. Those in the lowest IMD decile may expect around 35% to 40% of their remaining life from age 65 to be in good health, compared with roughly 60% to 65% for those in the highest IMD decile.

Figure 32. Healthy years versus total life expectancy at age 65, by Indices of Multiple Deprivation (IMD) decile



Source: ONS, 'Health state life expectancies, UK: 2017 to 2019' (January 2021), **ons.gov.uk/releases/healthstatelifeexpectanciesuk2017to2019**
Note: For information on the life factors used to create the IMD, see Appendix A.

Taking the fifth decile as the median, men aged 65 may expect to live a further 19 years of which around 10.5 will be healthy. Women of the same age may expect to live a further 21 years, 11 of them healthy.

So, despite great improvements in total life expectancy and healthcare provision across the 20th century, people will often spend a significant proportion their lives after they reach retirement age in poor health. Having suitable assets and income in retirement will be paramount in determining how well they weather these years.

Early retirement

As with working in retirement, early retirement, in the main, is either a voluntary personal choice or an involuntary response to factors limiting a person's ability to work.

Where a worker voluntarily leaves the labour market, it's often because they feel they have the financial resources to provide enough retirement savings or income to fund the remainder of their life. In some cases, stopping work can be beneficial to the person's health and wellbeing. Conversely, where a worker involuntarily leaves the labour market, retirement is strongly associated with poorer health and wellbeing, in large part because ill health is often a driver of the decision.

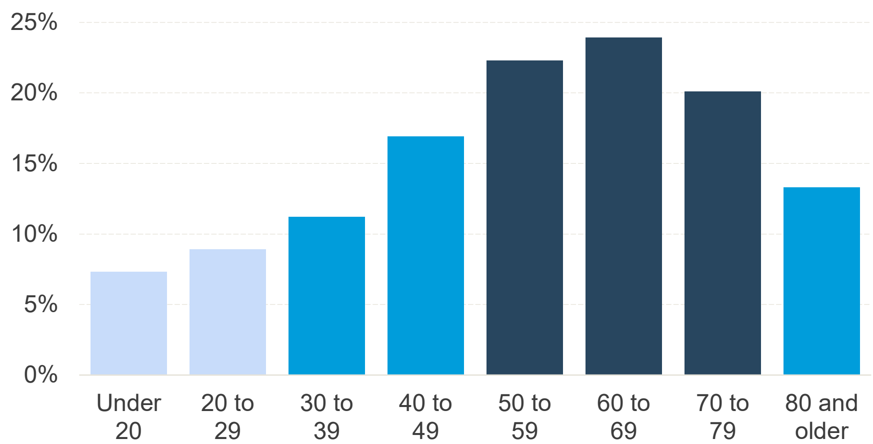
Indeed, we can see in Figure 33 that health was the second most common reason people aged 50 to 64 gave for leaving their last job. Only early retirement, which we assume were mostly voluntary actions, was cited more frequently. Further, evidence from the English Longitudinal Study of Ageing suggests that someone who considers their health to be good or fair is three times more likely to retire involuntarily than someone who rates their health as excellent.[32]

Figure 33. Reasons for leaving last job among people aged 50 to 64 currently not in work

Source: Annual Population Survey, January to December 2020

Another major reason workers involuntarily leave the labour market is to take up caring responsibilities for others in their family. While caring responsibilities can arise at any age, they are more common among those closer to retirement, as shown in Figure 34.

Figure 34. UK adults with informal caring responsibilities, by age



Source: ONS, 'Living longer: Caring in later working life' (March 2019), **ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/ageing/articles/livinglongerhowourpopulationischangingandwhyitmatters/2019-03-15**

[32] Institute for Fiscal Studies, 'The dynamics of ageing: Evidence from the English Longitudinal Study of Ageing 2002–15 (wave 7)' (2016), **ifs.org.uk/publications/8696**

The larger proportion of people aged 50 to 69 who have caring responsibilities may be due to a partner being in poor health, requiring the other partner to stop working to care for them. This would have a doubly detrimental effect on the household, with both partners forced to leave the labour market.

There may also be an increased likelihood that people in this age range are providing regular care for grandchildren. Some grandparents may continue to work part-time to facilitate the balance between earning an income and providing support to younger generations, both before and beyond their retirement age.

Early retirement: What does this mean for our investment approach?

- While most of our members appear to be retiring later in life, we need to be aware that some will retire earlier than planned or may move to part-time working as they approach retirement. Our investment approach should not assume that contributions to our members' pots will rise all the way to their expected retirement age, even among those members saving persistently with us.
- Recently we've developed a new investment pathway, the Nest Guided Retirement Fund[33], for our members with larger pots who wish to keep a portion of their pot invested for growth after they reach their expected retirement age. This was partly designed with later retirement dates in mind and to provide access to stable retirement income for many years. Going forward, we should track life expectancy for our membership as our members may fall in the lower end of the IMD deciles compared to the median for the overall UK working population. This data may help reduce the risk of unused savings being left in the Nest Guided Retirement Fund or similar pathways on a member's death.
- Understanding the life expectancy and healthy life expectancy patterns of our membership will help us to evolve retirement investment pathways for them. It will also potentially allow us to improve member outcomes, for example by developing options in the future for introducing elements of mortality risk-sharing along the lines set out in our 2015 retirement blueprint.[34]

Income needs in retirement

The government's 'freedom and choice in pensions' reforms have given pension scheme members more ways to access their savings. While many of our older members have taken advantage of the new freedoms to access their pot as cash from age 55, we've found that, for most, contributing to their Nest pot is about generating or supplementing an income in retirement.

In some cases, this additional income may be used to replace wages as our members move from full-time to part-time working or from working to being fully in retirement.

So far, we've seen little evidence to suggest that people who have spent years saving are likely to spend their pot quickly when they do access their savings. In fact, the challenge may be more about making sure individuals don't underspend and leave themselves less comfortable in retirement than they need be.

[33] More information about the Nest Guided Retirement Fund is available on our website at **nestpensions.org.uk/schemeweb/nest/aboutnest/investment-approach/other-fund-choices/nest-guided-retirement-fund.html**

[34] Nest Corporation, 'The future of retirement: A retirement income blueprint for Nest's members' (2015), **nestpensions.org.uk/schemeweb/dam/nestlibrary/the-future-of-retirement.pdf**. For more on the blueprint, see Chapter 6.

To inform the design of suitable investment strategies and pathways for our members, we need to understand people's changing patterns of consumption and needs in retirement. The International Longevity Centre (ILC) conducted detailed research on people's actual spending patterns in retirement and how these relate to their everyday activities.[35] The report utilised two large datasets:

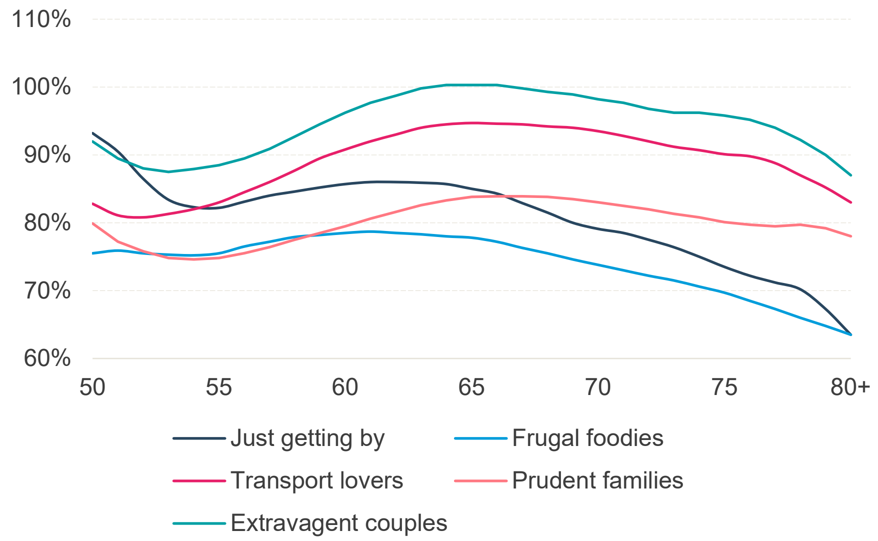
- the Living Costs and Food Survey, which gives insights into income and expenditure patterns of older people
- the English Longitudinal Study of Ageing, which explores what people are actually doing in their daily lives and whether they're content with this

The ILC report found that, as people get older, they spend progressively less on consumption, regardless of their level of income. Much of this decline in consumption is explained by less spending on 'non-essential' items – things like recreation, eating out and holidays. In contrast, spending on 'essential' goods and services remains relatively flat during retirement, which means they account for an increasing proportion of the household budget.

The data does not show any post-retirement spending boom on leisure and holidays. In fact, from age 50 onwards, spending on most non-essential items slowly declines. Among those aged 80 and older, over 50% of household expenditure goes towards essential items.

The ILC identified five consumer groups based on people's spending habits in retirement. Each group's consumption as a proportion of their income can be seen in Figure 35.

Figure 35. Consumption as a proportion of income, by market segment



Source: Adapted from Figure 36 in **ilcuk.org.uk/understanding-retirement-journeys-expectations-vs-reality**

The ILC identified five different consumer groups in retirement based on people's spending habits:

❶ Just getting by

who spend over 45% of their total expenditure on housing and bills

❷ Frugal foodies

who spend 28% of their expenditure on food and drinks and over 13% on furnishings, housing equipment and other household items

❸ Prudent families

who spread their expenditure evenly on many items and save consistently as they age

❹ Extravagant couples

who spend nearly 40% of their expenditure on recreational goods and services

❺ Transport lovers

who spend more than 37% of their expenditure on transport, both public and private

[35] International Longevity Centre (ILC), 'Understanding retirement journeys: Expectations vs reality' (November 2015), **ilcuk.org.uk/understanding-retirement-journeys-expectations-vs-reality**

Saving savings for later life

When people withdraw from the labour market and enter retirement, they typically experience a fall in their income. As this reduction is entirely anticipated, we wouldn't expect their consumption to fall immediately. We would instead expect a natural decline in the person's level of existing savings as they draw down these savings to maintain their level of spending in retirement. However, evidence suggests that, in general, people are inclined to hold on to their savings in retirement as a precaution against unforeseen events such as ill health. They also hold on to savings out of concern that they may not have enough savings to last the rest of their lives.[36]

Saving savings: What does this mean for our investment approach?

- If spending tends to decline during retirement, our post-retirement investment solutions may be able to focus less on inflation protection.
- Providing the highest sustainable income and liquidity early on in retirement would seem to fit best with both a more flexible approach to retiring and reduced consumption needs later in retirement.

The big picture

The changing nature of retirement, and changes in people's behaviour in retirement, has significant implications for our investment approach. With many people retiring later and a greater proportion working beyond their State Pension age, we should continually reassess when we start de-risking members' target-date funds in our default Nest Retirement Date Fund series, the speed at which this de-risking proceeds and the portfolio to which we move a member's pot when we de-risk them.

An investment strategy that contains growth-seeking, and thus more risky, assets for longer will increase the chance for a larger pot size at retirement. By considering both the path of return objectives in the years immediately prior to retirement and the number of years until the member's likely expected retirement, we may be able to increase pot size while also dampening volatility. We'll be conducting more research and modelling in this area.

How members access their savings is heavily influenced by their pot size. Members with smaller pots are likely to access their pot as cash while those with larger pots tend to want access to financial products such as drawdown. We developed the Nest Guided Retirement Fund as a solution for our members with larger pot values when their target-date fund closes. We need to continue to consider how best to meet differing and evolving needs across our membership.

[36] Jennifer Alonso-García, Hazel Bateman, Johan Bonekamp, Arthur van Soest and Ralph Stevens, 'Saving preferences after retirement' (December 2018), **papers.ssrn.com/sol3/papers.cfm?abstract_id=3184043**

We should plan for the inevitability that an increasing number of small pots are likely to go unclaimed for some time, as some of our inactive members may lose track of their Nest pot. In addition to supporting work on the pensions dashboard to help our members to be aware of pots they've accumulated in previous employments, we should aim to protect the value of these orphaned pots in real terms after charges. The ultimate objective of retirement saving is to secure an income in retirement. Even small pots can help to replace wages earned from employment, particularly when workers are transitioning slowly from full-time work to full retirement and have workplace pensions with multiple providers that they might draw upon. As noted earlier, pot size at retirement is a means to delivering income replacement and not itself the ultimate objective.

We're likely to see increased divergence between members who have a high dependence and those with a low dependence on their Nest pot in retirement. We should consider a range of post-retirement investment glide paths to cater to the different and evolving needs of our membership.

Chapter 6

Retirement expectations

Understanding what our members expect from their pension savings, in addition to what they need, influences how we design our investment strategies for members approaching and entering retirement.

Since the ‘freedom and choice in pensions’ reforms, there has been a significant body of research conducted by organisations such as the Pensions and Lifetime Savings Association (PLSA), the Pensions Policy Institute (PPI) and a variety of insurance and fund management providers into what defined contribution (DC) savers now expect from their pension pots. We’ve also commissioned or conducted qualitative and quantitative research to help us understand our members’ expectations, including as part of our work to develop the Nest Guided Retirement Fund.

In this chapter we summarise some of the key findings from this research.

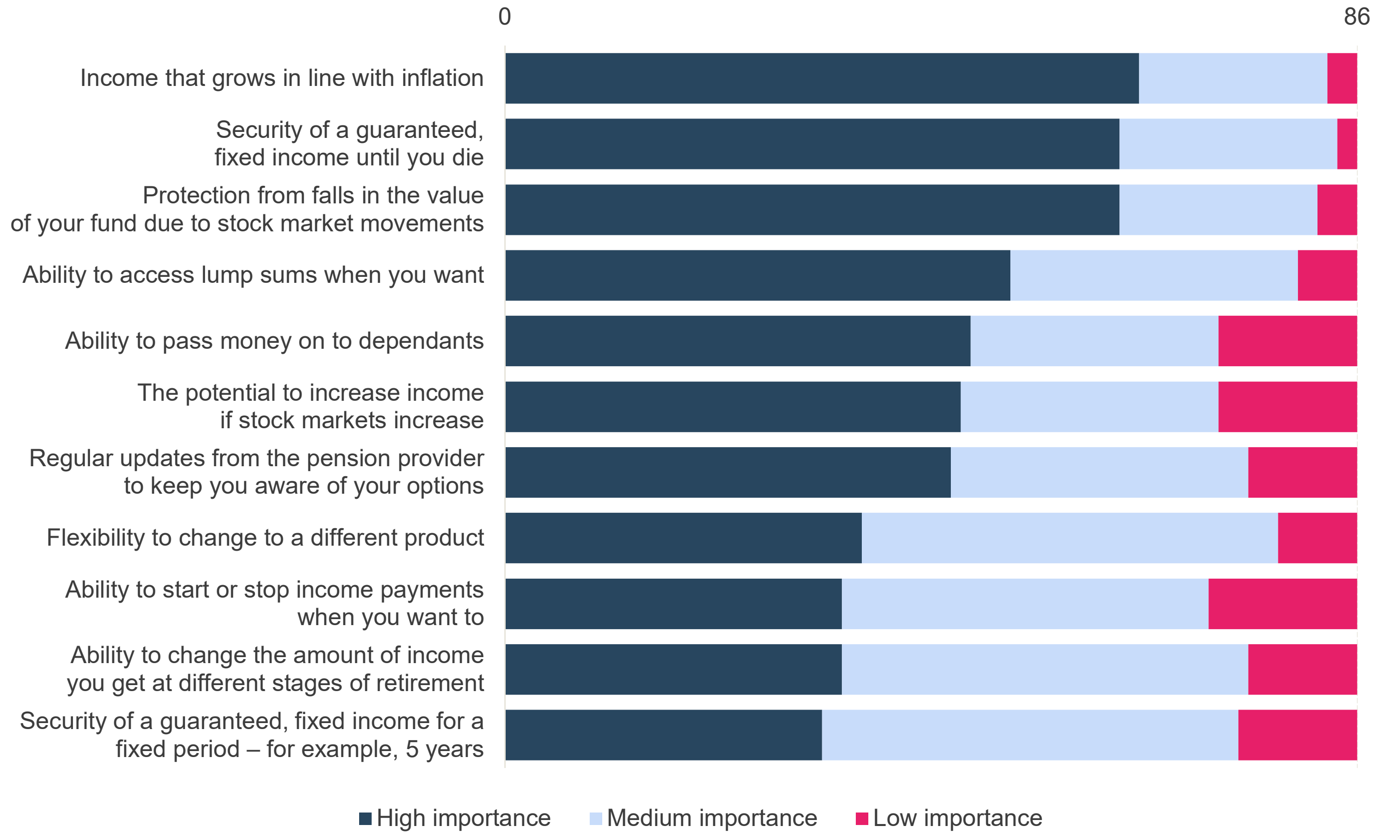
Desire for regular income and flexibility

Figure 36, Figure 37 and Figure 38 explore the findings of three research projects commissioned following the government’s announcement in 2014 that people saving in a money-purchase pension scheme would no longer be required to buy an annuity to access their savings. The first two projects involved qualitative research with people drawn from the general population who had been screened to have similar characteristics to our members who will be approaching retirement over the next decade. The third was an online survey of Nest members.

In both our qualitative and quantitative research, we’ve consistently found that people have a desire for some form of regular income in retirement. They also prioritise having a sense of certainty or security that their money won’t run out. Flexibility and ability to access cash lump sums is also appealing but perhaps a second-order priority.[37]

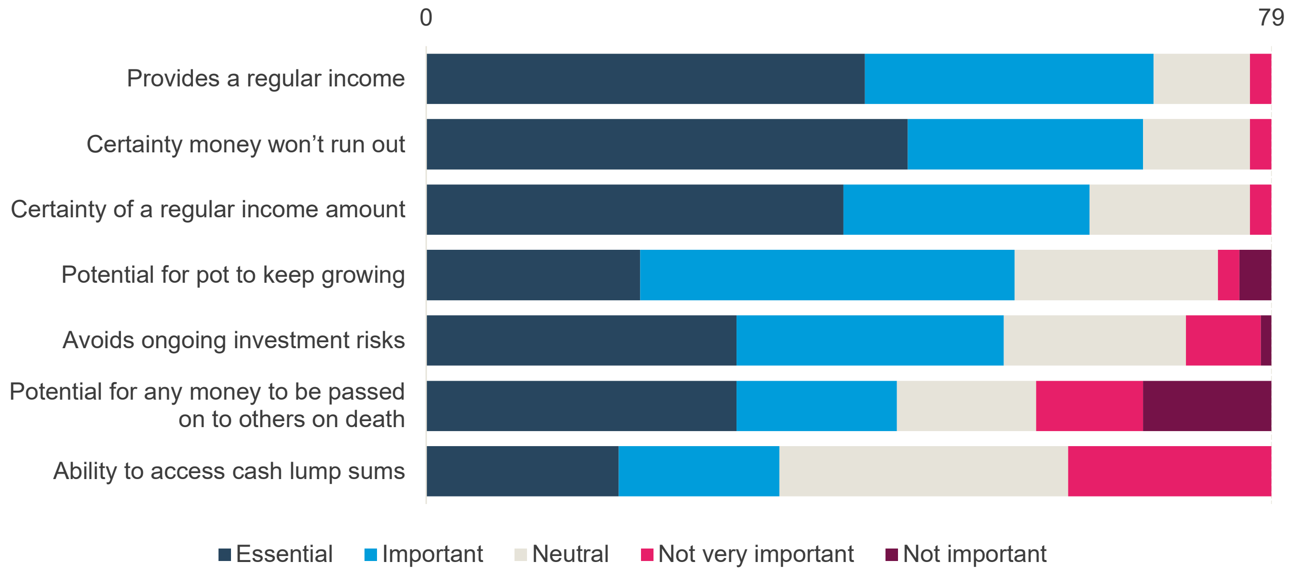
[37] Of course, there are trade-offs inherent in wanting both income certainty and flexibility to access your pension pot. We did not explore that question in this research, but we’ve taken it up more recently. See the discussion on page 72.

Figure 36. What people want from their retirement savings – qualitative research, 2014



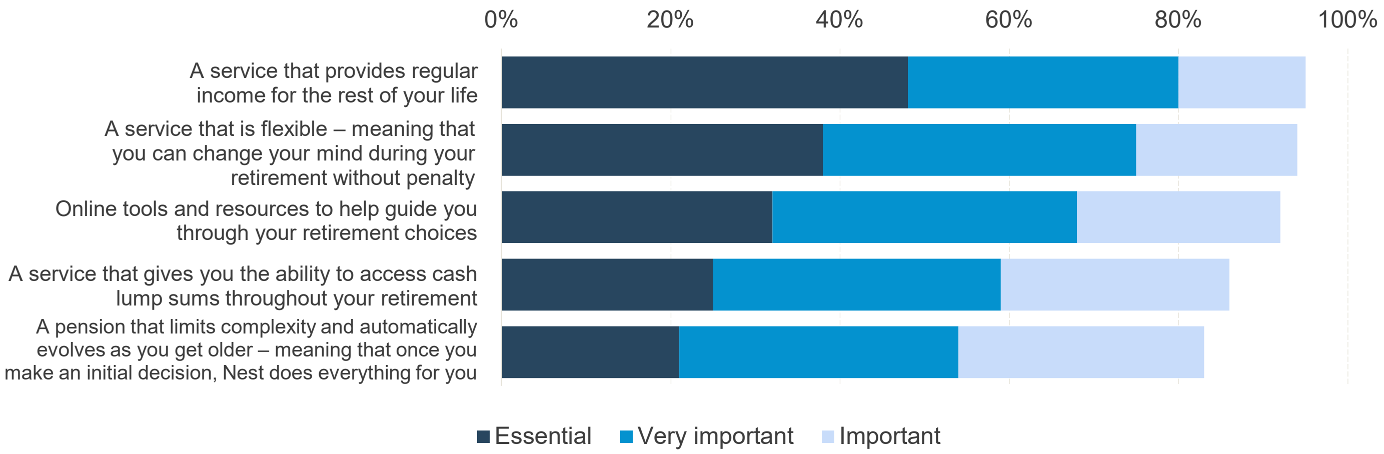
Source: Ignition House for Nest Corporation, 2014
Base: Qualitative respondents (86)
Note: Data is presented as counts, not percentages.

Figure 37. What people want from their retirement savings – qualitative research, 2015



Source: Ignition House for Nest Corporation, 2015
Base: Qualitative respondents (79)
Note: Data is presented as counts, not percentages.

Figure 38. Nest members' relative ranking of different features Nest could offer



Source: Nest Corporation, member survey, 2016
Base: All respondents (2,172)
Question: How important do you think it is that Nest offers the following types of solution?

In our 2015 qualitative research, most participants said they were looking for a regular income which would, ideally, last them for the rest of their life. For many, the ability to access cash lump sums from their pot was very important, as this could provide cover for unexpected events, or fund a treat upon or during retirement. This cash access was less important to people who reported having significant other savings, and to those with small pots, whose main priority was maximising their income.

People expressed a range of opinions on whether and how much they valued having the capacity for any money left in their pot to be passed to their estate on their death. Their opinions were highly dependent on their pot size and family situation, with respondents taking a realistic view on whether they'd have anything left to pass on. Regardless of what they thought about leaving their pot as a legacy, most stressed that, given the choice, they did not want to have money left on death kept by an annuity company or, as some thought, transferred to HMRC. They had a strong sense that their pension pot is **their** money and they didn't want someone they hadn't chosen to get their hands on it when they die.

Our discussion revealed that concerns about running out of money was a key area where people didn't feel comfortable in their ability to make the right decisions. Surprisingly, we heard that ongoing worries about making the wrong investment decisions over the next 10 to 20 years were actually a much bigger concern than running out of money in later life, perhaps because they would then feel personally responsible for any financial shortfall they suffer.

Many of the participants in this qualitative research were seeking replacement income for their monthly earnings rather than occasional access to lump sums. Most felt they would need a regular income to supplement the State Pension. For example, one person said they were looking for:

> A regular income, because I won't be able to live on the State Pension, so I do need a top-up… for everyday essentials, the State Pension won't cover that.
>
> Woman, aged 56 to 65, basic rate taxpayer, pot size £20,000 to £50,000

> Worries about making the wrong investment decisions over the next 10 to 20 years were actually a much bigger concern for our members than running out of money in later life.

Despite stating that they wanted a regular lifetime income, many people did not want an annuity. These individuals expressed very negative views about annuities, describing them as 'poor value' or as having 'rubbish rates'. They often recounted their family members' poor experiences with annuities and believed that annuities are deeply unfair. Few were aware of options such as value protection or variable annuities.

Desire for regular income: What does this mean for our investment approach?

- A wealth of research confirms that many people's ultimate objective for their pension saving is to secure an income in retirement to replace the income earned from employment. As we noted in Chapter 5, pot size is merely a means to delivering this. We must recognise this desire for a sustainable income in retirement and consider it in the design and development of our portfolios and the balance between seeking growth and avoiding risk. We should look at a wide range of income-generating assets, including illiquid assets, when building our investment portfolios.
- Our investment approach should also consider different retirement solutions that take into account that our members may have multiple pots, other assets or employment income – or that they may be highly dependent on their Nest pot as their main asset for retirement. Regardless, our retirement solutions should be focused on converting members' pots into regular income, however each member defines this.
- People's competing desire for flexibility suggests that we should maintain liquidity in our portfolios, particularly in the early years of retirement. However, even in our post-retirement pathways, member funds don't need to be entirely invested in assets with daily liquidity.

Miscalculating investment and income risks

Our research suggests that many consumers don't fully understand the interaction between pot size, longevity risk and how long they might expect withdrawals of cash lump sums from their pot to last. When consumers have been asked to estimate how much they could draw down in a year and the investment return they expected to make each year after charges, the picture they presented was remarkably out of step with historical investment returns and actual pot sizes.

People also struggle when estimating their likely age at death. Overall, they're able to take into account average life expectancy. However, they find it more difficult to consider the probability of living into their 90s, which many of our younger members could reasonably expect, and which many members who reach age 65 could expect too.

Miscalculating risks: What does this mean for our investment approach?

- The calculations required to work out what is a sustainable income and the impact on longevity of periodic cash withdrawals are extremely complex. Most people, including our members, are unlikely to be able to complete them for themselves. Setting sustainable rates and helping members manage longevity risk should remain a central part of our approach to investment pathways for members in retirement.
- Exploring ways to share mortality risk – the risk of a member dying before realising most or all of their pension saving – and to provide more predictability in retirement incomes would appear to benefit many of our members.

Trade-offs around income certainty

Our research suggests that most people would like to receive some form of regular income in retirement but not at the expense of having flexibility to access their pot as cash, if needed. To explore how we might address these desires while at the same time mitigating against the risk that individuals might run out of money, in 2015 we published a paper setting out a retirement income blueprint for our members.[38] In it we described guiding principles for developing a product that could meet a variety of retirement pathways.

The guiding principles of our retirement blueprint

1. Living longer than expected and running out of money is the key risk in retirement and a critical input into retirement income solutions.
2. Savers should expect to spend most or all of their pension pots during their retirement.
3. Income should be stable and sustainable.
4. Managing investment risk is crucial as volatility can be especially harmful in income drawdown-type arrangements.
5. Providers should look to offer flexibility and portability wherever possible.
6. Inflation risk should be managed but not necessarily hedged.

A key focus of our research since publishing this blueprint has been to explore the trade-offs inherent between guiding principles 1, 3 and 5.

We've conducted qualitative research to assess the appeal of the retirement blueprint and the guiding principles to our members. Many felt that a retirement product that was sustainable but flexible offered the right mix of security without the perceived downsides of an annuity. To test how this would work in practice, we asked survey respondents to participate in a trade-off exercise designed to identify how much income uncertainty they were willing to tolerate.

Participants were very surprised at how quickly the 'risk of ruin' – that is, the potential for their money to run out, in particular when drawing income from an invested pot when markets are performing poorly – increases as they set higher levels for the income received at retirement. A majority were willing to trade off some certainty of income to achieve a higher Day 1 income level than an illustrative 4% starting point, but most were not willing to bear a 40% chance that their money would run out. Their willingness to sacrifice income certainty perhaps reflected the influence of a human cognitive bias where greater value is placed on achieving rewards in the near term versus delaying gratification.

The participants in our exercise were making their choices after being presented with information about longevity, shortfall and accessibility risks, and so had greater knowledge about the trade-offs they'd be facing than the vast majority of our membership. However, their ability to quickly grasp the concept of these trade-offs and play with them in the trade-off exercise suggests avenues for developing information and tools for members who join the Nest Guided Retirement Fund in the future.

38 **nestpensions.org.uk/schemeweb/dam/nestlibrary/the-future-of-retirement.pdf**

Acceptance of income uncertainty

We launched the Nest Guided Retirement Fund, our approach to managing members' money in retirement, in 2020. The Nest Guided Retirement Fund doesn't provide an income as such, because it isn't a drawdown product. Rather, it sets aside a regular amount of money each year for the member into what we call their Nest Wallet. Members in the fund can access this money as and when they want.[39] While the Nest Guided Retirement Fund doesn't exactly match the approach set out in our blueprint paper, it does aim to address the paper's six guiding principles.

In developing the Nest Guided Retirement Fund, we revisited our blueprint research around people's tolerance for income uncertainty. The deliberative nature of the blueprint research was instructive. It helped us to understand not just how people reacted to the concept but also how their views evolved as they learnt more. We were conscious, however, that many of our members would not have the opportunity to make decisions about their retirement following an in-depth discussion with a skilled facilitator. We therefore wanted to see how people make decisions about the risk of ruin when they have more limited information.

To do this we appointed a research agency with particular expertise in stated-preference surveys. These sorts of surveys help to quantify how people might behave by showing them a series of choice experiments. Working with the agency, we developed a test to understand which starting level our members might choose for the amount of money allocated to their Nest Wallet – in other words, the amount of money allocated as their retirement income.[40]

Figure 39 summarises the overall results from the stated-preference survey. The most commonly chosen starting level was a 4.5% annual transfer from the member's pot to their Nest Wallet. This level was chosen by almost one quarter of participants.

However, we were less interested in the starting rate chosen than we were in what this said about the level of risk people were willing to tolerate as a trade-off. To understand this, within the exercise participants were prompted that a starting level of 3%, 3.5% or 4% would have a very small risk of the amount being paid into their Nest Wallet needing to be reduced over time.

At 4.5% they were prompted that this risk would increase slightly but remain very low. At 5% they learnt that the chance of the transfer amount remaining unchanged was still high but there was an increased risk of a future cut. At 5.5% they were told there was nearly a 50% chance that the amount would need to change. At starting rates of 6% or more they were told the chance of a significant reduction started to increase rapidly.

"In developing the Nest Guided Retirement Fund, we revisited our research around people's tolerance for income uncertainty."

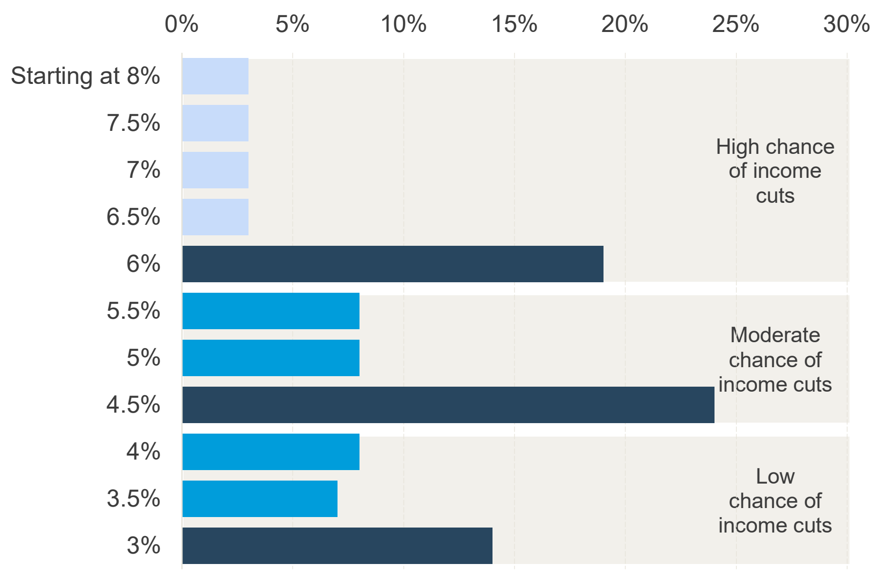
39 More information about the Nest Guided Retirement Fund is available on our website at **nestpensions.org.uk/schemeweb/nest/aboutnest/investment-approach/other-fund-choices/nest-guided-retirement-fund.html**

40 See Appendix B starting on page 107 for a more detailed explanation of the research methodology we employed in this test.

The majority of the members in the stated-preference survey were willing to take some level of risk that they'd have to reduce their income in the future in order to set a higher starting rate. This was similar to what we found in qualitative research for our retirement blueprint. However, in the stated-preference survey, just over half of our members chose a starting rate with a low or very low chance of their income being cut.

Additionally, we observed three key spikes in preferred starting rates: at 3%, 4.5% and 6%. These would seem to be indicative of people's risk appetite. Those choosing 3% (14%) were the most risk-averse and perhaps more suited to choosing a retirement product that truly guarantees their level of income, such as an annuity. There was also a group of individuals who were willing to take more significant risk that they'd have to reduce the payment into their Nest Wallet in the future, with roughly one third (31%) settling on a starting rate of 6% or more. The rest of the participants, just over half, chose a starting rate of 3.5% to 5.5%, associated with a low to moderate chance of income reduction in the future. These members could potentially be well served by a retirement pathway, such as the Nest Guided Retirement Fund, which attempts to manage the reduction in income risk without completely removing it.

Figure 39. Proportions of survey respondents choosing each starting level in the Nest Guided Retirement Fund exercise



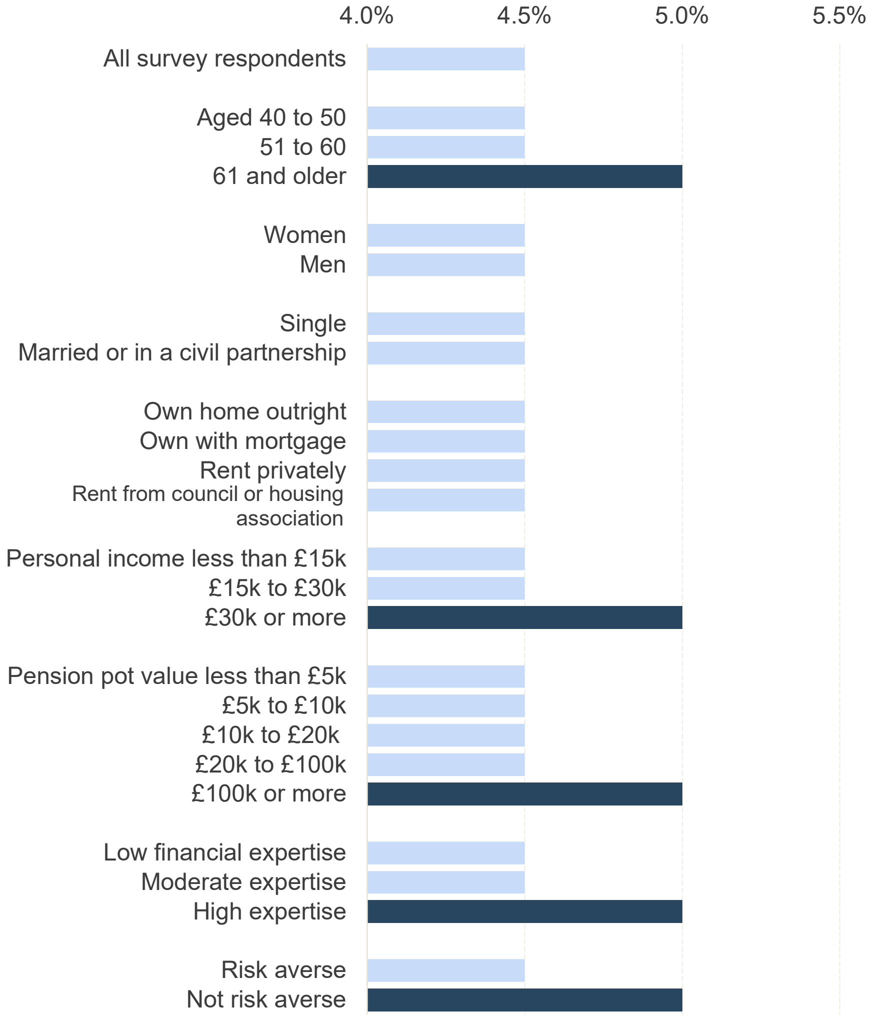
Source: Nest Corporation, stated-preference member survey, 2019
Base: Members aged 40 and older who completed the choice exercise (3,273)
Note: Figure represents final outcomes of the pairwise choice exercise.

We also considered whether members' characteristics, such as their gender, pot size or housing tenure, influenced their choice of starting level. These characteristics were identified through a series of demographic and attitudinal questions in the survey.

We looked at the median starting rate chosen by a variety of different characteristics and found very little variation across subgroups: most had the same median of 4.5%. Only among a few groups did the median rise, and then it only rose slightly, to 5% (Figure 40). These were members aged 61 and older, those with a higher personal income or predicted pension pot value and those with a greater self-described financial expertise or who were less risk-averse.

There was substantial overlap between the group with higher incomes or pot values and those with self-proclaimed greater financial expertise and risk appetite. Potentially these members felt more capacity to tolerate some of the monetary reductions they observed in the exercise and were therefore willing to take on a slightly higher level of risk.

Figure 40. Median starting level chosen in the Nest Guided Retirement Fund exercise, by member characteristics



Source: Nest Corporation, stated-preference member survey, 2019
Base: Members aged 40 and older who completed choice exercise (3,273)
Note: Figure represents median outcome of the pairwise choice exercise broken down by other survey variables.

The reasons the median was slightly higher for those aged 61 and older might be slightly different. In the main, this subpopulation of our membership tends to have smaller predicted DC pots but also a higher propensity to have a defined benefit (DB) pension than younger members. These two factors might have made the surveyed members more willing to take a risk. It's worth noting that, as the scheme matures, this difference may be muted, as fewer of our members currently under 50 have a DB pension and more of them are likely to build larger DC pots by the time they near or reach retirement age.

This research should not be interpreted as providing a definitive steer on the level of appropriate risk for our members in retirement. Rather, it re-enforces our previous findings that the majority of people would tolerate the possibility that their income might reduce in the future to achieve a higher starting income. There also remain a noticeable minority of individuals willing to take more risks or, conversely, for whom any sort of income reduction risk is unacceptable.

Likelihood of seeking guidance and advice

We believe that many of our members, though they have only some or little financial experience, will not seek any form of regulated advice because they can't or don't think they can afford it.

In addition, research published by the PLSA in 2017 suggested that only 22% of people decumulating a pension pot had sought help from Pension Wise in making their decision. Only 1% said they'd used the Pension Wise phone guidance service and 2% that they'd had a face-to-face guidance session.[41]

Similarly, qualitative research commissioned by State Street Global Advisors and The People's Pension found that consumers were reluctant to seek formal advice about their retirement planning, despite saying that the decision-making process was like a 'minefield'.[42]

Of the 80 participants in the research, 31 chose to speak with a financial adviser during their decision-making journey. Only 17 proceeded beyond the free consultation stage. A handful turned to an accountant, annuity broker or some other recognised expert. Most talked through their options with their family, friends or work colleagues. A few were nervous of appearing stupid if they did not understand what an adviser was telling them.

Many of the participants were making decisions on pots valued between £30,000 and £100,000. Some were surprised and disappointed to discover that not all financial advisers were keen to take on their business since they would be making a relatively small commission.

[41] Pensions and Lifetime Savings Association (PLSA), 'Decumulation decisions: Pension freedom journeys' (2017), **plsa.co.uk/Portals/0/Documents/Policy-Documents/2017/7153%20Pension%20freedoms%20infographic%20v1.pdf**

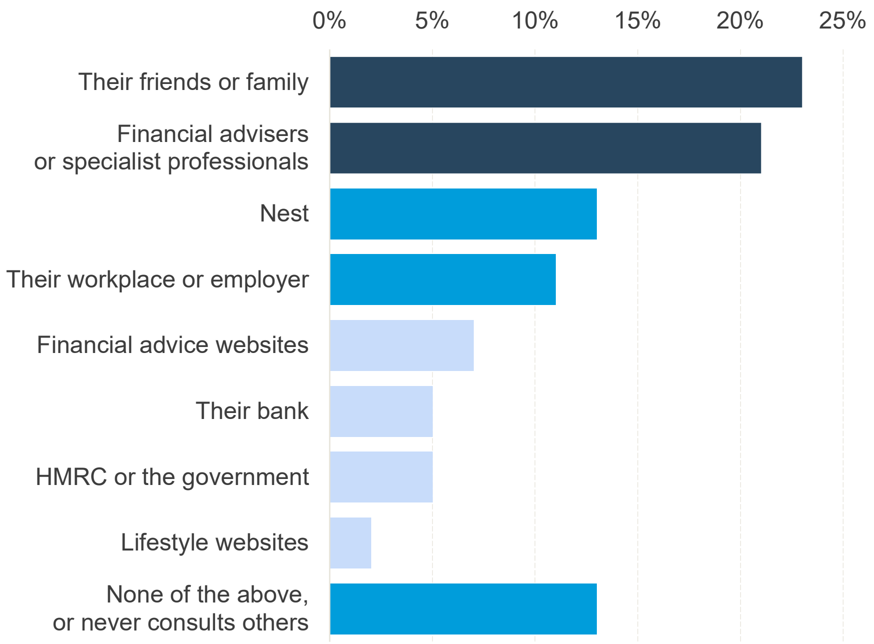
[42] The People's Pension and State Street Global Advisors, 'New choices, big decisions: Exploring consumer decision making and behaviours under pension freedom and choice' (February 2016), **bandce.co.uk/wp-content/uploads/2016/03/ssga-tpp-report-new-choices-big-decisions.pdf**

When it came time to take advice, many in the research baulked at the cost, both for a one-off consultation and for ongoing support. In response to fees, some said they could do better themselves. While some were happy to have a free initial consultation, most were unwilling to pay what they perceived to be a high fee for full service. Some felt a bit cheated that pension providers cannot offer a lower-cost solution.

We've seen a similar picture in quantitative research with our members. When we ask them in surveys who they'd turn to for help with their pension, friends and family are just as likely a source of advice as a specialist financial adviser. While speaking to a financial adviser is the most popular choice among those aged 50 and older, only 36% say this would be who they'd most likely turn to for help.

It's important to note that when we've asked our members about receiving financial advice, we have not provided details on the likely costs. Our survey data therefore may overstate the likelihood that our members would turn to a paid financial adviser. Indeed, in a recent survey of members aged 55 and older who had withdrawn money from their Nest pot, only 11% said they'd sought advice from an independent financial adviser (Figure 41). Our members' likelihood of seeking advice did not greatly differ based on how soon they were planning to retire.

Figure 41. Who Nest members would most likely turn to for help with their pension



Source: Nest Corporation, member survey, 2019
Base: All respondents (2,994)
Question: Who/Which, if any, of the following would you be most likely to go to in order to get help with pensions?

The big picture

In evolving our investment approach in the best interests of our members, the gap between what members need and what they want may be difficult to bridge. Sometimes, however, it may prove to be easy.

There is a significant communication challenge to make members aware of the realities of the income in retirement they might expect as well as the impact of making cash withdrawals and the risk of ruin from taking too much income too early in retirement. These calculations are complex and complicated by people's tendency to miscalculate their own tolerances for investment and income risk when asked about them.

The benefits of guided investment pathways, elements of mortality risk-sharing and tolerance for some income uncertainty suggest that it will be important for us to continue to evolve the Nest Guided Retirement Fund in the future.

We should explore how to reduce the risk of ruin through our investment approach and retirement pathways. Our ambition should be to increase members' investment returns while keeping downside risk low. We should also continue to develop our approach to managing the risk that people will live longer than expected.

Chapter 7

Members’ other fund options

Beyond our default strategy, we offer our members a choice of other investment options, including the Nest Ethical Fund, the Nest Sharia Fund, the Nest Higher Risk Fund and the Nest Lower Growth Fund.

In our previous member research brief, we reviewed what academic literature and our own research could tell us about how the target group for auto enrolment would approach investment fund choices. Based on the evidence we concluded that the status quo effect was likely to be extremely powerful. We anticipated that whatever fund we set as the default for members would be the fund with by far the most members in it.

This has indeed turned out to be the case, with about 99% of our members remaining in our flagship default strategy, the Nest Retirement Date Fund series.

Yet, given the scale of Nest, a significant number of members are invested in our other fund choices, even if they total less than 1% as a proportion of our membership. Observing the fund choices and switching behaviour of these members is helpful in establishing the investment return objectives and risk appetite for our full fund range. And although we should be cautious because of the small sample sizes, member-initiated fund switches are particularly interesting as they give us some insight into what members actually do when weighing different investment choices, as compared with what they say they will do when they're surveyed.

99%

of our members remain in our flagship default strategy, the Nest Retirement Date Fund series

Member demographics by fund choice

We intentionally provide a select range of fund choices beyond the Nest Retirement Date Funds. This is based on research by social psychologist Sheena Iyengar and others on people's behaviour when they're faced with more than five to six options in an economic decision.

Our fund choices are clearly named and explained so members can more easily understand each fund's guiding principles and objectives and then make an informed decision about switching funds, should they wish to do so. Essentially our members can choose to increase or decrease their level of investment volatility risk (and expected investment return) with the Nest Higher Risk Fund and the Nest Lower Growth Fund, respectively. They can choose to align their investments with their faith, beliefs or lifestyle choices through either the Nest Sharia Fund or the Nest Ethical Fund.[43]

The Nest Pre Retirement Fund was designed for members who were enrolled in Nest close to their expected retirement age. Very few members have switched to this fund. They range in age from under 22 to 66 and older, suggesting that the objective for this fund may not be serving our membership as intended.

We also have two pathways for members who have reached their intended retirement date. Those members who have a pot value of £10,000 or more are defaulted into the Nest Guided Retirement Fund, from which they're able to draw an income while their pot is invested for growth. Members in the Nest Guided Retirement Fund are also able to continue contributing to their pot.

The Nest Post Retirement Fund is the phase of our default strategy for those members who have reached their intended retirement age but have not yet accessed their pot and have a pot value less than £10,000.

When a member's Nest Retirement Date Fund reaches its target date and is closed, those who remain in the fund are automatically transferred into either the Nest Post Retirement Fund or the Nest Guided Retirement Fund, depending on their age and pot value.

Table 1 shows the number of members in our default fund series and each of our other fund choices as at 31 March 2021. Setting aside the retirement-orientated funds, we can see that only 1% of our members have made a switch into one of our other fund choices – the Nest Higher Risk Fund, the Nest Lower Growth Fund, the Nest Ethical Fund and the Nest Sharia Fund. The most popular choice among these other fund choices is the Nest Higher Risk Fund, which has around 0.7% of our members.

Both the Nest Higher Risk Fund and the Nest Ethical Fund are proportionally more popular among members aged 30 to 39. The Nest Sharia Fund doesn't exhibit any age-based skew.

43 More information about our other fund choices is available on our website at **nestpensions.org.uk/schemeweb/nest/aboutnest/investment-approach/other-fund-choices.html**

Table 1. Membership in Nest funds, by age

Age	Nest Retirement Date Funds	Nest Ethical Fund	Nest Sharia Fund	Nest Higher Risk Fund	Nest Lower Growth Fund	Nest Pre Retirement Fund	Nest Post Retirement Fund	All
Under 22	46,217	31	38	275	2	4	0	46,567
22 to 25	864,648	1,333	555	4,227	87	48	0	870,898
26 to 30	1,882,725	4,311	1,440	14,202	245	168	0	1,903,091
31 to 35	1,665,088	4,430	1,564	14,526	259	125	0	1,685,992
36 to 40	1,271,654	3,061	1,417	11,005	200	87	0	1,287,424
41 to 45	1,028,869	2,255	1,100	7,774	141	48	0	1,040,187
46 to 50	965,732	1,830	839	6,347	115	61	0	974,924
51 to 55	917,300	1,521	685	5,491	96	82	2	925,177
56 to 60	730,180	1,141	410	2,489	64	83	1,011	735,378
61 to 65	469,090	528	219	1,258	30	106	1,885	473,116
66 and older	36,131	147	59	292	14	173	75,941	112,757
Total	**9,877,634**	**20,588**	**8,326**	**67,886**	**1,253**	**985**	**78,839**	**10,055,511**

Source: Nest Corporation, scheme data, March 2021
Note: Nest Retirement Date Funds data includes our default starter fund for members aged under 22.

When we consider the other fund choices by gender, we note some interesting differences, as shown in Table 2.

Men are more likely to make active fund choices than women. This is markedly the case for members who have chosen to switch to the Nest Higher Risk Fund, the Nest Lower Growth Fund and the Nest Sharia Fund. Membership in the Nest Ethical Fund is much more balanced with respect to gender, similar to our default Nest Retirement Date Fund series.

Men are more likely to be in the Nest Guided Retirement Fund than women. This is a direct result of men having larger pot values on average than women, meaning that they're more likely to meet the pot value eligibility threshold of £10,000 or more for the fund.

Table 2. Membership in Nest funds, by gender

Fund	Women	Men
Nest Retirement Date Funds	47%	53%
Nest Ethical Fund	46%	54%
Nest Sharia Fund	25%	75%
Nest Higher Risk Fund	23%	77%
Nest Lower Growth Fund	30%	70%
Nest Pre Retirement Fund	30%	70%
Nest Guided Retirement Fund	34%	66%
All	**47%**	**53%**

Source: Nest Corporation, scheme data, March 2021
Note: Nest Retirement Date Funds data includes our default starter fund for members aged under 22 and the Nest Post Retirement Fund.

Automatic versus member-initiated fund switches

From the launch of the Nest scheme through to 31 March 2021, around 365,000 switches had been made by just over 200,000 unique members, equating to roughly 2% of our membership. Many switches, however, are not member-driven but rather made automatically when a member hits a certain age milestone in their saving journey.

The most common automatic fund switch occurs when a member turns 22, according to the data in our system, and is moved from our starter fund for members aged under 22 to a target-date fund in the Nest Retirement Date Fund series. Another common automatic move comes when a member reaches their intended retirement age, according to our system, and their Nest Retirement Date Fund matures. Once their target-date fund is closed, any value in their pot is transferred to one of our post-retirement funds.

Looking at the flow of member-initiated fund switches to one of our other fund choices reveals some interesting member behaviour. As shown in Table 3, some of our members actively switch out of one target-date fund into another. This occurs when they change their intended retirement date away from the default of their State Pension age. We believe they do this because they anticipate retiring either before or after their State Pension age.

We know from the number of members being moved to the Nest Post Retirement Fund and data on the UK labour market (see page 58) that an increasing percentage of workers are staying in employment beyond their State Pension age. This raises important questions about the default investment strategies that we employ in the consolidation phase of the Nest Retirement Date Funds, given that many members may access their pot some years after their target-date fund is closed.

After switches between target-date funds, the second most common member-initiated switch is from a target-date fund to the Nest Higher Risk Fund.

Table 3. Members' movements between fund choices

	Fund switched in to					
Fund switched out of	**Nest Retirement Date Fund**	**Nest Ethical Fund**	**Nest Sharia Fund**	**Nest Higher Risk Fund**	**Nest Lower Growth Fund**	**All**
Nest Retirement Date Fund	130,898	13,122	6,366	75,362	1,076	226,824
Nest Ethical Fund	252	–	296	610	85	1,243
Nest Sharia Fund	194	139	–	376	148	857
Nest Higher Risk Fund	5,236	1,394	1,948	–	1,198	9,776
Nest Lower Growth Fund	287	108	149	771	–	1,315
All	**136,867**	**14,763**	**8,759**	**77,119**	**2,507**	**240,015**

Source: Nest Corporation, scheme data, March 2021

Through the life of the scheme so far, 9 in 10 member-initiated switches have been a one-time switch. Only around 1% of switches have been made by members who've made four or more switches. Among members who have switched multiple times, the most common fund switch involves moving in to and out of the Nest Higher Risk Fund.

Timing of member-initiated fund switches

Where a member has initiated a fund switch, we would like to understand what causes the member to make the switch. So we've analysed the timing of these switches in relation to members' enrolment and saving history.

When workers are automatically enrolled, they're sent a member welcome pack. This is probably the first piece of communication about Nest that our members receive that mentions the possibility of switching funds.

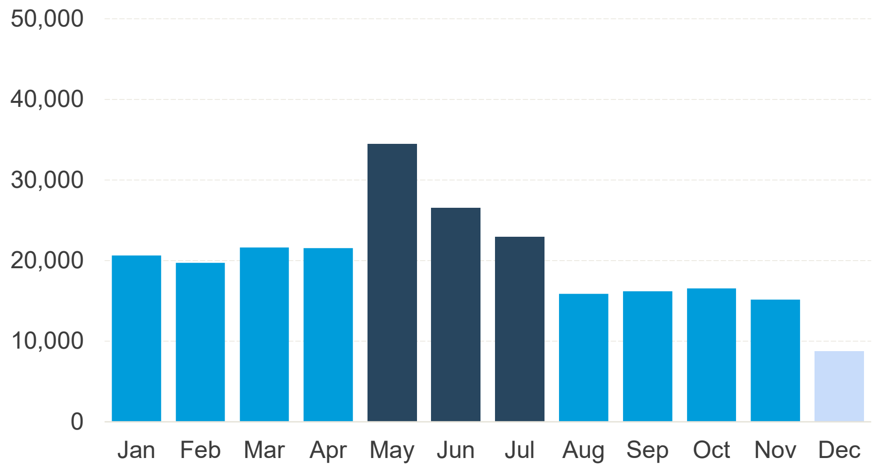
Looking at member-initiated switches, only around 1.4% of first switches occur within the first two months following enrolment. Only 11% occur within the first six months. From this it's clear that being enrolled for the first time is not the driver of fund switching for the majority of our members who switch.

Even switches from the default Nest Retirement Date Funds to the Nest Ethical Fund and Nest Sharia Fund typically take place many months after a member's first enrolment, with fewer than 1 in 6 switches from a target-date fund to these two funds occurring within a member's first six months saving with Nest. These are fund choices where investment objectives are based on factors beyond investment returns and risk, so a member's switch would presumably be less likely to be based on observed performance of their pot.

Taken together, this evidence suggests that enrolment doesn't play the most significant role in members' fund switching.

However, we do see a pattern in members' switching behaviour across the calendar year. As shown in Figure 42, around 35% of member-initiated fund switches occur in the months of May, June and July. This is around when members receive their annual benefits statement each year.

Figure 42. Number of Nest fund switches, by month in the year



Source: Nest Corporation, scheme data, March 2021

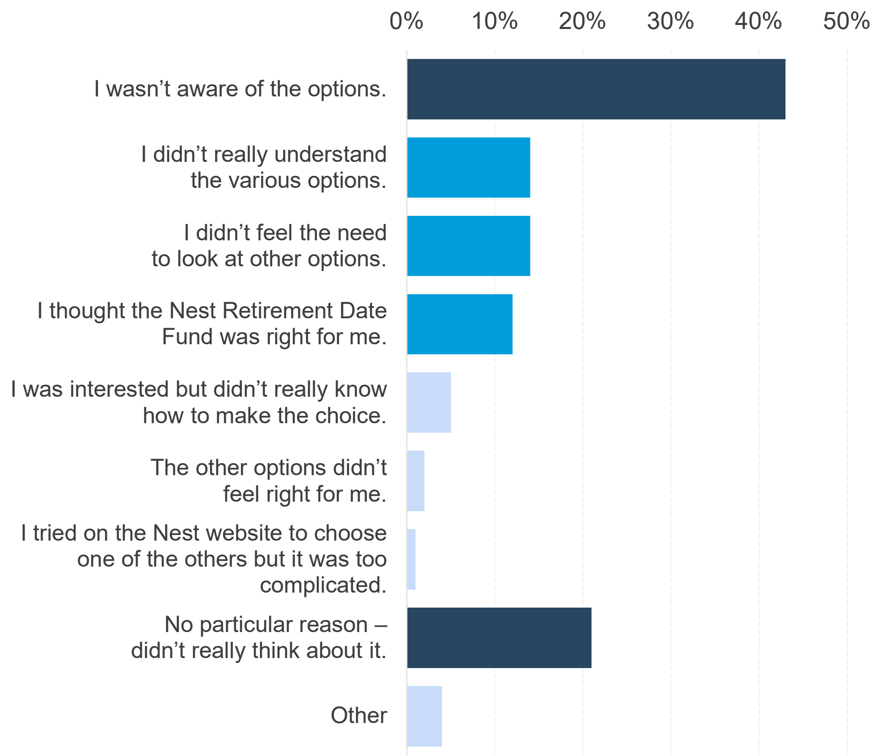
Awareness of other fund choices

The inertia among our members with respect to fund switches was expected. Still, we would like to understand to what extent they've engaged with the other fund choices available to them, even if they aren't making an active decision to move their pot to one of them.

We surveyed members in our default Nest Retirement Date Fund series to find out how much they knew about our other fund choices and whether they'd considered switching to one of them. We presented respondents with a short description of each of the different fund options open to them. Only 7% of the respondents said they were aware of all of our fund range (Figure 43). A further 29% were aware of only some of them. More than half said they'd not previously been aware of any of the other funds.

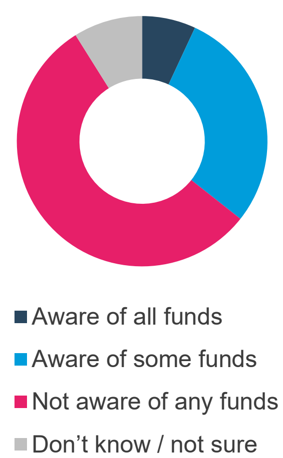
We then asked these members whether they had made an active choice to stay in the fund in which they'd been automatically enrolled and why they'd stayed in their target-date fund. Given that so many weren't aware that there were alternatives, it's not surprising that the two most common reasons given for not switching were that the member wasn't aware of the options (43%) or that they didn't really think about it (21%), as shown in Figure 44.

Figure 44. Nest members' reasons for staying in the Nest Retirement Date Fund



Source: Nest Corporation, member survey, 2017
Base: Nest Retirement Date Fund Members who said they haven't made an active choice of their fund (4,185)
Question: Why did you stay in the Nest Retirement Date Fund rather than choose one of the other funds? Please select all that apply…

Figure 43. Nest members' awareness of the scheme's fund range



Source: Nest Corporation, member survey, 2017
Base: Nest Retirement Date Fund members (3,293)
Question: Before today, were you aware of the range of funds that Nest has to offer?

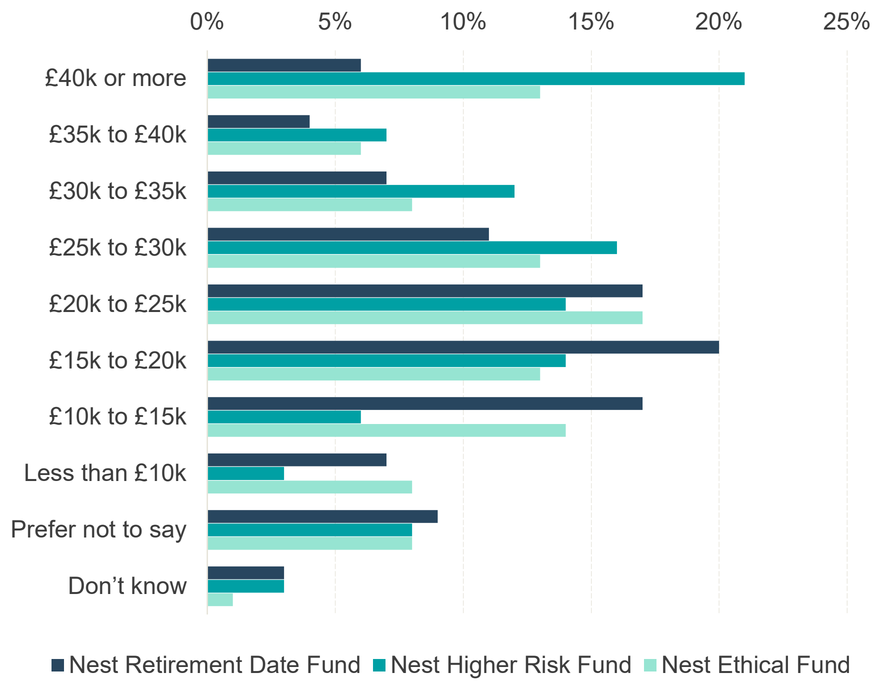
Members in the Nest Higher Risk Fund and the Nest Ethical Fund

We actively conduct survey research targeted at our members in the Nest Higher Risk Fund and the Nest Ethical Fund so as to compare their views with members who stay in our default strategy.

The first thing to note is the substantially better survey response rates among our members in these two funds compared to our general membership. We usually find that those who are contributing to their pot or who have registered their online account have a better response rate than non-contributing members as well as those who haven't registered. However, Nest Higher Risk Fund members are almost three times more likely to respond to a request to participate in a survey than our overall active membership. Nest Ethical Fund members are more than four times more likely to respond. So, without even looking at their survey responses, we could observe that members in these two funds are substantially different from the majority of our membership because they're much more engaged with their pension.

Nest Higher Risk Fund members are more likely to be men. They're more likely to have higher incomes, with 21% reporting an annual income of £40,000 or more, compared with only 6% of Nest Retirement Date Fund members (Figure 45). The income distribution for members in the Nest Ethical Fund is closer to that of the general membership, although these members were also twice as likely to have an income of £40,000 or more when compared with Nest Retirement Date Fund members.

Figure 45. Personal annual income, before tax, by member's fund



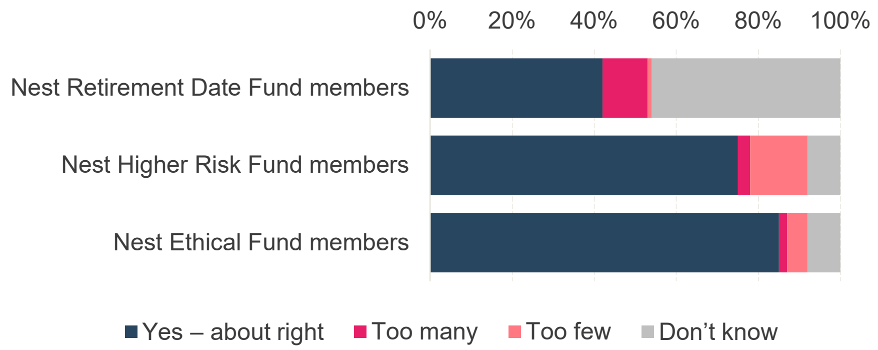
Source:	Nest Corporation, member survey, 2017
Base:	Nest Retirement Date Fund members (4,185), Nest Higher Risk Fund members (1,320) and Nest Ethical Fund members (472)
Question:	Which of the following bands best describes your own total salary per year before tax?
Note:	Income bands are up to but not including the top figure.

As we did with Nest Retirement Date Fund members, we asked members in the Nest Ethical Fund and the Nest Higher Risk Fund how aware they were of our other fund choices.

As noted on page 85, many of our members in the Nest Retirement Date Fund series weren't aware of our other fund options, and were therefore much more likely to say they didn't know if we offered the right kinds of options (Figure 46) or if they'd expected something different (Figure 47). Among those who expressed a view, the majority agreed that we offered the right number and the right range of funds.

In contrast, Nest Ethical Fund and Nest Higher Risk Fund members were usually able to express a view, with over three quarters agreeing that Nest had got our range about right. The most likely to disagree were higher earners – members earning £40,000 or more a year – who were in the Nest Higher Risk Fund. Almost one quarter (23%) of these Nest Higher Risk Fund members felt Nest didn't offer the right range of funds.

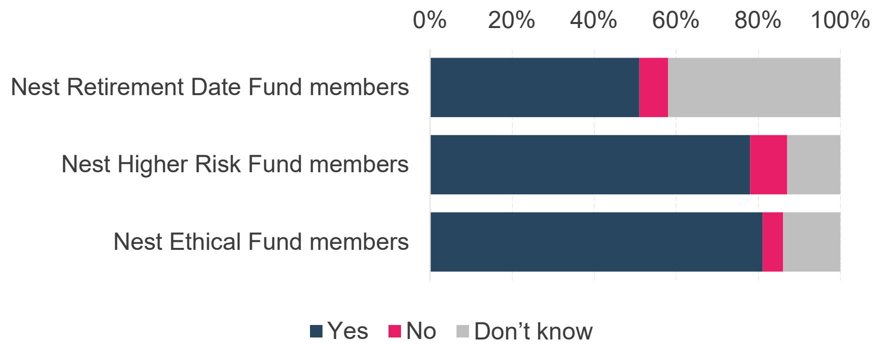
Figure 46. Nest members' views on whether Nest offers the right number of funds



Source: Nest Corporation, member survey, 2017
Base: Nest Retirement Date Fund members (4,185), Nest Higher Risk Fund members (1,320) and Nest Ethical Fund members (472)
Question: Thinking about the range of Nest funds available, is having one 'default' fund and five alternative funds the right number of choices?

Figure 47. Nest members' expectations for fund options

Is the fund range offered by Nest what you would expect?



Source: Nest Corporation, member survey, 2017
Base: Nest Retirement Date Fund members (4,185), Nest Higher Risk Fund members (1,320) and Nest Ethical Fund members (472)
Question: Are these the different kinds of options that you would expect to be available?

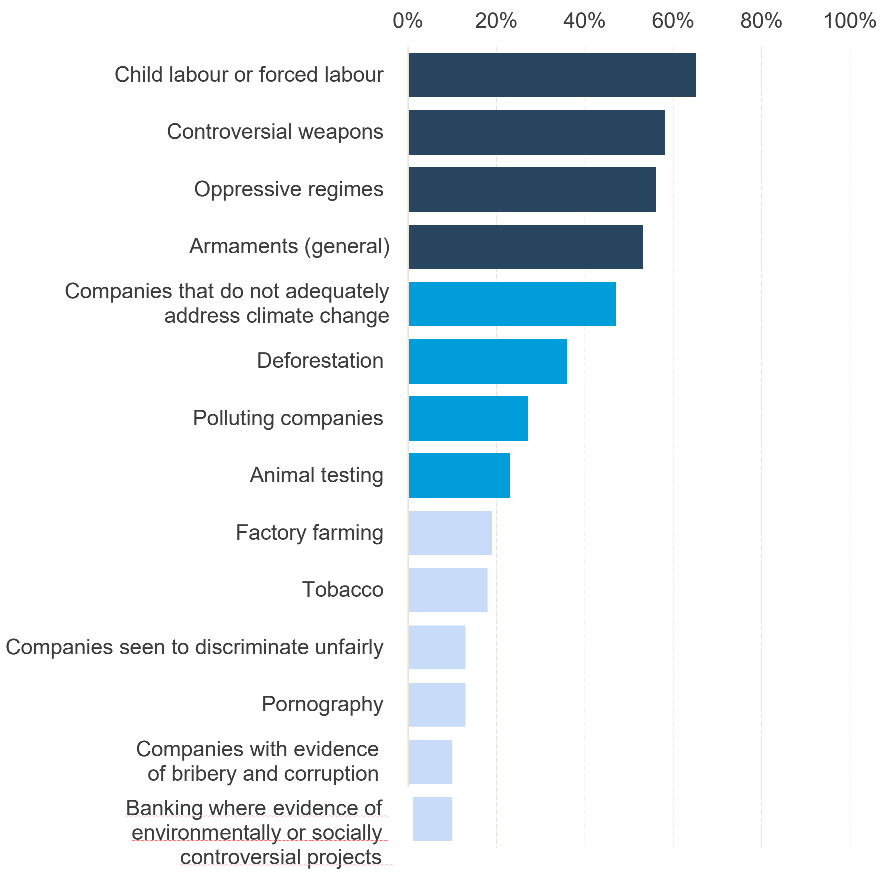
Nest Ethical Fund members' motivations and priorities

We've also surveyed Nest Ethical Fund and Nest Higher Risk Fund members about their reasons for choosing the fund they're in, and their views on their fund's investment approach.

The vast majority (92%) of Nest Ethical Fund members say that one of the factors influencing their switch to the fund was their desire to make sure their money was invested in firms that didn't harm the world, people or the environment. Most (70%) said they were looking for a generally more ethical option, while over one quarter (28%) said they had specific concerns they wanted an ethical fund choice to address.

To understand what issues particularly concern Nest Ethical Fund members, we presented them with a long list of factors that might influence which sorts of investments should be excluded from the Nest Ethical Fund or a similar ethical investment fund in a workplace pension. A short explanation of each factor was given and we asked respondents to rank their top five priorities for exclusion. Figure 48 presents the aggregated priority order for exclusion based on all responses. The top five responses were top both in terms of the total count of mentions by respondents and the likelihood that they were ranked as the no. 1 priority for exclusion by a respondent.

Figure 48. Nest members' top issues for exclusion from an ethical investment fund



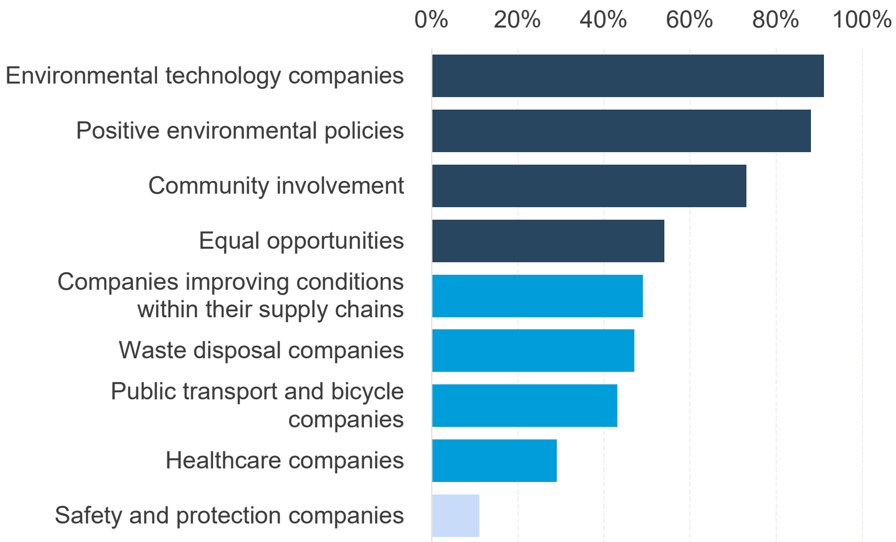
Source: Nest Corporation, member survey, 2017
Base: Nest Ethical Fund members (472)
Question: We would like to get some idea of the kinds of things that you think it is most important to exclude from your investments – companies that an ethical fund should ensure it does not engage with…

We also asked Nest Ethical Fund members about which factors they thought should be prioritised for inclusion in an ethical investment fund. The list we presented was shorter than the list for exclusion, so we asked them to rank only their top three priorities for inclusion. Figure 49 presents the aggregated results.

While concerns about climate change ranked high for exclusion, the factors that members ranked highest for exclusion were related to oppression and weapons. In contrast, the factors that members ranked highest for inclusion were focused on having a positive effect on the environment. Since this survey was conducted in 2017, there has been an even greater focus on climate change in the media. If members in the fund were asked the same question today, they might rank these issues higher, particularly in terms of the types of investments that should be excluded from an ethical investment fund.

In 2020 we conducted a small-scale research project with 34 Nest Ethical Fund members. Although we didn't exactly repeat the previous survey questions, we did hear members expressing the same motivations for switching – to ensure that their money wasn't negatively impacting the wider world. We also explored the types of investments they would consider to be unethical. Again, our findings largely mirrored our earlier research – members said they felt most strongly about avoiding investments in the manufacture of nuclear and other weapons, or in things that have a damaging impact on the climate or environment.

Figure 49. Nest members' top issues for inclusion in an ethical investment fund

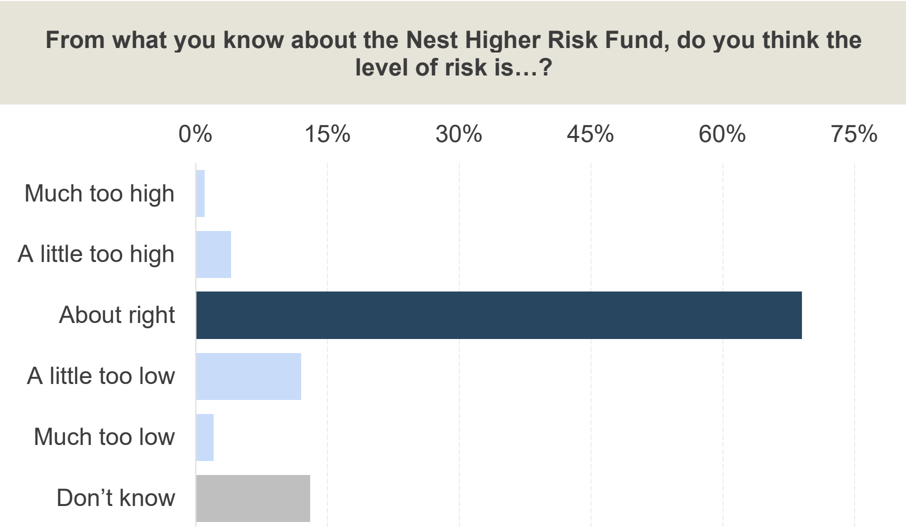


Source: Nest Corporation, member survey, 2017
Base: Nest Ethical Fund members (472)
Question: We would now like to get some idea of the kinds of things that you think it's most important to include in ethical investments – companies that an ethical fund should ensure it does engage with.

Nest Higher Risk Fund members' attitudes

As you might expect, members who choose to move their pot to the Nest Higher Risk Fund say they did so because they're willing to take on more risk to achieve higher returns (78%). We went on to ask them what they thought about the level of risk in the Nest Higher Risk Fund. As shown in Figure 50, around 69% said they thought it was about right, while 14% felt it was too low. Members in the fund who reported earning £40,000 or more a year were slightly more likely to think the risk levels were too low (21%).

Figure 50. Nest members' views on the Nest Higher Risk Fund



Source: Nest Corporation, member survey, 2017
Base: Nest Higher Risk Fund members (1,320)
Question: The Nest Higher Risk Fund is for people who are more confident about taking investment risk in return for potentially faster growth of their retirement pot...

We also asked Nest Higher Risk Fund members whether they were aware that they'd be switched out of the fund 10 years before their expected retirement date. This was done to reduce conversion risk for members approaching retirement. Only two thirds said they were aware of this policy. When we asked whether this was the right approach, 68% said it was and 27% said it was too cautious. The proportion thinking it was too cautious increased with age, with 37% of 40- to 49-year-olds and 64% of 50- to 59-year-olds saying this.

Since this research was conducted in 2017, we've further developed our approach to life-styling for members in the Nest Higher Risk Fund. Members now can choose between a life-styled and a non-life-styled version of the fund.

In addition, we asked members in the fund whether they'd be interested in more flexible investment options – for example, either splitting their pot between funds or constructing their own investment portfolio from different asset classes. Roughly three quarters said they might be interested in either option but only 4 in 10 said they would be very interested.

Members in the Nest Sharia Fund and Nest Lower Growth Fund

The total number of members in the Nest Sharia Fund and the Nest Lower Growth Fund is much smaller than in the Nest Ethical Fund and the Nest Higher Risk Fund. This means that conducting robust quantitative research with members of these funds isn't feasible. Instead, we've conducted exploratory research to give us some indication of members' motivations for choosing each of these funds.

A significant proportion may have chosen to move their pot to the Nest Sharia Fund for reasons other than religious preference. Indeed, 17 out of the 36 people we spoke to in our exploratory research said the potential for growth in the fund, rather than their beliefs, was their main motivation for choosing it. Another 5 specified that they'd chosen it because it was invested exclusively in shares. Only 12 said their main motivation was beliefs, with 5 citing religious beliefs and 7 saying they chose it because it avoided investing in what they considered to be unethical companies.

In our exploratory research, we spoke to a very small number of members in the Nest Lower Growth Fund, so we should be very cautious in drawing any firm conclusions about members' motivations for moving their pot to it. However, there was an indication that they'd chosen this fund either because they were extremely risk-averse (2 out of 6) or because they were trying to actively manage their exposure to market volatility, choosing the fund temporarily (4). In contrast to the Nest Sharia Fund, where most members we spoke to expected to keep their pot in the fund for the longer term, Nest Lower Growth Fund members expected to switch out of the fund once they thought the economy had recovered. In the main, these members said they expected to switch from the Nest Lower Growth Fund to the Nest Higher Risk Fund in the future. There was a clear awareness among these members that the fund would likely grow less quickly than our other funds.

The big picture

The overwhelming majority of our members stay invested in the target-date fund in which they were automatically enrolled. Building a high-quality, diversified portfolio which focuses on delivering the best outcome for the majority of our members over the longer term should remain our priority. We should design the risk appetite of our portfolios in the Nest Retirement Date Fund series to recognise both the capacity and the willingness of our members to take risk. A high probability of delivering consistent, moderate returns should be prioritised over a low probability of delivering very high returns.

Our members currently seem broadly content with the range of other fund choices we make available to them.

In our surveys, only 14% of members in the Nest Higher Risk Fund feel the risk in the portfolio is too low. This suggests careful consideration should be given before changing the risk profile of this fund.

We should regularly check that the Nest Ethical Fund's criteria align well with our members' stated priorities for excluding and including investments.

Members' awareness of their ability to make investment decisions and the options available to them remains very low. We should however regularly review our fund range and offering, as we expect members to become more aware of and engaged with their saving as pot sizes grow and pension saving and investing becomes increasingly normalised.

Chapter 8

Responsible investing

Nest has a set of investment beliefs, two of which relate to our activities to manage a wide variety of risks and be effective stewards of the assets we're invested in on behalf of our members. These beliefs guide our approach to responsible investment.

Being a responsible investor is primarily about achieving better retirement outcomes for our members through better risk-adjusted returns. At the same time, we're also conscious that, for some proportion of our membership, responsible investment could play a role in helping them understand how their money is invested. It could potentially increase confidence and trust in long-term saving.

Investment beliefs

Responsible investment

As long-term investors, we believe that integrating environmental, social and governance (ESG) considerations into the investment management process improves risk-adjusted returns.

We should invest resources in stewardship, consider ESG risks in asset allocation decisions and seek out sustainable investment opportunities. We should also seek to improve the functioning of financial markets. The ESG change we seek in our members' best interests is slowly emerging, and we believe the conditions for successful change require continuous effort from us and many like us.

We believe that long-term returns to investors are likely to be more sustainable if companies consider the interests of wider stakeholders – customers, employees and the wider public – as well as shareholders and lenders.

Companies are more sustainable investments and are more likely to sustain their performance when they meet their customers' needs, treat their employees equitably, pay fair taxes and respect their environment and community. There is also read across into infrastructure and property investments.

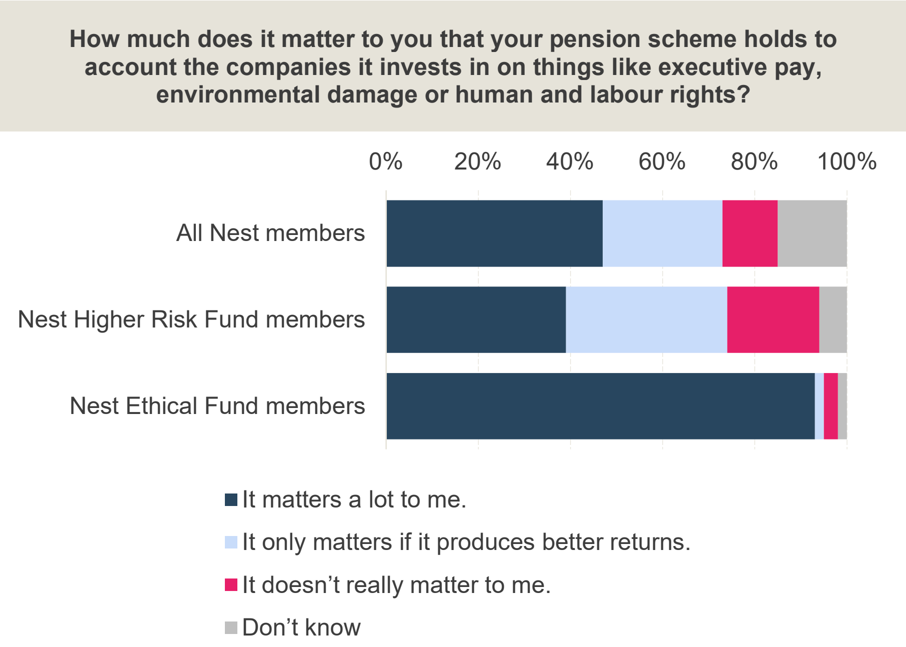
Attitudes towards responsible investment

In 2017 we surveyed our members about responsible investment. We asked how important it was to them that Nest made investment decisions that took account of how the companies they're invested in are run and how those companies treat people and the planet.

As you might expect, this was extremely important to Nest Ethical Fund members, with 93% saying it mattered a lot (Figure 51). Interestingly, it was important to many other members too. Almost half of Nest Retirement Date Fund members and 39% of Nest Higher Risk Fund members said that considering responsible investment issues in our investment approach mattered a lot to them.

A minority of members across both our default investment strategy and our other fund choices said responsible investment didn't matter to them. This attitude was highest among Nest Higher Risk Fund members, where one fifth said it didn't matter.

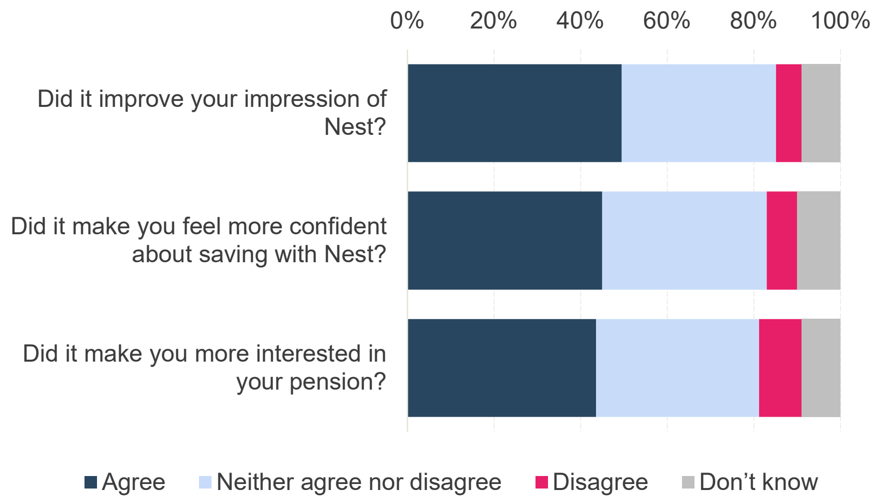
Figure 51. Nest members' views on responsible investment in 2017, by investment fund



Source: Nest Corporation, member survey, 2017
Base: Nest Retirement Date Fund members (4,185), Nest Higher Risk Fund members (1,320) and Nest Ethical Fund members (472)
Question: We would like to ask a question about what you think about 'responsible investment'…

In another member survey, we provided a short description of our approach to responsible investment and asked members if what they had learnt changed their views of Nest. Only a small minority said that learning about our responsible investment approach didn't have a positive effect on their views (Figure 52). Half strongly agreed that it improved their impression of Nest with a similar proportion agreeing it made them more confident about pension saving and more interested in their pension pot. Indeed, 63% strongly agreed that it was important that we inform our members about our responsible investment. Over one third of our members (38%) ranked it among the three most important features that were likely to increase their trust in Nest.

Figure 52. Nest members' views on responsible investment after learning about Nest's approach to responsible investment



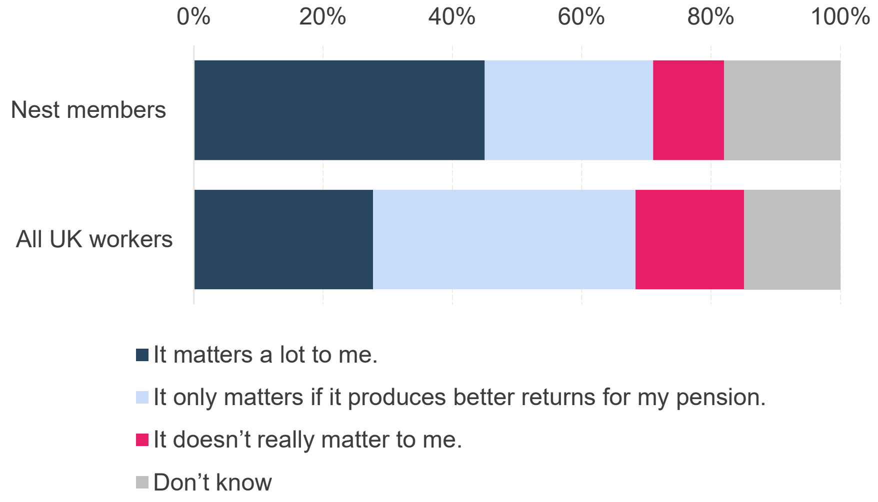
Source: Nest Corporation, member survey, 2017
Base: All respondents (3,535)

In 2019 we compared our members' attitudes with those of the wider population of eligible employees (Figure 53). For this research we repeated the question we had previously asked about how important it was to hold the companies Nest is invested in to account. We observed that our membership appears to care more strongly about this issue than the general public.

It's not quite clear why this might be the case, but our findings confirm the results of a previous survey where 74% of our members said that holding companies to account was very important, compared with 49% of all workers eligible for auto enrolment.

Figure 53. Views on responsible investment, Nest members compared to all UK workers

How much does it matter to you that your pension scheme holds to account the companies it invests in on things like executive pay, environmental damage or human and labour rights?



Source: Nest Corporation, member survey, 2019
Base: Nest members (2,994)
Source: Nest Corporation, consumer survey, 2019
Base: All UK workers (1,054)
Question: We would now like to ask a question about what you think about 'responsible investment'…

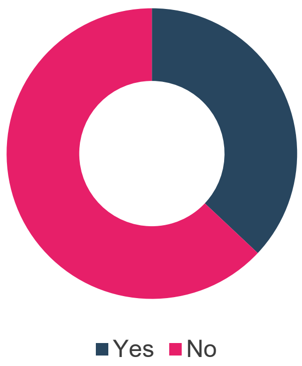
In 2021 we revisited the issue of responsible investment in a new survey of our members. We wanted to unpick members' understanding of the topic and the potential impact on their attitude towards their pension.

We should first note that the terms 'responsible investment' and 'environmental, social and governance' (ESG) are not well understood. As shown in Figure 54, around 63% of our members said they were not familiar with these phrases. Women (70%) were more likely than men (58%) to not recognise these terms, whereas members with an annual income of £40,000 or more a year were slightly more likely to be familiar with them (54%).

Even though many of our members aren't familiar with the jargon of responsible investment, when we presented them with a series of questions about their views on sustainability and investing in line with certain outcomes, such as net-zero carbon emissions by 2050, a clear majority were supportive. Almost three quarters (73%) said they wanted their money to contribute to positive outcomes for society, with the same proportion not wanting their money to negatively affect society.

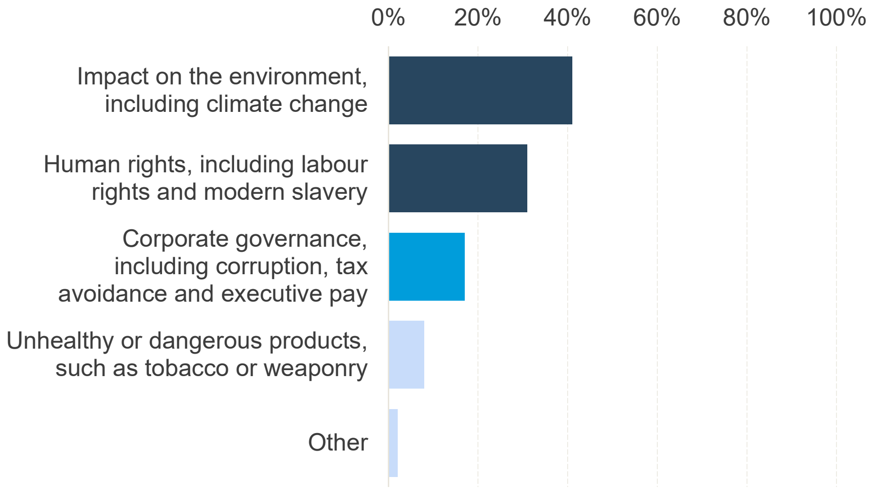
In this recent survey we also explored the types of sustainability issues that most concerned our members. As in our previous research with members of the Nest Ethical Fund, we found that the environment (41%), including climate change, and human rights (31%), including labour rights and modern slavery, were the top two concerns among our membership (Figure 55).

Figure 54. Are Nest members familiar with the term 'responsible investment'?



Source: Nest Corporation, member survey, 2021
Base: All respondents (1,263)
Question: Are you familiar with responsible investment (also known as environmental, social and governance investing)?

Figure 55. Nest members' views on the sustainability issues that most concern them

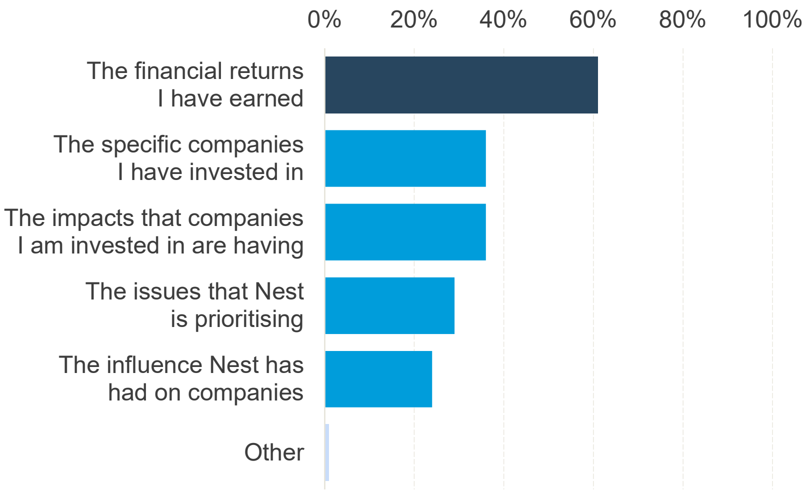


Source: Nest Corporation, member survey, 2021
Base: All respondents (1,263)
Question: When it comes to sustainability, what is your top area of concern?

Much of the evidence shared above indicates our members' latent agreement with our approach to responsible investment. Yet, at the beginning of this chapter we noted that we should be careful not to over-emphasise the potential for responsible investment to encourage members to engage with their pension. Why would we be so cautious?

Our members' answers to a question about what information they'd be most interested in hearing about, are a reminder that our members' focus remains on the personal. Around 61% told us that hearing about the financial returns they've earned is most interesting to them (Figure 56).

Figure 56. Nest members' views on what types of investment information would most interest them



Source: Nest Corporation, member survey, 2021
Base: All respondents (1,263)
Question What information about your investments would you be most interested in?

Nest Insight is undertaking a research programme in partnership with Legal & General Investment Management (LGIM) to test the potential for responsible investment and ESG messaging to be a motivator for members' pensions engagement.[44]

Our climate change policy

In July 2020, Nest announced a new climate change policy with an ambition to be net-zero across our investment portfolios by 2050 or earlier. This ambition is aligned with the Paris Agreement's goal to keep global warming within 1.5C above the levels recorded in the late 19th century.

To reach our target, we expect that carbon emissions in our portfolio will need to be halved by 2030. We report on our progress towards our climate change ambitions each year in line with guidance from the Task Force on Climate-related Financial Disclosures (TCFD).[45]

To support the announcement of our climate change policy, we conducted a survey of UK consumers exploring their view of the role pensions should play in tackling climate change. The survey found that 65% of pension savers in the UK believe their pension should be invested in a way that reduces the impact of climate change. Just 4% strongly disagreed. While most pension savers when asked said their pension should be used to tackle climate change, only 1% reported having made a change in the way their pot is invested in the previous 12 months.

Many people seem to be put off checking how their pension might be invested to manage climate change-related investment risks and opportunities, for a variety of reasons. Around 15% said it was too complicated or difficult to know how to check on what their pension provider was doing. Another 17% didn't know they could change funds. One quarter (25%) assumed their money was already being invested responsibly. Almost 2 in 5 (38%) had simply never thought about it.

There may also be a mismatch in pension savers' understanding of the role their pension could play in tackling climate change, with nearly two fifths (38%) not knowing that their pension is invested, at least partially, in stocks and shares.

In July 2020, Nest announced a new climate change policy with an ambition to be net-zero across our investment portfolios by 2050 or earlier.

[44] nestinsight.org.uk/research-projects/engagement-in-pensions/esg-and-member-behaviour

[45] nestpensions.org.uk/schemeweb/dam/nestlibrary/Nest-SARA-2020-21.pdf

The big picture

Our approach to responsible investment is driven by our belief that this is, quite simply, sensible investing on behalf of our members and appropriate for a scheme with a long investment horizon. The way we invest and how we exercise our stewardship rights are not driven by ethical considerations or a show of hands about member views on any particular issues. We have designed the Nest Ethical Fund and the Nest Sharia Fund as options for those members who want to invest primarily in accordance with their values.

However, our member surveys strongly indicate that many of our members are encouraged by our responsible investing approach. It lines up with their expectations and gives them more reason to trust that Nest as an organisation has their best interests at heart.

We should continue our efforts to communicate with our members about our responsible investing approach because of the clear alignment of sensible investing and member expectations. Where possible we should also seek to engage our members in more of a dialogue on how we may want to prioritise particular stewardship activities, such as engagement with companies and voting on shares.

We’ll continue to explore ways to involve our members as we evolve our responsible investing approach.

Appendices

Appendix A. Data sources

This paper makes use of data sources from external agencies such as the Office for National Statistics (ONS) as well as Nest's 'Voice of the customer' and other bespoke surveys of members and consumers. We have chosen external data in instances where we believe such a source represents the most robust data available to us for analysing the topic areas we were interrogating.

External data sources

Annual Survey of Hours and Earnings

Our discussion of members' earnings in Chapter 2 draws upon data from the Annual Survey of Hours and Earnings (ASHE). This survey is the most comprehensive source of information on the structure and distribution of earnings in the UK.

ASHE provides information about the levels, distribution and make-up of earnings and paid hours worked for employees in all industries and occupations. The ASHE tables contain estimates of earnings for employees by gender and by full-time or part-time working status. Further breakdowns include by region, occupation, industry, age group and public or private sector.

ASHE is conducted each year in April under the provisions of the Statistics of Trade Act 1947. The sample for ASHE includes specific employees who are members of PAYE income tax schemes and it is essential for that sample to remain as stable as possible. Consequently, once a National Insurance number is selected for inclusion in the survey, a questionnaire will be issued in respect of that employee, irrespective of the employer. Once selected, a business is legally obliged to comply.

As discussed in Chapter 2, to compare Nest members to all UK workers who are eligible for auto enrolment, we've used a subset of ASHE data, specifically those workers who were members of a workplace pension scheme. This subset was supplied through ASHE's ad-hoc data service.

Labour Force Survey

In Chapter 2 and Chapter 5, we've utilised data from the Labour Force Survey (LFS), a survey of households living at private addresses in the UK. The purpose of the LFS is to provide information on the UK labour market which can then be used to develop, manage, evaluate and report on labour market policies. The survey is managed by ONS in Great Britain and by the Central Survey Unit of the Department of Finance and Personnel in Northern Ireland on behalf of the Department of Enterprise, Trade and Investment (DETINI).

Since 1992, the LFS has been run quarterly in Great Britain. Since 1994/95, it has been run quarterly in Northern Ireland. Before May 2006, these surveys were conducted on a seasonal quarter basis (March–May, June–August, September–November, December–February). However, mostly due to an EU requirement, in May 2006 the LFS moved to calendar quarters (January–March, April–June, July–September, October–December).

The LFS is intended to be representative of the whole population of the UK. The sample currently consists of around 33,000 households responding each quarter. The survey has a panel design, whereby households stay in the sample for five consecutive quarters (or waves), with one fifth of the sample replaced each quarter, so that there is an 80% overlap in the sampled households in each successive survey.

Wealth and Assets Survey

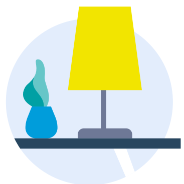
In our review of members' investment risk capacity in Chapter 3, we've relied on data from the Wealth and Assets Survey (WAS), a longitudinal survey which aims to understand the economic wellbeing of households. The survey gathers information on level of assets, savings and debt, saving for retirement, how wealth is distributed among households and individuals, and factors that affect financial planning. Private households in Great Britain are sampled for the survey.

The WAS commenced in July 2006, with wave 1 of interviews carried out over two years, between July 2006 and June 2008. Interviews were achieved with 30,595 households during wave 1. Those households were approached for an interview during wave 2, carried out between July 2008 and June 2010, with 20,170 households taking part again.

From wave 3 onwards, the same original set of households were surveyed but a new random set of households were added for each wave to boost the sample size.

The WAS is funded by a consortium of government departments: ONS, the Department for Work and Pensions (DWP), HM Revenue & Customs, HM Treasury, the Financial Conduct Authority (FCA) and the Scottish government. Fieldwork is undertaken by ONS.

English Housing Survey



In Chapter 3, we've made use of existing published data on home ownership trends from the English Housing Survey (EHS). This is a national survey of people's housing circumstances and the condition and energy efficiency of housing in England. It's one of the longest standing government surveys, first run in 1967.

The report is split into two sections. The first section, on households, covers tenure (owner occupation, private rented accommodation and social housing) and the demographic and economic characteristics of the people who live in the three tenures. It explores how affordability varies between the three tenures and how this has changed over time, average mortgage and rental costs, buying expectations among renters, the extent to which private and social renters claim housing benefit to help meet the cost of their rent and rates of mortgage and rent arrears. Rates of overcrowding and under-occupation by tenure are also examined, as well as the extent to which wellbeing and loneliness vary by tenure. The second section, on homes, provides an overview of the housing stock in England including the age, size, type and energy efficiency of housing stock. It also reports on the proportion of homes rated as providing decent living accommodation, considering issues such as whether the home has a smoke alarm or is affected by damp and mould.

Annual Population Survey

In our discussion of early retirement in Chapter 5, we reference data from the Annual Population Survey (APS). This is a continuous household survey designed to provide information on important social and socio-economic variables at local levels. Topics include employment, unemployment, housing, health, ethnicity, religion and education. The published statistics enable monitoring of estimates between censuses for a range of policy purposes and provide local area information for labour market estimates.

The Labour Force Survey and the APS are the sources recommended for employment-related statistics, such as estimates of the number of people in employment or unemployed. They are also unique sources for comprehensive, coherent information about economic inactivity, as they separate information about people who want a job from those who do not.

The APS is not a stand-alone survey; it uses data combined from two waves of the main Labour Force Survey collected on a local sample boost. These boosts are sponsored by DWP, the Department for Business, Innovation and Skills (BIS), the Welsh government and the Scottish government. There are also many other central and local government users of APS data.

Indices of Multiple Deprivation (IMD)

In Chapter 5, we discuss differences in healthy life expectancy based on people's socio-economic deprivation (see page 60). For this analysis we used the Indices of Multiple Deprivation (IMD). The IMD is the official measure of relative deprivation for England. The IMD ranks every small area in England from 1 (most deprived area) to 32,844 (least deprived area).

To produce an overall relative measure of deprivation, the IMD combines information from seven domains. The domains are combined using the following weights:

- income deprivation (22.5%)
- employment deprivation (22.5%)
- education, skills and training deprivation (13.5%)
- health deprivation and disability (13.5%)
- crime (9.33%)
- barriers to housing and services (9.33%)
- living environment deprivation (9.33%)

These weights were derived after consideration of the academic literature on poverty and deprivation as well as the level of robustness of each of the indicators.

A fuller account of how the IMD is devised can be found in Section 3.7 and Appendix G of the technical report prepared by the Department for Communities and Local Government at **assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/464485/English_Indices_of_Deprivation_2015_-_Technical-Report.pdf**

Understanding Society

In Chapter 5, we cite 'Living longer: Caring in later working life'. This ONS report is based on findings from Understanding Society, the UK Household Longitudinal Study, which surveys members of households in the UK over time. The survey provides high-quality longitudinal data on subjects such as health, work, education, income, family and social life to help researchers and policymakers understand the long-term effects of social and economic change as well as policy interventions.

Approximately 40,000 households were recruited for wave 1 of data collection and members of these households are visited each year to collect information on changes to their household and individual circumstances. Interviews are carried out face-to-face in respondents' homes by trained interviewers or through an online self-completed survey. Young people aged 10 to 15 complete a youth questionnaire, while those aged 16 and older complete the adult survey.

The main survey sample consists of a large general population sample and three other components: the ethnic minority boost sample, the immigrant and ethnic minority boost sample and a sample drawn from the British Household Panel Survey, which was an independent survey from 1989 until 2008, when it became part of Understanding Society.

Nest sources

Nest Corporation conducts a large amount of research with our scheme members as well as general consumers. Our research uses a number of different methods, with different methods appropriate to different types of questions.

While Nest has in-house research expertise, we typically work with a specialist research agency to support us in this programme of work. Qualitative research projects and quantitative surveys utilised for the member evidence in this report have been conducted in partnership with a number of agencies, including RS Consulting, Opinion Leader Research, Jigsaw Research, Quadrangle, Accent and Ignition House.

Qualitative research projects

A number of qualitative research projects are referenced throughout this report. Qualitative research focuses on understanding – 'how' and 'why' questions – seeking in-depth diagnostic information on the reasons behind people's attitudes, behaviours, wants and aspirations.

Qualitative research is:

- **exploratory** – seeking to gather knowledge in an area where there is little existing evidence
- **investigative** – seeking to understand the dynamics of attitudes and mindsets
- **explanatory** – seeking to explain attitudes and possible behaviours

These research projects are relatively small in scale and composed of in-depth interviews and group discussions. They provide indicative insight but not percentage figures.

Deliberative research is a particular type of qualitative research. This was used for our study to understand people's reactions to volatility and loss and some of our research exploring members' retirement needs. Deliberative techniques seek to explore what people think and feel after being exposed to information, arguments or scenarios. It can be useful to explore complex topics where levels of understanding among the target group for research are low or misinformed. Commonly, it uses hypothetical situations to attempt to understand how research participants may react if those situations occur in real life. It is important that any education is done as neutrally as possible and that hypothetical situations are realistic to avoid biasing the research.

Quantitative surveys

A large number of quantitative surveys, including surveys from our annual and quarterly 'Voice of the customer' member research programme and general consumer surveys, are referenced throughout this report. Quantitative research focuses on description – 'what' questions – seeking numeric information on the extent of attitudes and behaviours in a given population, for example what percentage of people hold certain opinions or behave in a certain way.

This type of research is larger in scale than qualitative research projects and may involve hundreds or thousands of interviews or survey invitations. It's designed to provide results which are representative of the population being researched within certain confidence limits.

The topics and contents of Nest surveys vary, so throughout this document we reference questions from different surveys which are relevant to our investment strategy.

All Nest member surveys are conducted online. A random sample of members are selected and invited by email to take part in the survey. Responses are weighted back to the known member population. Responses are typically weighted by age and gender but also sometimes by other characteristics.

One of the surveys utilised in this report was a stated-preference survey. See the technical notes in Appendix B for more detailed description of what this means.

'Retirement saving in the UK'

Nest Insight is a collaborative research unit set up by Nest Corporation to help understand the challenges facing Nest members and other defined contribution (DC) savers.

Since 2018 it has published a series of annual research reports and research supplements, originally in partnership with Vanguard's Center for Investor Research as 'How the UK saves' and, starting in 2020, independently under the banner 'Retirement saving in the UK'.

The reports present evidence about who Nest's members are, including their demographics, employers, earnings, contribution rates and histories, and fund and pot activity. This evidence serves as the foundation of our understanding of members in this report. Several chapters summarise findings from the series, but readers interested in more detail would be advised to refer to the full reports, in particular the most recent edition at the time of publication, 'Retirement saving in the UK 2021'.

For more information visit **nestinsight.org.uk/research-projects/retirement-saving-in-the-uk**

Appendix B. Technical notes

Research methodology for stated-preference survey

In Chapter 6, we described a stated-preference survey we conducted with our members to understand their acceptance of income uncertainty in retirement while we were developing the Nest Guided Retirement Fund[46] (see page 72). As noted in the chapter, these sorts of surveys help to quantify how people might behave by showing them a series of choice experiments.

The main stage of the survey was conducted in July 2019. An online survey invitation was sent to a random sample of 187,620 Nest members aged 40 to 65 years. We chose to survey only our older members because we felt retirement decisions were too far removed for those under 40. The survey was completed by 4,020 members.

The first section of the survey asked for information about the size of the participant's current pension pots. This was used to calculate a likely final value of their Nest pot and other pots.

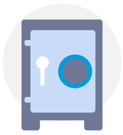
The next section presented each participant with information about our proposed new retirement solution, the Nest Guided Retirement Fund. The information presented was similar to the level of information they would see on the Nest website if they logged in and looked for information about what to do with their pension pot as they approached their retirement age. This described:

Nest Wallet

Provides for a regular income, topped up once a year. Depending upon the performance of the fund, and the starting drawdown rate chosen to top up the Nest Wallet, the annual top-up amount may need to be reduced from its initial level.

Nest Vault

The main invested part of the fund, which Nest manages to ensure the Nest Wallet can be regularly topped up, and to ensure a guaranteed income beyond the age of 85.



Nest Safe

Includes an initial 'lump sum' and potential additional 'bonus' payments which may be added from the Nest Vault if performance is better than expected. Payments into the Nest Safe are more likely the lower the starting level of income is set. Money in the Nest Safe is available to access whenever desired.

We intentionally did not go into any greater detail about the different risks it would be sensible to consider when making decisions about how to use their pot in retirement.

We then asked the participants to say how likely they would be to choose to use the Nest Guided Retirement Fund based on the information they'd been shown. Just over half (54%) said they were very or fairly interested. Only one quarter (26%) were not at all or not very interested. The remainder (20%) were unsure.

We then presented the choice exercise to the participants interested in the Nest Guided Retirement Fund. For this exercise we were able to combine the answers each member had given in the first part of the survey to present them with a specific starting value for their pension pot. This meant that we asked participants to make their choices based on a relatively realistic pot value rather than a hypothetical value that might be substantially different to their personal situation. This also ensured a wide range of different starting values were included in the exercise.

46 **nestpensions.org.uk/schemeweb/nest/aboutnest/investment-approach/other-fund-choices/nest-guided-retirement-fund.html**

The key objective of the choice exercise's design was to present retirement income trade-offs in a meaningful but easily understandable way. It was important to give people sufficient information to make a meaningful decision without overburdening them. Prior to launching the main stage of the stated-preference survey, we'd tested a number of different formats with members through a series of in-depth interviews where a variety of formats were presented in different orders. The version selected for the main survey was deemed most suitable based on the comments made by participants in these interviews.

The exercise asked each participant to choose between different starting income levels they might receive from their Nest Wallet if they were a member of the Nest Guided Retirement Fund. Participants were shown a sequence of pairwise choices. Each subsequent pairwise choice was based on the participant's answer to the previous questions. Participants were shown an example choice before beginning the exercise.

As can be seen in the example screen in Figure 57, the pairwise choices were presented in three rows. The first row showed the annual top-up amount to the Nest Wallet over time, including the initial starting level. The second row showed the chance of different annual Nest Wallet top-up levels. The third row showed the total additional payment into the Nest Safe over time.

This information was framed only in consumption terms. However, the choice experiment was designed to arrive at each participant's preferred initial rate from 3% to 8%, measured to the nearest 0.5%. The information shown to individuals was based on Nest Corporation modelling of potential investment performance over a 20-year time horizon.

The sequence in which the choices were presented was based on an assumption that a choice of X% over Y%, where X < Y, implied that the participant would always prefer a rate of Y% over Z% whenever Y < Z. This assumption was deemed reasonable given that all outcomes – the amounts received over time, risk levels and total additional payments over time – were also monotonic with the starting rate.

Figure 57. Example starting-level choice screen in the Nest Guided Retirement Fund exercise

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p122550 53202 12/2021