



# Understanding reactions to volatility and loss

A report of research carried out by Opinion Leader

September 2010

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## Foreword

On 5 July 2010, ownership of the research and findings contained in this report transferred from the Personal Accounts Delivery Authority (PADA) to NEST Corporation.

PADA commissioned the research but its authority passed to NEST Corporation as the report was being prepared for publication.

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Any deficiencies in the report remain the responsibility of the authors.

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**Alan Terry**, Opinion Leader, led the research project. He has a background in qualitative and quantitative research, and is particularly interested in exploring ways of engaging the public in what can often be dry and complex research issues.

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## Glossary

<b>Absolute loss</b>	A fall in the value of a pension fund that is greater than the original value of contributions made during a period of time, typically during the 12 month period on which an annual pension statement reports
<b>Active member</b>	A member who is currently accruing benefits into an occupational pension scheme. This means that contributions (either by the worker/individual, employer or both) are currently being made to that scheme. Also known as a current member.
<b>Annual management charge</b>	(AMC) a charge levied annually by a pension provider on a member's pension fund. The charge is usually levied as a percentage of the total fund value.
<b>Annuity</b>	An insurance policy that converts a lump sum (for example a pension fund) into an income stream, usually guaranteed until the annuitant's death. The process of conversion is sometimes referred to as annuitisation.
<b>Automatic enrolment</b>	A pension scheme enrolment approach whereby an employer automatically enrolls eligible workers into its pension scheme, while allowing members to voluntarily opt out. Automatic enrolment is currently not available within the UK, but from 2012 employers will have a duty to automatically enrol all eligible workers into a qualifying pension scheme and to make contributions on their behalf.
<b>Defined benefit</b>	(DB) scheme. An occupational pension scheme that provides pension benefits related to the member's salary or some other value fixed in advance.
<b>Defined contribution</b>	(DC) scheme. A pension scheme that provides pension scheme benefits based on the contributions invested, the returns received on that investment (minus any charges incurred) and the rate at which the final pension fund is annuitised.
<b>Member/Membership</b>	A person who has joined a pension scheme, and is entitled to benefits under it, is a member of that scheme.
<b>Money purchase schemes</b>	Alternative name for DC schemes - see definition above.
<b>Occupational pension scheme</b>	An employer-sponsored pension scheme. Benefits can be DC or DB.
<b>Pension fund</b>	The assets that form a pension scheme.
<b>Relative loss</b>	A fall in the value of a pension fund that reduces or eliminates any investment gain, up to a given point in time. See absolute loss.

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## Abbreviations

<b>NMW</b>	National Minimum Wage
<b>NEST</b>	National Employment Savings Trust
<b>PADA</b>	Personal Accounts Delivery Authority
<b>SPA</b>	State Pension Age

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# Summary

## Background

There are low levels of pension saving particularly by workers with low earnings. In response, the Pensions Act 2008 sets out a series of measures that will aim, from their launch in 2012, to make it easier for individuals to save for their retirement. The Pensions Act 2008 also sets out plans for a new national, low cost, pension scheme, NEST (National Employment Savings Trust). NEST is focused on a target market of people who are largely new to pension saving, and the organisations that employ them.

Many NEST members will be members of a pension scheme for the first time and will be unfamiliar with defined contribution pension schemes and investment generally. NEST, in designing a suitable investment approach, wants to be aware of members' attitudes, preferences, reactions and possible behaviours. Much is already known about risk appetites, but far less is known about those in NEST's target market, might react to interim pension loss.

## Aims and approach

NEST commissioned Opinion Leader to undertake in depth exploratory research to understand more about reactions to loss and, in particular, to provide a picture of the mindset the target market for NEST might adopt in response to the value of their pension fund falling from time to time.

The research was qualitative in nature, incorporating some deliberative approaches as well as individual exercises to reveal individual level responses. The groups initially met for 1.5 hours and then met again one week later for a longer discussion lasting 2.5 hours. Groups met between November 2009 and February 2010 in seven locations in England, Scotland and Wales.

A total of 102 people took part in the research. The sample was based on NEST's target market but also included a small number of groups with participants who were in an occupational scheme to provide a point of comparison.

The research focused on attitudes, not actual behaviour, and used hypothetical situations to prompt thoughts and feelings about experiencing an interim loss. It was not the aim of this research to reveal whether people like experiencing financial loss because the answer is obvious: nobody does.

## Main findings and conclusions

### Emotional reactions to interim loss

The main emotional responses to loss were disappointment, anger, helplessness and often surprise and incredulity. When participants' hypothetical pension lost value, they wanted to know where the money had gone and who to blame for losing it.

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Pension loss was also felt with a sense of immediacy and was not considered within the context of a long term savings vehicle. Participants talked about the loss as if it they had less in their current account or wallet than they expected to have, given what they had put in. It was commonly thought that pensions grew slowly but steadily in value, in line with their contributions and with a modest amount of gain. A loss was seen as an anomaly or a fault, particularly by those without pensions, as they did not understand the difference between pensions as a form of investment and savings accounts that accumulated with interest.

### **Whether there are loss intolerant attitudes amongst the target market**

Reactions to interim pension losses were predominantly negative rather than understanding or accepting. Losses in the value of a hypothetical pension prompted surprise, anger and blame, regardless of the circumstances surrounding it. However, different types of loss resulted in different strength of feeling. Loss of contributions was felt more negatively than loss of gains. Contributions were felt to be sacrosanct so where loss was of some or all of previous investment gain, the reaction was less strong. However, examples of loss of gains prompted many to question the point of saving in a pension if this outcome was a possibility.

The risk of inflationary loss, which preserved the face value of contributions but not their spending power, was only appreciated with prompting and tended to be seen as less alarming and blameworthy than absolute loss or relative loss.

A consistent run of interim losses over several years was regarded as more alarming to participants than an equally large loss in total that was experienced in a single year or intermittently in three years out of five, for example. Participants tended to think that consistent losses foretold an inability to improve in future.

Some participants with experience of having a pension showed more understanding of pensions as a form of investment than those who had no experience of pensions.

When faced with a hypothetical interim loss, participants rarely articulated a long term view of pension performance to balance their immediate and tangible sense of loss. Furthermore, a general lack of understanding of pensions as investments prevented participants from considering the possibility of compensating gains in future.

### **The extent to which people are motivated to protect against loss**

When offered three possible investment strategies for a pension, participants were somewhat more inclined to select the one that offered a medium chance of loss and a medium chance of gain. The option offering a low chance of loss and a low chance of gain was more popular than the most aggressive one (high chance of loss and a high chance of gain), but the most loss averse strategy was not the most preferred, despite participants' strongly negative reactions and attitudes to loss.

Those on the lowest incomes (earning at or around National Minimum Wage), were somewhat more likely than those earning more to prefer the investment strategy that minimised the chance of loss, as were those without a pension, in contrast to those who had experience of having a pension.

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## **The extent to which the target market might seek a loss avoidance strategy**

On the whole, a loss in the value of a pension fund prompted such strong negative feelings that participants thought they would take loss avoidance action if such a loss were to occur. Stopping contributions was the most common response, but it was not clear whether participants factored the loss of employer contributions into their judgements about this course of action. Stopping contributions was accompanied in the thinking of some participants by considering alternative means to save for the long term that would not involve the possibility of losses occurring.

Some participants thought it would be appropriate to monitor the situation to see if losses continued into a consistent pattern, which would make them more alarming. Their patience varied, but some said they might ‘wait and watch’ for up to three years. Some participants were also minded to seek information and advice. Despite being blamed for losses, pension providers along with Independent Financial Advisers and Citizens Advice Bureaux were most commonly suggested as suitable sources.

Participants only considered switching the funds in which their contributions were invested when stimulus material had been provided explaining this possibility. Invariably, switching was discussed in terms of reducing the possibility of the losses that participants had hypothetically experienced.

Younger single people without children presented as the most prepared to take an immediate loss avoidance strategy. This might be explained by young people being more likely to discount the long term and having even less understanding of and exposure to pensions. This would need to be the subject of further research, however.

## **Whether there are circumstances that mitigate against loss avoidance action being taken**

Participants volunteered three suggestions for ‘softening the blow’ of pension losses. They wanted:

- Clear explanations of what had happened to ‘their money, not technical descriptions of investment strategies;
- Reassurance about what was being done to prevent future losses and to recoup the amount that had been lost;
- Personalisation, in the form of more helpful statements and a named contact within the pension provider’s organisation from whom information about a loss could be obtained.

It was also apparent that use of framing or presentational devices that indicated that the loss came from the employers’ contributions or did not exceed the contributions made by the worker could be helpful in managing reactions to loss. Preserving the value of personal contributions was of paramount importance to participants, hence the wish for the ability to ‘frame’ any loss in terms of the value of these contributions.

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Finally, when asked what might mitigate loss avoidance reactions, some participants suggested that more information should be provided about pension performance and the possibility of interim loss before people joined a scheme. The deliberative nature of this research, whereby participants were exposed to a range of information that they might not ordinarily have encountered or considered carefully enough to comment on, demonstrated that providing information might not allay concerns and may even produce new ones. On the one hand, there is an appetite to know that interim loss is possible, how and why; on the other, knowing this may lead to losing faith in pensions as a vehicle for retirement savings.

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# 1 Introduction

In 2009, the Personal Accounts Delivery Authority (PADA) launched a public consultation to help inform recommendations about the design of the Personal Accounts scheme<sup>1</sup> and the investment approach it should take<sup>2</sup>. Respondents to the consultation agreed that scheme members would be risk averse. Some also thought that many potential members of the new scheme would be less interested in gains that might be achieved by accepting investment risk and more concerned about contributions losing value, even in the short term. To explore attitudes toward pensions falling in value from time to time, PADA commissioned Opinion Leader to conduct a programme of qualitative and deliberative research to understand attitudes and emotional responses to loss and to provide a picture of the mindset that would affect responses among the scheme's target market to the value of a pension fund falling from time to time.

## 1.1 Financial decision making and attitudes to risk and loss

Traditional economics assumes that people weight short term gains and losses equally and behave as 'rational investors'. That is, with the right information they will seek to make informed choices that optimise benefits.

This assumption has been challenged by behavioural economics, an emerging academic discipline which incorporates psychological insights to explain and model financial decision making. It suggests that in some situations, especially when individuals face complex financial decisions, loss aversion along with other cognitive and emotional biases, may lead people to behave in ways that contradict traditional economic principles of 'rational' investor behaviour.

In traditional economic theory, a gain of £10, for example, is seen as being as pleasant as a loss of £10 is unpleasant, and the possibility of a gain of £10 is as enticing as the possibility of a loss of £10 is off-putting.

In contrast, Prospect Theory<sup>3</sup> showed that people do not weight gains and losses equally. A gain of £10 is seen as **less** pleasant than a loss of £10 is unpleasant, and the possibility of a £10 gain is **less** enticing than the possibility of losing £10 is unattractive.

Prospect Theory argues that people find it easier to forego a gain than to accept a loss. Therefore, they are likely to put more effort into preventing a loss than achieving a gain.

This research is concerned with attitudes to loss amongst the scheme's target market and the extent to which the central argument of Prospect Theory - that people can be motivated to protect against loss - applies to potential future members.

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<sup>1</sup> The Personal Accounts scheme has now been branded as the National Employment Savings Trust (NEST). It is referred to as the Personal Accounts scheme throughout this report because the research was conducted before the new name was adopted.

<sup>2</sup> Building Personal Accounts: Designing and investment approach, 2009.

<sup>3</sup> Kahneman, D., and Tversky, A. (1979). Prospect Theory: An analysis of decisions under risk. *Econometrica*, 47, 313-327.

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## 1.2 Pension reform in 2012

### Employers

The Pensions Act 2008 establishes new duties on employers that start to be introduced from 2012. For the first time, employers will have to enrol their workers into a workplace pension scheme. Employers must make a minimum contribution for each enrolled worker, as will workers who choose to remain enrolled, with government contributing the remainder of the total contribution in the form of tax relief.

The amount that an employer will have to contribute to a worker's retirement pot will rise gradually between 2012 and 2016 and will ultimately be a minimum of three per cent of an enrolled worker's qualifying earnings. The worker's minimum contribution will rise to four per cent of qualifying earnings by 2016, and the government will bring the total minimum contribution to eight per cent of qualifying earnings.

Currently, many commercial providers of pensions do not find it economic to serve all employers. Small employers, employers with lower earning workforces, and employers with high staff turnover or a high proportion of casual, seasonal or part time workers may find it difficult to access a workplace pension scheme at competitive charge levels.

Therefore, to ensure that all employers have access to a high quality workplace pension scheme, the Government is establishing a new national trust based, defined contribution occupational pension scheme, which was known as Personal Accounts when this research was carried out. At the time of reporting, Personal Accounts is known as NEST (National Employment Savings Trust).

NEST will:

- be open to all UK employers
- be open to any worker working for an employer who has chosen the scheme
- be open to self-employed people
- be low cost
- have high standards of governance and administration.

### Individuals

People will be eligible for automatic enrolment in NEST if they meet all three of the following criteria:

- are aged 22 to State Pension age;
- work, or ordinarily work, in Great Britain or Northern Ireland, full or part time<sup>4</sup>;
- earn more than £5,035 per year (in 2006/07 terms) from a single job.

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<sup>4</sup> These individuals (except for self-employed people and single person directorship) can only become members of the scheme if their employers have chosen to use the scheme to meet their employer duties.

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The reforms intended target group are those that:

- meet all of the above eligibility criteria; and
- are not members of a qualifying employer-sponsored pension scheme, i.e. a scheme that meets the requirements of the Pensions Act 2008.

Although the scheme will accept any eligible worker that an employer chooses the scheme for, PADA and NEST Corporation have further refined the target market to focus on low to moderate earners. As a result, membership for the scheme includes those who:

- meet all of the above criteria; and
- do not earn more than £35,000 (in 2006/7 terms).

This research is primarily concerned with NEST's target membership group. The majority of participants, 76 out of 102, were recruited to reflect the four criteria that define the target market. In addition, a small number of participants, 26 out of 102, were recruited who matched the criteria for NEST's target membership, but at the time of recruitment, had experience of participating in a pension scheme<sup>5</sup>. Chapter 2 provides a more detailed description of the methodology that was employed.

### **PADA and NEST Corporation**

The Personal Accounts Delivery Authority (PADA) was established under the Pensions Act 2008, and was tasked with setting up the delivery structure of the Personal Accounts Scheme, now known as NEST. PADA was a non-departmental public body accountable to Parliament and reporting, through a Board, to the Secretary of State for the Department for Work and Pensions (DWP). It was a transitory body which ceased to exist in July 2010, when NEST Corporation, a trustee body, was established to undertake the day to day running of the scheme.

## **1.3 Study objectives**

The aim of the research was to provide a picture of the mindset the target market might adopt in response to the value of their pension fund falling from time to time. Such losses are referred to as interim losses, i.e. losses to the value of a fund between two points in time that may or may not affect the final value of the fund, for example, at the point when a member takes their money out of NEST.

The research was designed to provide insight into the following issues:

- what loss means to the target market
- whether there are loss intolerant attitudes amongst the target market<sup>6</sup>
- the extent to which people are motivated to protect against loss

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<sup>5</sup> Note that this group were not asked whether their pension scheme met the criteria of the Pensions Act 2008.

<sup>6</sup> Note that this research, given its qualitative design, does not explore whether participants weight loss and gains equally, as described by Prospect Theory. However, it does explore the implication of Prospect theory in so far as it seeks to explore whether participants will be motivated to protect against loss, even if this means foregoing gain.

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- the extent to which the target market might seek a loss avoidance strategy
  - whether there are circumstances that mitigate the taking of loss avoidance action.

It was not the aim of this research to reveal whether people like experiencing financial loss. The answer is obvious because no one does.

## 1.4 Interpretation of data and conventions for presenting findings

### 1.4.1 Qualitative research

Qualitative research such as this is designed to be exploratory and investigative and to address questions of how and why. As the first study of this nature of NEST's target market, it sought to explore new territory, not to test familiar hypotheses. While the sample is large for qualitative work, it does not provide a statistically reliable base from which to make generalisations about the views of the target market. That is, it does not measure views and attitudes in the target market as a whole. This needs to be taken into account when interpreting the findings presented here. Chapter 2 provides a detailed description of the qualitative methodology that was used.

### 1.4.2 Attitudes, not behaviour

The research provides a thorough analysis of participants' attitudes to loss, how these attitudes are formed, and emotional reactions to hypothetical interim losses in the value of a pension. It did not investigate or attempt to predict actual behaviour. Therefore, it is not known how the attitudes and mindsets that were revealed will translate into behaviour. The results do, however, provide insight into the attitudes and reactions that are likely to arise and that could affect behaviour as pension reform is implemented.

### 1.4.3 Classification of sub-sets of the sample

The sample for this study was designed to include people who have no experience of pensions and those who have had some such experience. This was done to explore whether those with experience of pensions have different attitudes to interim pension loss than those who have no experience<sup>7</sup>.

Throughout the report, we refer in the following way to three sets of participants.

- **Participants without a pension** met all four criteria that define NEST's target membership. These participants did not have a pension of any sort when the research was conducted.
- **Participants with a pension** met three of the four criteria NEST will use to identify its target market (age, employment status, and earnings), but were currently members of a pension scheme<sup>8</sup>.
- **Participants** refers to all those who took part in the research, those with and those without a pension.

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<sup>7</sup> Those with a pension were a small proportion of participants; those without a pension were the main focus of the research.

<sup>8</sup> These participants may or may not have been actively contributing. No questions were asked in recruitment about the level of contribution that they or their employer made as it was felt that many would be unable to supply this information. Furthermore, some of these participants may have been in a pension scheme that would not be classified as occupational because it is possible that they did not know the difference.

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#### 1.4.4 Attribution of verbatim material

Extensive use has been made of verbatim comments to exemplify particular attitudes and viewpoints, although such comments do not represent the views of all participants. Where verbatim has been used, the attributes of the participants making the comment are given in the following order: life-stage, income level (where those earning the National Minimum Wage are shown as NMW), and finally, the sub-set of participants to which the speaker belongs - those without a pension or those with some experience of a pension.

### 1.5 Organisation of this report

The remainder of this report is organised as follows.

**Chapter 2, Methodology**, describes the structure of the sample and the two stages of focus groups that were used to collect data. Research materials used are found in Appendices A through G.

**Chapter 3, Financial context**, explores money management and expectations for retirement in the sample. It looks at how the sample organises and plans their money to provide some context to the target markets' financial capability and approach to spending and saving generally. Findings about these contextual issues broadly confirm findings of other research carried out by DWP and PADA, and provide context for the findings set out in subsequent chapters.

**Chapter 4, Emotional responses to interim loss**, reports on feelings associated with loss in general and seeks to understand how interim pension loss in particular would be experienced. It focuses on immediate responses to interim loss and seeks to understand what underpins them.

**Chapter 5, Dynamics of interim loss**, contrasts attitudes toward loss of contributions and loss of investment gains made. The amount, frequency and duration of loss are also discussed in terms of their impact on the overall experience of loss. Finally the economic climate and peer group experiences are discussed as influences on the experience of loss.

**Chapter 6, Loss avoidance measures**, covers the possible behavioural responses considered by participants, given their attitudes and mindsets toward interim loss. Possible responses that were explored include ceasing contributions, seeking other ways to save for retirement, giving the pension more time, changing funds and seeking information and advice.

**Chapter 7, Prevalence and extent of loss aversion**, explores the extent to which participants seek to protect against loss, based on their reactions to pension investment strategies that involve different chances of loss and gain. Possible reasons for favouring the investment approaches that were preferred are explored.

**Chapter 8, Managing reactions to loss**, discusses three suggestions for managing loss that arose spontaneously and explores the potential for framing loss through mental accounting. Chapter 9, **Conclusions**, draws together the main findings and considers their implications for the scheme<sup>9</sup>.

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<sup>9</sup> These implications take into account the focus on automatic enrolment and other aspects of the scheme prior to the conclusion of the review of automatic enrolment that will report in autumn 2010.

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## 2 Methodology

### 2.1 Approach

The approach involved a total of 16 reconvened discussion groups (32 groups in total). The groups met initially for 1.5 hours and then again one week later for discussions lasting 2.5 hours. Research took place in seven locations, London, Birmingham, Bridgend, Glasgow, Bristol, Croydon and Exeter, between 25 November 2009 and 4 March 2010. A total of 102 participants took part in the group discussions.

The research was wholly qualitative, incorporating some deliberative elements that gave participants more time and information than a more traditional approach. Because of the complex nature of some of the issues and the low levels of financial literacy, it was necessary in any case to provide a certain level of neutral information to inform discussions, for example, explaining inflation and investment gains.

This approach was selected for three reasons.

- The need to overcome predictable reactions and dismissive negative responses argued for a group format and its attendant dynamics.
- The need to provide a foundation level of knowledge for discussions, and for participants to assimilate it, argued for an element of deliberative research, but the need to understand unadulterated opinions made the case against excessive deliberation.
- The need to allow participants to take in and react to hypothetical pension losses made reconvening the groups an appropriate strategy that avoided eliciting ‘snap’ decisions in the course of one evening’s discussion.

### 2.2 Sample structure

Each group comprised six to eight participants with similar profiles with respect to life-stage, level of personal income and pension status, i.e. with or without a pension. There were four defined life-stages and four defined levels of income representing the characteristics of NEST’s target market. The groups were organized so that each had a unique combination of life-stage and income level.

Twelve of the 16 reconvened groups consisted of participants without pensions and four were composed of participants with experience of pensions. The latter four groups served as informal ‘control’ groups or references for comparison with the groups composed of participants without pensions, to provide some indication of how experience of having a pension affected responses. The composition of the groups is shown in Table 2.1.

**Table 2.1 Composition of 16 reconvened groups**

Life stage	Age/children	Income before tax	Pension <sup>10</sup>	Location	Number of participants	Group ID
Young single	22-34, no children	NMW*	No	Bridgend	7	G
Young single	22-34, no children	£10,600 - £15,999	No	London	7	A
Young single	22-34, no children	£16,000 - £24,999	Yes	Bristol	7	K
Young single	22-34, no children	£25,000 - £35,000	No	Croydon	7	M
Young, with children	22-34, children (0-18) at home	NMW	No	Birmingham	7	F
Young, with children	22-34, children (0-18) at home	£10,600 - £15,999	No	Glasgow	6	J
Young, with children	22-34, children (0-18) at home	£16,000 - £24,999	Yes	Exeter	5	P
Young, with children	22-34, children (0-18) at home	£25,000 - £35,000	No	London	6	D
Established at work	35-44, no quota on children	NMW	No	London	6	B
Established at work	35-44, no quota on children	£10,600 - £15,999	No	Exeter	6	O
Established at work	35-44, no quota on children	£16,000 - £24,999	No	Birmingham	6	E
Established at work	35-44, no quota on children	£25,000 - £35,000	Yes	Glasgow	7	I
Nearer retirement	45-SPA**, no quota on children	NMW	No	Croydon	6	N
Nearer retirement	45-SPA, no quota on children	£10,600 - £15,999	No	Bridgend	6	H
Nearer retirement	45-SPA, no quota on children	£16,000 - £24,999	Yes	London	7	C
Nearer retirement	45-SPA, no quota on children	£25,000 - £35,000	No	Bristol	6	L

\* National Minimum Wage;

\*\* State Pension age

<sup>10</sup> It was agreed with PADA that pension scheme members were rare and atypical among those at the lowest income levels (NMW and £10,600 - £15,999) and, as such, the groups composed of participants with experience of pensions were distributed across each of the four life-stages rather than the four income levels.

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In addition to the core recruitment variables shown in Table 2.1, a number of additional criteria were also taken into account when recruiting participants.

As far as possible, each group comprised at least:

- two men and two women
- one participant in council or housing association accommodation, but a maximum of three in privately rented accommodation
- two participants in manual jobs and none in senior managerial/ higher professional occupations
- three working for small employers having fewer than 50 workers and at least one working for a micro employer having one to four workers
- one BME participant with at least three BME participants in areas where black and ethnic minority groups are a significant presence.

As far as possible, the total sample comprised at least:

- five participants per location, and at least 40 in total, working in hospitality, retail, manufacturing, call centres or building services
- two participants per location, and at least 20 in total, who had had three or more jobs in the last three years or been out of work in the last three years
- one participant per location with a disability and at least five in total
- one participant of non-Christian faith per location and at least five in total.

Anyone educated to degree level or higher and earning less than £16,000 was excluded, as were students working part time. The former exclusion, based on a high level of educational attainment but relatively low current income, was intended to rule out trainee barristers, for example, and others whose current income would be a poor predictor of their situation in retirement. Furthermore, a maximum of 10 people classified as social grade AB were allowed to be included across all 16 groups.

There were a few discrepancies between the final sample composition and these prescribed additional recruitment criteria. There were six groups (A, E, G, K, M and P) in which no participants rented accommodation through a council or housing association and two groups (A and B) in which more than three participants lived in rented accommodation. Across all groups, however, the total number of participants who rented accommodation through a council or housing association or lived in privately rented accommodation matched the recruitment criteria. Four groups (D, E, H and O) did not contain the desired number of participants working for small or micro employers but, again, the total sample matched the recruitment criteria.

There were no participants with a disability in one of the seven locations (Bristol) and no participants of non-Christian faith in three locations (Bristol, Exeter and Croydon). Across the whole of the sample, the recruitment criteria for five people with disabilities and five people of non-Christian faith were met. Additionally, there were two participants in Group A in income bracket £10,600 - £15,999 who were educated to degree level or beyond.

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## 2.3 Topics covered in the two rounds of group discussions

The initial discussion groups were designed to explore overall attitudes to financial loss and general levels of understanding of pension schemes. When they reconvened a week later, the groups focused on more specific attitudes to pension losses, how they might react to such losses and how, if at all, these reactions might be managed. The discussion guides that were used appear in Appendix A.

### 2.3.1 Initial group discussions

The first group discussions were 1.5 hours long and explored what financial loss meant to participants, expectations regarding pension loss and how it was subjectively and emotionally experienced, before moving on to explore understanding of pension schemes and expectations of how they may perform. When they were recruited, participants were asked to bring something that symbolised for them a ‘personal money related loss’, for example, a newspaper cutting, a bank statement or an empty piggy bank. The item they brought in was referred to in the group as a ‘financial symbol’.

The discussions progressed as follows:

- initial exploration of how participants organised money to spend or to save, their financial timeframe, and how they defined the short, medium and long term in a financial context
- a ‘guided fantasy’ exercise<sup>11</sup> to understand participants’ expectations of retirement in terms of their lifestyle, how much money they will have and from what sources, and what they will spend money on
- exploration of participants’ baseline understanding of pensions and their expectations of pension performance; only after their spontaneous understanding of pensions was fully covered were the principles of pensions explained
- discussion of participants’ financial symbols<sup>12</sup> to explore attitudes to money related losses and then discussion of different scenarios to explore attitudes to losses in pensions, including relative and absolute losses
- discussion of three investment options; low chance of loss with a low chance of a small gain, some chance of loss with some chance of a modest gain, or highest chance of loss with the greatest chance of a large gain
- participants were briefed and given a hand out with basic information explaining a pension scheme that functioned as NEST will, although no reference was made to NEST. Participants were then informed that they would receive a letter updating them on the performance of a hypothetical or simulated pension scheme during the following week.

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<sup>11</sup> Participants were asked to close their eyes and imagine their lifestyle and income in retirement. The facilitator used various prompts to focus participants’ thoughts; how would they spend their time, how would they spend their money, what lifestyle would they lead, how much money would they have. They then opened their eyes and discussed what they imagined.

<sup>12</sup> At the recruitment stage, prospective participants were asked to bring to the discussion group an item or object that symbolised a personal money-related loss. These items and objects were referred to in the discussion groups as ‘financial symbols’.

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### 2.3.2 Between the initial and reconvened group discussions

During the week between the first group meeting and the reconvened group session, participants were sent a letter regarding a simulated pension scheme that was a statement of loss in all cases. The letter and amount of loss were independent of the investment option the participant had chosen at the end of the first group session.

There were two types of mocked up pension statements, sometimes referred to in this report as a ‘loss letter’<sup>13</sup>. One detailed an absolute loss in terms of contributions: a decline in value of £220 lost in one year, on contributions of £1,320. This letter was sent to all participants in groups A through H, as described in Table 2.1 in Section 2.2. The other letter detailed a relative loss to previous investment gains: investment gains to a value of £460 followed by losses of £400, with a net gain over five years of just £60 on contributions totalling £6,600. The second letter was sent to participants in groups I through P, as described in Table 2.1. These two letters appear in Appendix G.

With the ‘loss letter’, participants were sent an ‘emotion tree,’ and asked to circle the figures that best represented how they felt on reading the ‘loss letter’. The figures on the emotion tree represent a whole range of feelings, including anger, fear, happiness, comfort, and support. Participants were also asked to record what action(s) they might take as a result of reading the letter and to bring all these materials with them to the reconvened discussion session. These materials appear in Appendix H.

### 2.3.3 Reconvened group discussions

The reconvened group discussions were designed to understand loss aversion and reactions to loss in the context of pensions. The discussion took the following course:

- discussion of participants’ emotional reactions to the statement of loss to their simulated pension using the emotion tree as a basis for discussions
- exploration of how reactions to loss are affected by the context and type of loss, for example, previous gains, economic downturn, participants’ age when the loss occurred, amount of loss, duration of loss, frequency of loss
- establishing what, if any, action participants would take in response to a pension loss. Between the initial and reconvened sessions, participants recorded what action(s) they might take as a result of reading the statement of loss and this was used as a basis for discussion
- a role play exercise in which participants were cast as pension scheme managers or members and were then asked to choose the most appropriate investment strategy for a national pension scheme, with discussion of the rationale for the recommendations made
- exploration of what might mitigate against loss avoidance behaviour and the extent to which the scheme’s provider could affect this.

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<sup>13</sup> At the recruitment stage, prospective participants were asked to bring to the discussion group an item or object that symbolised a personal money-related loss. These items and objects were referred to in the discussion groups as ‘financial symbols’.

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## 2.4 Short questionnaires to gauge changes in attitudes and knowledge

In addition to the discussion groups, short questionnaires, shown in Appendix B, were completed by participants prior to the first group discussion and towards the end of the reconvened group session. The questionnaires were broadly similar and designed to gather directional data on 'before' and 'after' attitudes to risk, loss aversion, financial product holdings, attitudes to finance, financial knowledge and confidence and attitudes and expectations of retirement. The purpose of including the questionnaire as part of the research design was to allow quick collection of information about individual circumstances that was not suitable for discussion with a group and to gauge how opinions might change as participants experienced the discussions and the stimulus material that was presented.

Given the small sample size (N = 102) and qualitative nature of the discussion groups, data from the questionnaires has been used with considerable caution and should be interpreted in a similar manner. Information based on this exercise has been included in the report at various points. This information can only provide a steer on participants' attitudes, their financial knowledge and confidence, and how these may have changed. Analysis at sub-group level may provide some indicative comparisons, but conclusions cannot be drawn from such small samples.

## 2.5 Methodology and the findings that follow

Cautions have been set out for interpreting the qualitative data this research was designed to produce using the methodology described in this chapter. While they are entirely appropriate, these cautions do not undermine the integrity of the findings presented in the following chapters. For a qualitative study, the sampling strategy was especially ambitious and the number of participants included was relatively large.

The use of reconvened groups allowed time for participants to assimilate information and consider their responses to a notable event, albeit simulated, that occurred between the two meetings, and attitudes could be captured before and after. The inclusion of those with and without pensions among participants allowed comparisons to be made between groups that are likely to be found among NEST's first members, and to get an indication of the potential impact of previous pension experience. Finally, the sensitivity with which the groups were moderated, the candour of the participants, and the rigor of the analysis are reflected in the findings that follow.

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## 3 Financial context of the participants

### 3.1 Introduction

This chapter explores money management and expectations for retirement. It looks at how participants organise their finances and plan their use of money. This provides context, particularly with respect to participants' financial capability and general approach to spending and saving, for the evidence on attitudes and reactions to loss in the following chapters. A general discussion of money management, time horizons for saving and expectations about retirement also provided a good starting point for more focussed discussions of interim pension loss.

It is important to note that gathering insight on participants' financial capability and attitudes to saving for retirement was not an objective of this study. More detailed and specific work in this area has been conducted already, and this evidence base was taken into account in the development of this research<sup>14</sup>. The approach to money management taken by participants chimes with what has been found for lower earners in the working age population more generally.

While the findings presented here do not represent new evidence on the subject of money management and low earners, this is the first qualitative analysis of money management and retirement expectations to focus on the Scheme's target market in particular. Where findings corroborate, further explain or differ from existing research, this has been noted.

### 3.2 Chapter Summary

- Making ends meet was the ongoing priority for participants. After spending on necessities, limited income was seen to be 'left over' for spending on luxuries or for saving. A pension was generally seen as belonging to the latter category.
- Some participants, especially younger ones, were without savings. Commonly, savings that did exist were set aside for particular uses in the not too distant future, such as an annual holiday, or marked out for meeting likely household needs, such as broken appliances or car repairs. A sense that they should, ideally, be saving for retirement was common among participants, particularly older people and those with children, but the feeling that financial circumstances made this impossible was also common.
- Apportioning money to 'mental pots' that assign income to specific purposes was a common approach to money management, i.e. providing a strategy to cope with many demands on limited income. As such, apportionment money management tended to reflect a sense of financial insecurity and correlated with the short term time horizons that were typical of participants.

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<sup>14</sup> Working Paper 72, 'Individuals' attitudes and behaviours around planning and saving for later life', DWP, 2009.

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- Expectations of retirement were mixed. There were younger participants who had high expectations of retirement relative to their current income, which they expected to rise over time. Others' expectations were more modest and expressed in terms of freedom from worries about meeting basic needs such as food, housing and energy bills. Older participants had more concerns and fears about retirement, and some expected to have to carry on working, at least part time, to afford an acceptable, if basic, quality of life.
  - Those with experience of pensions seemed to have somewhat more optimistic expectations for retirement.

### 3.3 Savings behaviour

Participants tended to regard their current financial circumstances as being not particularly good. Living day to day and meeting basic expenses had priority, rather than anything longer term. Considerations such as paying the mortgage or rent, meeting utility bills and shopping for food had to come first. Participants on the lowest incomes, in particular, explained that this left little each month for saving.

Overall, participants took a short term attitude to money management and savings. Where there were examples of savings, these were generally for the purpose of buying something in the not too distant future, rather than saving over many years. When asked to describe how they would define short and long term savings, long term was generally perceived as saving over several months, rather than over years, and an annual holiday was commonly the longest term purpose for which participants saved. This is consistent with previous research with the working age population, which showed that, for some, timeframes for saving were exceptionally short<sup>15</sup>.

*'I'm looking at short term, to be truthful. I just get what I get paid, and then I just split it up between travel, cigarettes or whatever, and I've got a daily kind of budget. I just look at it short term really.'*

Young with children, NMW, without a pension

Some participants, especially younger people and those without pensions, did not have any formal savings. Participants who had accumulated savings over several years tended to be older participants or to have young children, although not exclusively so. Savings that were considered to be longer term had been built up through a Sharesave scheme at work, for example. In this case, the savings were intended to mature after three years, and the resulting sum would be used to pay off a loan. This is consistent with existing research and analysis<sup>16</sup>.

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<sup>15</sup> Working Paper 72, 'Individuals' attitudes and behaviours around planning and saving for later life', DWP, 2009.

<sup>16</sup> DWP research with the target group for the reforms (22-SPA, in full or part time work, earning at least £5,035 from a single job and not in a qualifying pension scheme) found that 15 per cent had no savings at all and 23 per cent had savings of £1,000 or less. See DWP research report 669, 'Individuals' attitudes and likely reactions to the workplace pension reforms 2009', 2010.

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The predominant form of savings was a bank account; some participants had an instant access savings account, but current accounts were also used as a repository for savings. In some instances, a physical money ‘pot’ such as an envelope or a sock drawer was used to accumulate savings over the short or medium term<sup>17</sup>. Whether saved into bank accounts or sock drawers, such savings were accessed for purposes such as a holiday or for expenditures such as car repairs, school shoes or replacing a broken fridge, for example, that were regarded as inevitable but hard to predict precisely. This cycle of building up and running down savings reportedly took place over periods of several months, rather than many years.

*‘(We had been saving for a) nice holiday because we haven’t had one for quite a few years, but I spent the money on the car ... I needed two tyres and the exhaust went on it last week.’*

Nearer retirement, £10,600 - £15,999, without a pension

### 3.4 Apportionment money management

Previous research has shown that some people, and especially those on lower incomes, tend to apply tight money control mechanisms in order to match income with expected outgoings in ways that reveal a sense of ‘money anxiety’. Mental ‘pots’ provide a way of micro-managing the household budget to ensure that required outgoings are covered. Each money ‘pot’ is assigned a different purpose, for example, the gas and electricity bill or an upcoming school trip. This has been termed ‘apportionment mentality’<sup>18</sup>.

The same previous research also identified three types of money managers: apportioners, active money growers and low risk money growers.

This research suggests that participants were predominantly ‘apportioners’. Much of what participants said about month by month, payday to payday money management could be described as apportionment management. In some instances, money was withdrawn from current accounts and then placed in different envelopes or places in the home, each earmarked for a different purpose.

*‘I’ll sit on my bed with my list and I’ll separate proper physical chunks of money out and then if I need to put stuff in the bank to pay for it by card or whatever then I’ll do that.’*

Young single, £10,600 - £15,999, without a pension

*‘I’ve got a pot that looks like a tin of soup and there’s always about £100 in there, just for emergencies. I’ve also got another little jar, a little jam jar with all 50p’s in it, there’s a good £20 in there as well, it’s just to have that safety of knowing that it’s there (in case I) have to get a cab or something like that.’*

Established at work, NMW, without a pension

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<sup>17</sup> Participants were asked to define for themselves, short, medium and long-term. Weekly or monthly income and expenditure were considered to be short-term whilst medium-term ranged from one month up to a year. Long-term definitions were more variable; for some, ISAs, Child Trust Funds and Sharesave schemes were given as examples of ‘long-term’ savings for those who held these. In other cases long-term was perceived within a far shorter timeframe such as saving for or buying an annual.

<sup>18</sup> Working Paper 72, ‘Individuals’ attitudes and behaviours around planning and saving for later life’, DWP, 2009.

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*'I have two accounts, we have a shared account and that pays the mortgage and all the utility bills and the petrol, all our essentials, and then my current account pays for mobile phone, daughter's dancing and anything else that comes in.'*

Established at work, £16,000 - £24,999, without a pension

### 3.5 Financial priorities

For participants generally, paying for necessities often consumed most or almost all of their income, although this was somewhat less likely among those in the higher income bands that were included. 'Necessities' included a broad range of items such as food, energy bills, rent/mortgage, insurance and petrol, but also things such as rugby club money for a child.

This meant there was often little money left over for luxuries, and when luxuries could be contemplated, they commonly involved buying DVDs, going out for a meal or going shopping, rather than larger expenditures.

*'In my mind I'd love to put away a certain amount a month for rainy days or the future but there's never enough, there's always something [for it] to go out on.'*

Young single, £10,600 - £15,999, without a pension

*'I do have children and I'd rather not have the money in a pension scheme so I can spend it on my children right now.'*

Young with children, NMW, without a pension

Some of the younger people in the sample, while citing affordability as a reason for not saving, also reported being less concerned with the future generally and more focussed on the 'here and now'. Saving for retirement in particular, as has been evidenced in previous studies, was considered to be a distant prospect and one which younger participants assumed they would be in a better position to do later rather than now<sup>19</sup>.

*'So my policy is, why scrimp and save now when in the future I should be earning a bit more?'*

Young with children, £25,000 - £35,000, without a pension

Affordability, therefore, is not just about how much money people have available to cover their outgoings and meet their spending expectations. It is also a mindset and reflects spending priorities. Some young people in the sample reported not being able to 'afford' to save for the long term or for their retirement more specifically, despite earning at the same level as others who participated in such saving, regardless of dependents.

Overall, pensions and retirement savings were largely perceived as a luxury, that is, something that could not be prioritised above required day to day expenditures.

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<sup>19</sup> Working Paper 72 'Individuals' attitudes and behaviours around planning and saving for later life', DWP, 2009, provided an attitudinal segmentation of the working age population in terms of planning and saving for later life. One segment was 'Don't worry, be happy,' comprised of people more focussed on 'here and now' and not concerned at all with long term planning, regardless of affordability. This segment is predominantly made up of younger people.

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## 3.6 Expectations for retirement

Previous research has found that people struggle to envisage themselves far enough in the future to have become retired<sup>20</sup>. In order to help participants discuss the subject of pensions, they were asked to imagine what their retirement might be like. The expectations that participants had for their retirement were mixed and ranged from quite basic to fairly luxurious lifestyles. Expectations, however, were typically somewhere in the middle.

Older participants, particularly those near State Pension age, were more likely to anticipate a retirement in which they were “just getting by.” Participants nearing retirement were also more likely to worry about making ends or to assume that retirement might be postponed indefinitely because of a financial need to continue working.

*‘... if I’m honest, it’s hurtling towards me now and it’s a bit scary ... You talk about living on a state pension and you look at those (current expenditures) and your state pension is not going to touch it. That is realistic, and that is scary.’*

Nearer retirement, £25,000 - £35,000, without a pension

*‘Because I’m 59, 65 is six years away ... I’ll carry on working; I’ll be working until they carry me out (in a box) because I don’t think I’ve got any choice.’*

Nearer retirement, NMW, without a pension

Some participants did foresee a comfortable retirement in which they would be financially secure. The main characteristic of a comfortable retirement, however, was not overseas holidays or a nice new car, but more often than not, simply not having ‘money worries’.

Younger single people were more likely to imagine retirements where they would be more comfortable than ‘just getting by’. This is perhaps because they were basing their expectations on savings they imagined they would accumulate in the future as their income rose, rather than on savings they were making from their current income. This supports the hypothesis put forward in previous research on perceptions of retirement that people imagine they will be better off in the future and in a better position to save<sup>21</sup>.

*‘... what I want is my own home, own a holiday home, obviously a nice car, then I think it’ll be a nice settled life.’*

Young single, £10,600 - £15,999, without a pension

*‘You want to keep the same sort of standard of living as you (have during) your working live, I suppose. But you probably will go on holiday more because you’ve got a lot of time on your hands.’*

Young single, £16,000 - £24,999, with a pension

Overall, with the exception of some younger people, participants hoped for a retirement that was not much worse than their current lifestyle, with the absence of serious or constant money worries being a common summary of expectations.

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<sup>20</sup> Working Paper 72, ‘Individuals’ attitudes and behaviours around planning and saving for later life’, DWP, 2009.

<sup>21</sup> Working Paper 72, ‘Individuals’ attitudes and behaviours around planning and saving for later life’, DWP, 2009.

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### 3.7 Summary comments

This chapter has described the priority given by participants - all of whom were earning less than £35,000 per year - to meeting payday to payday costs that were deemed necessary, at the expense of long term savings and pensions, which tended to be regarded as a luxury.

Although some participants, especially younger single ones, were without savings. Savings that did exist tended to be set aside for specific uses in the not too distant future.

Participants, all on low or modest incomes, commonly used ‘apportionment money management’ to synchronise income and outgoings, an approach that was described as being more attuned to meeting short term than long term aims and which previous research suggested betrayed money anxiety.

Expectations about financial wellbeing in retirement were mixed. Some younger single participants were aspirational, expecting a secure and enjoyable retirement relative to their current circumstances and income. In general, participants did not expect luxury but did hope to be able to meet basic needs and be free of money worries. Older participants, especially those near retirement, tended to have more concerns about making ends meet in retirement or to envisage postponing retirement because of the financial need to keep working.

Discussion of these and related issues revealed a generally modest level of financial literacy and a perceived inability to engage in saving for the longer term, with participants prioritising day to day living and meeting basic expenses. Anxiety about money, or expectations for a comfortable retirement that were out of touch with current financial realities, were also revealed.

Participants’ emotional responses to financial loss generally, as discussed in Chapter 4, and specifically to loss of value in pension funds, as discussed in Chapter 5, should be understood in the light of these findings.

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## 4 Emotional responses to interim loss

### 4.1 Introduction

This chapter explores emotional responses to losses that may occur in the value of members' pension funds from time to time and seeks to understand what underpins them. A loss of this kind is referred to as an interim loss<sup>22</sup>.

In this chapter, reference is made to symbols representing personal financial loss that participants were asked to bring to the first group discussion. It also refers to hypothetical scenarios outlining interim losses and mocked up, unbranded pension statements showing a loss of this sort. The use of these simulation materials has been explained in Section 2.3.2 and the materials themselves appear in Appendices E and G.

### 4.2 Chapter summary

- Reactions to interim pension losses were predominantly negative rather than understanding or accepting. All groups, by age, income and even participants with and without pensions, reacted with a mix of anger, disappointment, helplessness and often surprise and shock.
- Expectations were that pensions grew slowly but steadily, as money 'put aside.' In this context, interim losses were seen as an anomaly or a fault, rather than a probability during the long term over which pension funds accumulate.
- The nature of pensions was, on balance, still poorly understood by participants, despite the basic information about pensions that was provided to facilitate deliberation in the focus groups. Lack of understanding appeared to contribute to participants' feeling they had little control over a pension's performance.
- Low levels of understanding and perceived personal control over a pension's performance also seemed to contribute to low levels of acceptance and high levels of aggrievement in relation to losses. Interim losses were seen to be someone's fault, usually a pension provider or fund manager, and questions about 'where has the money gone' ensued.
- Participants expressed a strong sense of connection to 'their money', even though the losses that were 'experienced' were simulated, not real. In this sense, the simulation worked. Interim losses were seen by participants as personal losses, and the pension scheme was often seen as almost akin to a physical pot of money, with falls in value meaning money had been 'lost'. The resulting attitudes suggest that actual interim pension losses may have a sense of immediacy and tangibility that disregards longer term opportunities for better investment performance.

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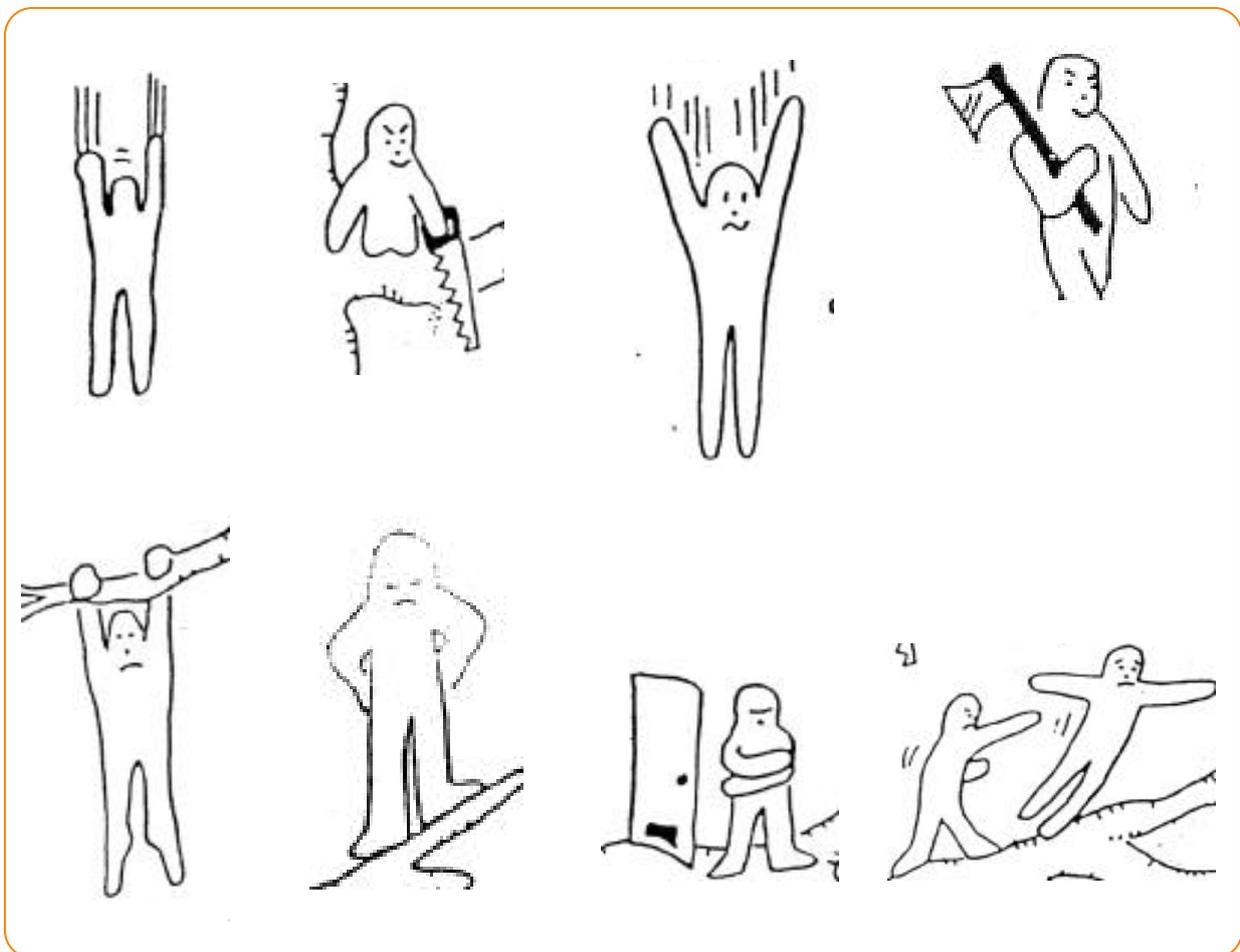
<sup>22</sup> Interim loss may or may not affect the final value of the pension fund.

### 4.3 Emotional responses to interim pension loss

Participants discussed their emotional responses to interim pension loss primarily in the reconvened groups, following receipt of mocked up pension statements showing an interim loss, of which there were two kinds. These are shown in Appendix G. With the simulated ‘loss letter’, participants were also sent an ‘emotion tree’ with cartoon style depictions of a wide range of emotions - positive, negative and indifferent - to illustrate possible reactions to the loss letter. The entire emotion tree appears in Appendix H.

Figure 4.1 shows images from the emotion tree that were most commonly selected by participants to convey emotions they felt on opening their mocked up pension statement. Participants picked this core set of images consistently, regardless of their age, income and pension status (those with a pension and those without).

**Figure 4.1** Pictorial emotional representations selected by participants



#### 4.3.1 Feelings of anger and disappointment

The experience of a hypothetical interim pension loss commonly evoked feelings of anger and disappointment. Pictures showing a figure wielding an axe or knocking another off the limb of a tree indicate the extent of this anger. Participants referred to feeling ‘cheated’ out of money, ‘robbed’ or ‘mised’, and were looking for someone to blame or punish.

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*'I went for the guy with the saw and the guy with the axe and the guy hitting someone. Anger really, someone's lost my money.'*

Young single, NMW, without a pension

*'I've circled the angry man sawing the branch, because I would be peed off as well. You wouldn't do it, but obviously you'd want someone to pay for it, and nobody's going to.'*

Young with children, NMW, without a pension

Participants with experience of pensions, in comparison to those without pensions, tended to show a somewhat greater degree of acceptance of loss and were, by comparison, less demonstrably angry.

*'I circled the man hanging on (on the Emotion tree exercise), but I wasn't too depressed because I thought 'alright, I've lost some money, but I'll hang on for a while and I'll set in my mind a loss limit per year, and if it goes over that, then I'm out'.'*

Nearer retirement, £16,000 - £24,999, with a pension

The origins of this somewhat greater degree of acceptance and tolerance of losses were not clear from the discussions. It might have occurred because those with some experience of having a pension understood the nature of pensions better. It might also have occurred because personal experience of interim losses during the recent recession had blunted emotional reactions to such losses. Acceptance, because it was the exception, highlighted the rule that participants without pensions generally tended not to accept the idea that interim losses were a possibility that was inherent in pension investments.

It was rare for participants to direct their anger towards themselves or to feel responsibility for the loss. Pension performance was perceived to be the responsibility of the provider or more specifically, a fund manager. It was assumed that the loss was a direct result of poor decision making on someone's part. Contributing to a pension, albeit hypothetically, did not make participants feel that they were active investors. Rather, they described themselves more as passive victims, which may help to explain the level of anger and the strength of the emotional responses. This point is discussed further in Section 4.4, which seeks to understand such emotional responses.

This lack of personal responsibility and understanding of investments, particularly among the unpenioned, gave rise to a sense of incredulity. 'How could this happen?' was a common question. It was perceived to be irresponsible for a pension provider or a fund manager to have allowed a loss to occur. Also, there was little expectation that interim pension losses were a possibility in a contributory scheme.

It should be noted that as part of the deliberative design of the research, participants were exposed to a description of occupational pension schemes and investment generally in their first group meeting. Reactions to the mocked up pension statement, which showed an interim loss, were expressed in the second group. Despite having received this basic information about investing and the potential for loss, participants reacted with anger and incredulity when faced with a hypothetical loss. This could suggest that receiving information does not

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necessarily change mindsets and emotional reactions, especially for those who have no history of investing or contributing to a pension.

*'... if I'm paying that money, they're putting it somewhere, so surely they (pension provider) are making money on my money? So I shouldn't lose no matter what.'*

Established at work, NMW, without a pension

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

Young with children, £25,000 - £35,000, without a pension

*'It feels like a con to be honest ... it's like you're giving your money to them and they go and lose it for you.'*

Young single, NMW, without a pension

*'... I thought, like you said, you shouldn't be losing right? Alright fine, if it stays the same it stays the same, but why should you lose out on it, really?'*

Established at work, NMW, without a pension

See Chapter 5 for more discussion on the possible roles that context and understanding of pensions may play for those who experienced a hypothetical interim loss.

### 4.3.2 Feelings of helplessness and vulnerability

Participants also commonly selected images showing people hanging onto branches of the 'emotion tree' or falling downwards, signifying feelings of uncertainty, worry and helplessness (see Figure 4.1). Participants reported feeling unsure about the future performance of their pension, unsure what action they should take, a lack of control and vulnerability, and being 'left in limbo'. These feelings were primarily evident among those without pensions but were expressed by participants of varying ages and income levels.

*'Vulnerable. I'm paying in and I know I should pay in because it'll mean a future but I'm also gambling and I'm a little bit worried and I'm hanging on in there.'*

Young with children, £25,000 - £35,000, without a pension

Participants rarely reacted with resignation to a hypothetical interim loss. This was so rare that it was impossible to tell if resignation represented a pessimistic personality, some understanding of pensions and investment, or a generalisation based on a recent run of bad luck. Nevertheless, resignation, when it was voiced, was tinged with disappointment about the interim loss.

*'I think you almost expect it now. You get to our age and you get so many disappointments and whatever and you just give up in the end. You don't give in but you're calmer aren't you? 'Oh yeah the boiler's blown up, oh God.''*

Nearer retirement, £10,600 - £15,999, without a pension

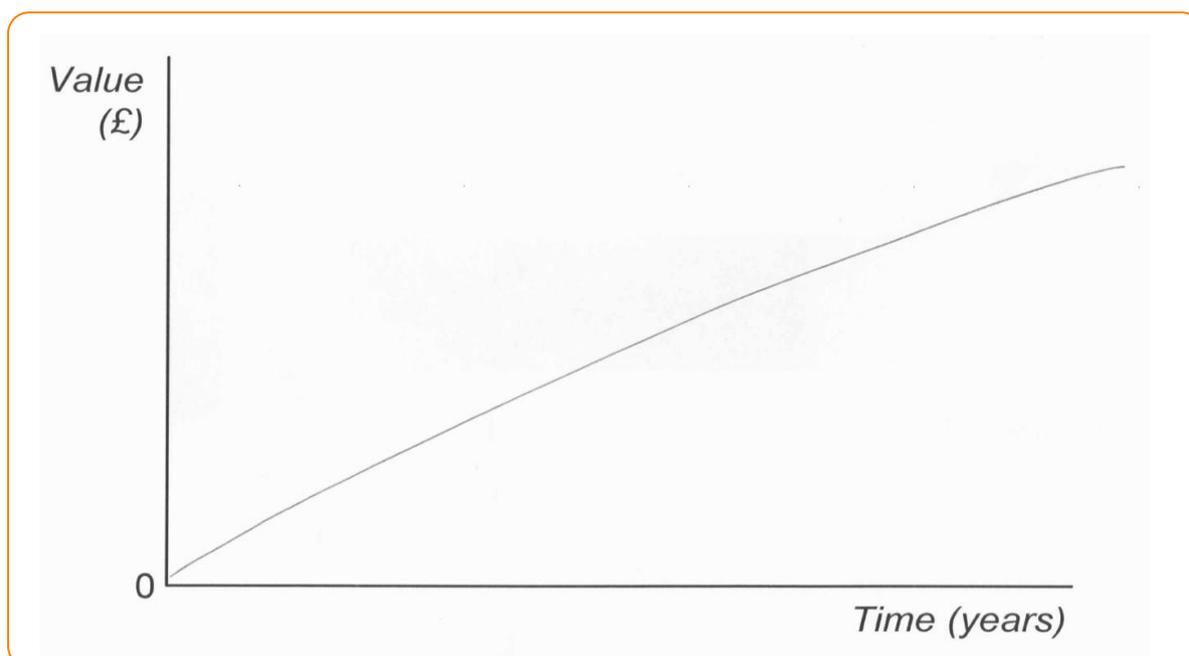
## 4.4 Understanding emotional responses to interim pension loss

### 4.4.1 Understanding of pensions and investments

The negative feelings of anger displayed in reaction to losses as well as the surprise, especially among participants without pensions, were strongly rooted in a lack of appreciation that pension schemes could lose money on an interim basis, i.e. that the value of the fund could go up and down over the course of a member's contributing history. Many participants imagined that a pension would behave in the same way as a savings account. That is, it would smoothly increase over time rather than rise and fall in value.

As with a savings account, the expectation was that value would go up at least in line with contributions, plus interest. Though some recalled that pension schemes had 'collapsed' in the past, loss during the lifetime of making contributions was not expected nor understood. This view of pension performance was demonstrated visually when participants were asked to sketch out a graph to show how they thought a pension plan would perform over time, given contributions of £50 a month, with time along the horizontal axis and the value of the fund along the vertical axis. Typically, the graphs were drawn as smooth, upwards sloping lines, as illustrated in Figure 4.2.

Figure 4.2 Expectation of pension performance over time: an illustration typical of participants' graphs



*'Basically if I'm putting £50 in a month then there's going to be £50, £100, £150, £200 - it's going to be going up like that.'*

Young single, NMW, without a pension

*'I don't know, my immediate thought is that you put in £50 each month, it's just going to slowly go up and up and up.....'*

Established at work, NMW, without a pension

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Exceptionally, some participants had a different view of pensions and drew a continuously upward curve that rose exponentially at the end. In some cases, this expectation had to do with final salary schemes that reflect higher incomes in later years or a final payment into the fund. For others, though, it reflected optimism or their ideal scenario.

*'I think I'd like to see it doing sort of something steady and then towards the end you want it to rocket!'*

Established at work, £16,000 - £24,999, without a pension

There were individuals, however, particularly among those with a pension, who demonstrated a greater understanding of how pensions work. These individuals were more likely to understand that the value of pension funds reflected investment performance and market moves over time as well as contribution levels. As a result, interim losses were not seen necessarily as totally unexpected anomalies or causes for blame, although the hope was that they would be offset by greater growth later.

*'I had a little bit ups and downs (in the graph) but gradually increasing over time and towards the end of its life maybe increasing a little bit more because I'll be earning more and therefore investing slightly more and therefore a higher investment so a higher return but obviously as the market fluctuates up and down it will be doing that.'*

Young with children, £16,000 - £24,999, with a pension

*'We just think it fluctuates, hopefully going more up than down and then obviously with the stock market crash it went down and then recovering a wee bit again and this is just maybe a bit optimistic but we've put it flying off at the end there.'*

Established at work, £25,000 - £35,000, target with a pension

In light of limited experience and understanding of pensions, especially among participants without pensions, it was rare for individuals to have any idea of what rates of return were typical for pensions. Some felt that, as pensions were akin to savings accounts, they should offer marginally higher returns since pensions seemed to involve a degree of risk. Others were unsure what rates of return on pensions might be, or gave wildly varying and often unrealistic guesses.

*'It's like an account but it also generates more interest than, say, a normal account would.'*

Young single, £10,600 - £15,999, without a pension

*'It should normally exceed the normal interest rate at the local building society, otherwise you'd just put it in the building society wouldn't you?'*

Established at work, £10,600 - £15,999, without a pension

*(Returns in a year based on contributions of £1,200) 'A couple of hundred quid?' (i.e. 17%)*

Young single, £25,000 - £35,000, without a pension

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#### 4.4.2 Feelings of ownership, control and personal responsibility

Anger was a more likely response when a financial loss was perceived to be out of the control of the participant or directly the fault of someone else. During discussion of participants' 'financial symbols' of personal money related losses, anger was often mitigated somewhat when participants were prepared to accept some or all of the responsibility for the loss, for example, bank charges incurred for going overdrawn, or where the loss was acknowledged as being entirely predictable, for example, a new car depreciating immediately in value. It should be noted, however, that this was not always the case; some viewed bank charges as unfair despite their role in going overdrawn, for example.

Participants commonly saw themselves as passive savers in the context of pension schemes. What happened to their money was felt to be someone else's responsibility. As in other studies, participants in this study were rarely familiar with the concept of fund choice in defined contribution (DC) schemes, which give members a role in deciding how their money is invested within the confines of funds offered.

The view that interim fund loss is entirely the responsibility of the pension scheme provider or fund manager was reinforced by automatic enrolment<sup>23</sup>. Even when it was explained that people often can choose between higher and lower risk investment strategies that can give higher and lower returns and greater and lesser chances of loss<sup>24</sup>, as well as the opportunity to opt out of such a scheme from the outset, there was still a feeling that automatic enrolment made interim loss less acceptable and less subject to the individual's control.

*'You (ought) to be accountable for your own mistakes, so if I'm giving you £70 a month (in a pension) and you lose it, then you're to blame for losing my money, aren't you? But if I lose the money, it's like I put on a bet every Saturday and I lose every Saturday, but I can't blame anyone else.'*

Young with children, £25,000 - 35,000, without a pension

*'If you went to the bookies, you know the risk and what you can lose from it, but if someone else is taking that risk for you, it's more frustrating when you lose because you've got no control over it.'*

Young with children, NMW, without a pension

#### 4.4.3 Short term mindset

Those in the target market did not think that interim loss might be recouped over the lifetime of the pension; interim losses were generally expected to have a bearing on the final value of the fund. Though participants with experience of pensions were still disappointed by an interim pension loss, overall they tended to react less dramatically because the potential for such losses appeared to be more understandable in terms of the somewhat greater grasp they had of how pensions might behave.

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<sup>23</sup> Twelve per cent said they would definitely leave their contributions in the default fund, and a further 34 per cent felt they would probably do this. Half (52 per cent) say they would choose investments rather than stay in the default fund. However, this result should not be overstated as evidence from the pensions industry indicates that a high proportion of members do save in the default fund. See DWP research report 669 'Individuals' attitudes and likely reactions to the workplace pension reforms 2009'. 2010

<sup>24</sup> Depending on which provider is responsible for the scheme and the variety of fund choice, NEST will offer funds in addition to a default. Final decisions about which funds will be offered have not been made public at the time of writing.

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*'I would know when I got to the end that I would still be happy because I would be expecting to see my pension materialise, so it wouldn't be a nasty surprise. I wouldn't be disappointed with it because I chose to opt for the pension scheme but I would think I'd keep (paying) into it for the long run.'*

Established at work, £25,000 - £35,000, with a pension

This more loss tolerant attitude might suggest that after several years' experience of a workplace pension, participants currently without pensions might have a different and less emotional response to interim loss. Whether such tolerance will develop in the scheme's target market is not clear from this research, as other factors, such as nearness to retirement, might contribute to a short term view of loss regardless of pension experience.

#### **4.4.4 Immediacy and tangibility**

Immediacy also appears to have been a factor in determining participants' responses to a hypothetical interim loss, and it is related to short-termism. Participants, especially those who were without pensions, appeared to perceive the loss almost as if money had physically been taken away from them.

There was a strong sense that they would notice their contributions disappearing from their pay packets or salaries, and that this money would, therefore, no longer be available to them to use for any purpose.

*'It will never be (the case that) you won't notice the money going because there will be a point where you're going to get paid £100 less than you did the month before.'*

Young with children, £25,000 - £35,000, without a pension

*'If you did have it then it would be there for you to spend on what you want.'*

Established at work, £16,000 - £24,999, without a pension

Rather than seeing the loss as a fall in fund value that might be made up later, the loss was generally perceived as an almost immediate and tangible loss of their contributions. Feelings associated with this loss were akin to feelings about the loss of money from their income for that month. Participants talked about what they could have done with the money, had they not contributed and lost it. Contributions were felt to maintain the spending value they would have had if they were cash in a wallet or current account. Therefore, the interim pension loss was experienced as tangible and immediate, 'real' in the context of 'here and now'.

*'I just thought of it as a personal loss, like it was actually happening ... obviously you're gutted at losing money.'*

Young with children, NMW, without a pension

*'You kind of want it broken down, okay so £220's gone, but why, where from, how, what?'*

Young single, £10,600 - £15,999, without a pension

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Participants talked about wanting to know ‘where the money had gone’. There was a tendency to think that the money had physically been removed from a container holding their contributions, rather than to see the loss as a fall in the value of a fund that many other scheme members have paid into and that the fall in value may recover in the future. The commonly used phrase ‘pension pot’ may exacerbate this. Participants perhaps imagined that there was an actual or a metaphorical holder of their cash contributions, not unlike those involved in apportionment money management.

As discussed in Chapter 3, participants had low to moderate incomes and often lived with a month to month financial outlook. Participants generally had little money to spare and felt that they could not afford to lose it. Having or not having a pension scheme appears to make little difference to feelings on this point. For some, this also made for an immediate translation from loss in value of a pension fund to a missed opportunity to spend their limited resources on other things.

*‘People on low incomes can’t afford losses. That’s the bottom line.’*

Nearer retirement, £16,000 - £24,999, with a pension

*‘If you did have it (money contributed to pension from wages) then it would be there for you to spend on what you want.’*

Established at work, £16,000 - £24,999, without a pension

This sense of immediacy was also apparent among participants with experience of pensions, but not to quite the same degree. Participants in this group were more accustomed to making pension contributions and expressed a level of detachment. Since pension contributions had gone out of their pay packets or salaries, they were more used to spending without factoring this money into their plans or their sense of what was immediately possible. Therefore, the hypothetical loss seemed less immediate.

*‘You only really think about what you’re going to get after you pay your tax and National Insurance.’*

Nearer retirement, £16,000 - £24,999, with a pension

*‘You don’t really see it as part of your salary, because you’re really looking at your net line when you get paid to see that all your bills and whatever come out of that ... you don’t really think about it as an income I suppose.’*

Established at work, £25,000 - £35,000, with a pension

This might suggest that once participants’ currently lacking pensions have been enrolled in a scheme for some time and are used to contributions being deducted from their pay at source, they may react to interim pension losses with less emotion, becoming a bit more like participants who currently have experience of pensions. As was pointed out in Section 4.4.3, further research would be needed to understand how attitudes and behaviour will evolve once the unpensioned become pensioned.

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#### 4.4.5 Sense of proximity and automatic enrolment

Without a good understanding of how pensions work and without the personal link that may come with opening an account in a High Street bank, for example, participants said that pension schemes in which workers were automatically enrolled would feel remote and distant. An automatic enrolment scenario was described where money was taken directly from salaries and managed by a pension scheme provider, chosen by the employer, who might not be familiar to participants<sup>25</sup>. Participants thought that this was likely to contribute to feelings that a pension was out of their control because workers would not have chosen the pension provider, the brand or the provider's product.

*'As far as I'm concerned if you're investing in something you have the power to say "Okay, I'm coming to you, you're not doing so good, you need to move it on or I'm going to take all my money back", and if you go into a pension you can't do that.'*

Established at work, NMW, without a pension

*(What might make loss more acceptable?) 'What about if you had the choice of which company you wanted to gamble on and where you wanted to invest it and you're a bit more to blame then if you start losing, because I chose the wrong company.'*

Young with children, NMW, without a pension

#### 4.5 Summary comments

Responses to interim loss were strong. Anger, disappointment, helplessness and vulnerability were the emotions mainly reported. Such reactions were rooted in lack of understanding about pensions and long term investments insofar as expectations were that a pension would increase in value as contributions accumulated over time. Overall, participants were incredulous that pensions might lose value from time to time.

There was little understanding that an interim pension loss might be recouped before an annuity was taken. Only those already in a workplace pension scheme demonstrated any medium term or longer term thinking. Participants who were without a pension were particularly likely to perceive an interim loss in terms of what the money could have been used for and the difference it could have made to their lives, had they not contributed the sum that was lost to a pension.

Strong emotional responses also came out of a sense of betrayal and an inclination to blame: the loss had been 'done to them' by the pension provider and irresponsible fund management. It seemed likely to participants that this feeling would be exacerbated by automatic enrolment, a context in which participants supposed they would have less choice and control than they would have had if they had chosen a scheme for themselves.

Chapter 5 explores responses to the various forms and dimensions that interim pension loss might take.

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<sup>25</sup> Many low to moderate earners are expected to become NEST scheme members. Employers would still be free to choose a different scheme in which to enrol workers, and it is possible that this could be an existing and well known provider with which the enrolled workers might have a degree of familiarity, or not.

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## 5 Dynamics of interim loss

### 5.1 Introduction

Interim loss can take a variety of forms. It might be absolute loss or relative loss. It might be experienced as a single event confined to one limited time period or as an occasional event occurring at different times during a long history of making contributions. It could also be something that occurred over several consecutive years.

Interim losses, or poor investment gains, might mean that a pension's value would be worth less in real terms than the sum of contributions made, given the impact of inflation. This research explored whether such contextual factors of hypothetical interim losses might affect how participants experienced them.

Interim loss occurs in the context of individuals' personal circumstances, market conditions and wider macro-economic trends. How personal context and the financial environment can affect attitudes to loss is also explored here, although findings must be regarded as tentative. These topics are complex and further research, with the involvement of disciplines such as behavioural economics and time series data, would be needed to document patterns and establish causal relationships.

The research aimed to explore the relative acceptability of some forms of interim loss versus others. This chapter reports on the relative acceptability of different forms of interim loss, ways in which different forms of interim loss might be experienced and ways in which different contextual factors may affect the experience of loss.

### 5.2 Chapter summary

- The value of contributions seemed to frame participants' responses to interim losses, and, consistent with the findings in Chapter 4, losses in any of the forms that were explored tended to involve surprise and anger.
- Absolute losses were seen as more unacceptable than relative losses. The risk of inflationary loss, which preserved the face value of contributions but not their spending power, was only appreciated with prompting and tended to be regarded as less alarming and blameworthy than the other two forms of loss.
- Differences in reactions were also apparent when comparing the amount lost in a single year, the duration of losses, and the frequency of losses over a number of years. While many did see a relatively large loss on a single occasion as the worst case, on the whole, smaller but consecutive losses that reached the same total after three years were seen as least acceptable. The consistent pattern of losses was interpreted by participants as a sign that losses were likely to continue, while intermittent losses were thought by some to suggest that improvement was possible in the future.

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- Participants who had some experience of having a pension grasped the connection between recession in the economy and losses in the value of pensions somewhat more readily than those without any experience of pensions because the former group were more likely to see a difference between a pension as a form of investment and an interest bearing savings account. Among participants generally, most of who were unpensioned, interim losses during a recession might be more understandable but this did not make the losses more acceptable. Similarly, knowing that members of other pension schemes were experiencing interim losses did not diminish the personal and tangible sense that most thought they would feel about an interim loss.
  - In times of economic growth, an interim pension loss was less understandable, and pensioned and unpensioned participants alike were inclined to feel angry and to blame a provider or a fund manager.
  - Participants rarely articulated a longer term view that their strong negative reactions to loss might be offset by the prospect of improved pension gains made in good times in the future.

### 5.3 Forms of loss

Between the first group meetings and the reconvened group meetings, participants received a mocked up pension statement that showed an interim loss - either a relative loss or an absolute loss - in the value of the hypothetical pension fund. Participants in half of the groups received the statement illustrating a relative loss and the other half received the illustration of an absolute loss, although the form that the loss took was not labelled as such or called to the participant's attention. Immediate reactions on receipt of the 'loss letter' were captured before the groups reconvened using the emotion tree, as reported in Section 4.3, and subsequently discussed when the groups reconvened, as reported in Section 4.4.

There were no clear differences in initial emotional reactions between the groups that had received statements showing relative and absolute losses. The alarming fact that the pension's value had declined was the focus of reactions, not the form of the loss.

Participants were also shown pension scenarios that illustrated the different forms that interim losses could take. This was done to facilitate comparisons between the two forms of loss by the groups. Two scenarios showed how an absolute loss could be incurred and the second two showed how a relative loss could be incurred, by highlighting:

- falls in the value of a pension fund so that the value was below the sum of contributions made during the period of time that the fund had been in place
- falls in the value of a pension fund, which together equalled all of the investment gains achieved and left the value of the fund equal to the sum of contributions made during the period of time that the fund had been in place.

Appendix E contains copies of the material used to illustrate these pension scenarios. Loss of gains has been termed 'relative' loss, and loss to the amount of contributions has been termed 'absolute' loss for the purposes of this report.

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### 5.3.1 Absolute loss

Absolute loss, where the amount of contributions was the reference point, was seen to be far less acceptable than relative loss, where the value of previous investment gains was the reference point. Absolute loss provoked the strongest reactions, incredulity in particular, from participants across groups defined by age, income and pension status.

Since participants tended to see pension contributions as a form of savings rather than an investment that involved a degree of risk, their expectation was that a pension fund's value would, at a minimum, be equal to the amount of contributions made. Anything less was generally considered to be unacceptable and even wrong or unjust. Absolute loss was, therefore, the most shocking for participants overall.

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

Young and single, £10,600 - £15,999, without a pension

Because interim pension loss was considered in the context of what the money might have been spent on (see Section 4.3.5), absolute loss was felt to be particularly unacceptable by those who might have been least able to afford pension contributions, i.e. those on the lowest incomes and those who expressed concerns about the affordability of a pension.

*'You'd be dead angry if you'd been paying a pension for 15 years, you wouldn't expect to have less than you put in would you?'*

Young and single, NMW, without a pension

As mentioned in Section 4.3.2, a fund manager or the provider of the scheme was generally held responsible for interim loss. The tendency to blame was even stronger when participants were confronted with a scenario involving absolute loss.

(In response to a scenario outlining an absolute loss over 15 years):

*'Well, I'd be really annoyed because for 15 years he's been making these contributions, he's slaved at it, he's 42, he's not earning very much money, he's married, he's got no kids, and now he's got even less money, so generally I feel pretty bad for Brian.'*

Young and single, £16,000 - £24,999, with a pension

On learning that absolute loss was a possibility on an interim basis, questions were raised about why anyone would want to save into a pension. Some were shocked and exasperated to learn that interim absolute loss could turn into absolute loss in the final value of a pension fund<sup>26</sup>.

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<sup>26</sup> Absolute loss of the final value of a pension fund may also occur without interim absolute loss. The endpoint is unknown in advance in occupational defined contribution schemes.

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### 5.3.2 Relative loss

In contrast, relative loss, i.e. loss of investment gains but not of the amount of contributions made, was seen to be very undesirable but less unacceptable than absolute losses.

(When comparing a relative loss to an earlier absolute loss):

*'He's broken even, so he hasn't lost anything. It's better than the first one.'*  
Nearer retirement, £10,600 - £15,999, without a pension

For many participants there was a feeling of relief that at least contributions were still intact.

*'I don't think I'd be (too) peed off; I'd be a bit, urgh, that money I told you about had gone up last year, it's gone down again, but I'd be safe thinking that my money I'd put in, is actually still there.'*  
Young with children, NMW, without a pension

*'If I'd been told I'd made money in previous years, but I'd lost this £200, I never had it anyway, but I've made a gain in previous years, so it's just one of those things where I'd be like, okay it's one of those situations, because also it's not coming from the money that I've invested, it's £200 out of the gain I've made out of the situation.'*  
Young single, £10,600 - £15,999, without a pension

This was, nevertheless, tempered by comparison to expectations, which were of smooth and consistent increases in value due to the accumulation of contributions and gains over time that some assumed to be akin to interest. Given such expectations, any form of interim loss seemed surprising and unfair.

*'I'd just feel really cheated that I've invested my money for eight years and I'm coming up with the same.'*  
Young single, £16,000 - £24,999, with a pension

As noted in Section 5.3.1, absolute loss caused some participants to raise questions about why anyone would put money into a pension if its value, from time to time, could be less than the sum of contributions made. Relative loss raised questions about the merits of saving into a pension instead of other vehicles for saving if some growth was not guaranteed. That is, if it was possible to find that a pension fund's value amounted only to the money that had been contributed, why was it not better to put the money into a high interest savings account, rather than in a pension? It should be noted that such comments might have overlooked the value of employer contributions<sup>27</sup> or tax relief available on pension contributions.

*'I know I might lose money but at the end of the day it's worth it, there's something there. But after I read this (letter) I was like, what's the point? For the £60 that I made I might as well put that somewhere else and I'm going to get more money in return.'*  
Young single, £25,000 - £35,000, without a pension

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<sup>27</sup> The pension scenarios describing absolute and relative loss did not include explicit references to employer contributions

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The generally short term mindset of participants, especially those who were unpensioned, and the sense of immediacy and tangibility of interim losses as discussed in Section 4.4.3 and Section 4.4.4 contributed to the dominant feeling of anger at any loss, whether absolute or relative.

*“I’d be just as pissed off (with a relative loss) as the first time (with an absolute loss), because you think ‘why didn’t I put it into a savings account and gain interest?’”*

Young with children, NMW, without a pension

Among participants with experience of having a pension, there were some who grasped that pensions worked as investments rather than as savings that paid interest. In Section 4.3.1, attention was called to the occasionally greater acceptance of fluctuations in the value of a pension fund among those with a pension. As noted in Section 4.4.3, some with pensions tended to be less dramatically short term in their outlook, but in Section 4.4.4 not much different was found between the pensioned and the unpensioned in terms of the tendency to regard interim losses as immediate and tangible.

The absence of differences between the pensioned and unpensioned in terms of accepting relative loss suggests that the information advantage of some prior acquaintance with pensions may be slight for those on relatively low incomes in the face of actual losses, no matter which of the two forms the loss takes.

### 5.3.3 The impact of inflation

Another scenario involving loss in the value of a pension fund could arise because inflation had outstripped investment gains. Even if the fund’s value exceeded the face value of contributions made over time and included some modest investment gains, the value of the fund after two or three decades might be worth less in real purchasing power than the contributions were when they were made, due to the impact of inflation<sup>28</sup>.

Participants showed no spontaneous recognition of the impact that inflation might have on the value of a pension fund. Only when an example of such a situation was shown were comments forthcoming to the effect that a pension fund should at least make gains to match inflation, and that if it did not, it was effectively making a loss. The example, shown in Appendix J allowed participants to understand that if the fund were taken as a pension with the value shown, the money would not have had the spending power that it had when it was contributed. While participants generally understood the concept of inflation some volunteered without prompting that if they were in a pension scheme they would not make a comparison between its performance and the rate of inflation.

*‘No I wouldn’t even know what the yearly inflation rise is really. I go by a rough guide of three per cent because generally your salary increases by three per cent, but I wouldn’t actually twig and think “Oh wait a minute, that’s less the inflation rate.” I’m not that financially clued up ...’*

Young with children, £16,000 - £24,999, with a pension

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<sup>28</sup> In the course of the reconvened groups we outlined a scenario where a pension plan showed zero growth (excluding contributions) in an economy experiencing inflation. Thus since prices had gone up over the last two years while the pension pot had not, in real terms it had shown a loss.

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In the absence of stimulus material explaining inflationary loss to participants, it is unlikely that the impact of inflation would have been considered as a threat to the value of a pension fund. Even with an explanation, inflationary loss did not elicit the aggrieved, blaming comments that other forms of loss did. There was also a tendency to regard it as somewhat more bearable than other forms of loss, possibly because it was thought to be harder to prevent.

*‘Well, I would recognise that it is a loss, but like Paul, I would probably think that it’s not exactly a loss ...I don’t need to change my plans or anything for that, that’s just life, but I think I would be more (upset about a)...physical loss of the money. The inflation part I can handle.’*

Established at work, £25,000 - £35,000, with a pension

Across all groups, spontaneous recognition was lacking that pensions were vulnerable to inflation eroding their value, but when the scenario on the impact of inflation was presented, those who had had some experience of pensions seemed to understand it more readily, in some cases.

*‘It’s only now you’ve explained it (that I see it as a loss). If the actual numerical figure hadn’t changed I probably wouldn’t ruminate about it that much, I’d just be like ‘Oh I haven’t lost anything’. I wouldn’t be like ‘Oh but it’s not worth as much as it would have been ten years ago’. I probably wouldn’t really care.’*

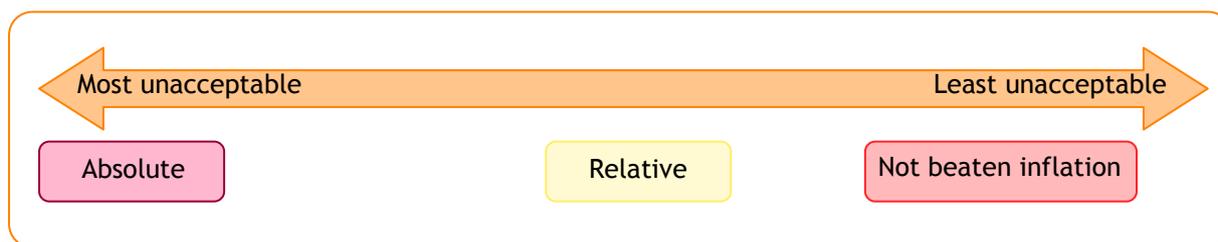
Young single, £16,000 - £24,999, with a pension

#### **5.3.4 Reactions to three forms of loss compared**

Overall, contributions were perceived as tangible, immediate and foregone spending power. Pensions were generally expected to perform in a way similar to a savings account; the distinction between investing and interest-bearing savings was not common in the mindset of participants. Interim losses were surprising and objectionable and commonly seen as evidence that something had gone wrong in the design or administration of the pension. Short term thinking dominated, and few spontaneously thought that losses might be recouped over the longer term.

The amount of contributions seemed to frame participants’ responses to interim losses that were shown to arise in three different forms. Interim losses of contributions (absolute loss) were most unacceptable. Where interim losses were made to previously achieved investment gains (relative loss), they were regarded as less unacceptable even when they had wiped out almost all of the previously achieved gains. The vulnerability of pensions to inflation was not a familiar concept to participants, but when this was pointed out as a potential form of interim loss, the surviving face value of contributions plus some quite modest investment gains provided the least unacceptable scenario among the three that participants were asked to consider, despite the erosion of spending power. Figure 5.1 summarises the findings on reactions to different forms of interim loss.

Figure 5.1 Reactions to three forms of interim loss



## 5.4 Amount, frequency and duration of loss

In addition to considering reactions to different forms of interim loss, in the reconvened groups participants were also asked about their reactions to three different scenarios of loss that differed in amount at each point of loss, frequency and duration. What the scenarios had in common was a total loss of £1,500 from a pension pot having a value of £17,000 before the losses occurred. These consistencies in loss to value made comparisons possible.

The three variations on loss, as shown in Appendix I, involved:

- losing £1,500 in one year (to explore the impact of 'amount' of loss)
- losing £500 for three years in a row (to explore the impact of 'duration' of loss)
- losing £500 in three years out of five (to explore the impact of 'frequency' of loss).

None of these losses were deemed to be acceptable, and were described by phrases such as 'disastrous', 'money down the drain', 'gutting', 'terrible', and 'suicidal'. Despite this, there were differences in terms of relative acceptability, which are discussed below considering the least acceptable losses first.

### 5.4.1 Duration

Consecutive loss in each of the years was on the whole seen as the most difficult to bear. The consistency of the pattern, three years in a row in the example given to participants, was of greater importance than the amount lost year by year or in total.

*'That's worse, because it's not getting any better, it keeps on. Every year he's losing the £500 so he's only 35, he's got another, what 30 years to go? So imagine that's every year he's losing £500, £500, £500.'*

Young single, £10,600 - £15,999, with a pension

Although some participants suggested they would stop contributing after losses in one year (see Section 6.3.1 for more detail), the tipping point more commonly came after three years. Three years, rather than two, seemed to be the rule of thumb indicating a pattern.

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For some, repeated losses had an emotional impact that was described in language akin to suffering physical blows.

*“If I got my letter saying £500 (was lost) in the first year, I'd think ‘Gutted’, but then to wait another whole year to then get another £500 down, and then the triple whammy ... to me, that would be devastating.”*

Established at work, NMW, without a pension

Some suggested that loss over three consecutive years was ample and convincing evidence of incompetence in terms of scheme/ fund management, equating this to other areas of life, such as punishment of a child or performance management in the workplace.

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

Young single, NMW, with a pension

### 5.4.2 Amount

Losing a significant amount in one time period - £1,500 in a single year in one of the scenarios - was seen as the second most difficult type of loss to bear. The amount tested was seen as a substantial sum, especially in the context of surprise that pension funds could lose money at all. As a result, a one year loss of £1,500 was seen as devastating, but the common, though not universal, view was that because it was only a one-off, it was not as bad as three consecutive years of losses.

*‘I'd be anxious and worried. To lose that, I wouldn't expect to lose as much as that in a single year.’*

Established at work, £25,000 - £35,000, with a pension

*‘A loss is a loss whatever way you look at it and that's quite a big one.’*

Nearer retirement, £25,000 - £35,000, without a pension

After considering this scenario, participants were presented with different amounts of one-off losses with £1,500 as a starting point, to try to understand whether there was a threshold of acceptance of a one-off loss. While £1,500 was universally viewed with dismay, as an absolute amount and relative to the total value of the pension, tolerance of losses smaller than £1,500 varied somewhat. For some, £1,000 was seen as a ‘cut-off’ point for acceptability, while for others anything above £500 would be unacceptable.

*(What's the cut-off point?) ‘Probably the £200 to be honest. It would scare me enough to think, you know, okay next year I lose the same, the following year I lose the same, at what point do you stop? Because it's like you say 'Yeah, it might turn around but if it doesn't, £200 is a lot better than £1,500.’*

Young with children, £16,000 - £24,999, with a pension

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One participant did note that this view was affected by initially being asked to consider a loss of £1,500, which made a £200 loss seem reasonable in comparison.

*'I think that you kind of clouded us by showing us these big losses ... So the fact we're looking at £1500 next to £200 less, if I got a statement that I hadn't made any money I still would be questioning that.'*

Nearer retirement, NMW, without a pension

The metrics that participants used when considering their tolerance of losses of different sizes were not uniform from person to person or across the gradient of losses. Some compared the amount lost to the amount of contributions, some compared the amount lost to investment gains, some compared the amount to the total value of the fund, and others reacted to the absolute amount of money lost. The amount of loss that someone might find tolerable, therefore, may be determined by several factors, including income and pressures on finances. The metrics used and the preference or perceived suitability of different metrics in different situations were not fully explored in this research.

### 5.4.3 Frequency

Frequency of loss (intermittent losses in three out of five years, for example, in one of the scenarios) was seen as the least unacceptable scenario of the three presented. Participants generally felt that this scenario offered some respite from losses and suggested that the years without loss offered hope for future years.

*'The £500 is three out of five years, I mean at least over five years there's two years that something else happened other than losing £500 so at least there might have been some growth or something else might have occurred in the other two years.'*

Nearer retirement, £25,000 - £35,000, without a pension

*'Yeah it's probably more understandable, it's not a complete downward trend, and obviously it's been up and down and up and down. If you were going to play along with it it's probably easier to play along with that one.'*

Nearer retirement, NMW, without a pension

## 5.5 Responses to interim loss in different contexts

### 5.5.1 Reactions to interim loss in a recession

With mock ups of newspaper headlines and text to stimulate thinking about the possible impact of a financial crisis, discussion in the reconvened groups also explored how participants' attitudes to interim loss in the value of a pension might be affected by external factors, such as a recession. Participants were shown a number of fictitious headlines, including those in Figure 5.2, along with supporting stories that might have appeared under these headlines. The entire collection of mocked up newspaper headlines and stories appears in Appendix K.

Figure 5.2 Example of headline stimulus material shown to participants



On balance, participants were inclined to see some connection between a severe financial downturn and losses suffered in the value of a pension, as illustrated by Figure 5.3. In some cases, participants said that news of a recession would lead them to think that they were more likely to suffer financial losses themselves, possibly including loss in the value of a pension.

Figure 5.3 Link between recessions and personal pension plan value



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For many, however, a causal connection between a recession and an interim pension loss fell well short of making an interim loss acceptable.

*'I'd understand a bit more because you could see why it's lost now. I'd still be pretty peeved off though because I wouldn't be expecting a loss.'*

Young single, NMW, without a pension

While some spontaneously made the link between the economic health of the country as a whole and the performance of their individual pension fund, many others had to be prompted to link the two, and might not have done so unaided. The split between those who made the connection unaided and those who did not corresponded largely, but not exclusively, to that between those who had some experience of pensions and those who did not. This in turn probably reflects the more limited understanding of pensions as investments that existed among the unpensioned, as discussed in Section 4.4.1. It appeared to be easier for those with some experience of pensions to see the relationship between the value of pensions and the state of the economy, as reflected in stock market trends. In comparison, participants without pensions were less likely to understand that pension contributions were invested in the stock market and so were less likely to make the link between a recession and a fall in the value of their pension fund.

*'Everything goes in cycles; you expect it's going to be good sometimes, bad others.'*

Established at work, £25,000 - £35,000, with a pension

For more than a few participants, the effect of a recession would more likely be panic and pessimism than a greater understanding of pension performance and lower expectations of pension fund growth. Participants said that news such as that reported in the mocked up newspapers might make them question afresh the point of a pension or continuing to save into one.

*'There's a phrase that says 'cut your losses', that's what people will do, that's what I would look to do, cut my losses.'*

Nearer retirement, £25,000 - £35,000, without a pension

*'You might as well just stuff it in the mattress.'*

Young with children, £10,600 - £15,999, without a pension

### 5.5.2 Reactions to a loss in a benign economic climate

Given a more benign economic climate, participants thought that they would react to interim losses with deepening anger. Participants sometimes could not understand why the value of their pension might be standing still while the economy was improving.

Interim pension losses in the face of economic growth led to a greater propensity to blame the fund manager. If there was good economic news everywhere else, then it was commonly thought that pension losses must be a function of poor investment decisions.

*'If you see headlines saying, woo, everyone's got loads of money and investments are going well and then you look at your pension and it's going down, then that's going to piss you off.'*

Young with children, NMW, without a pension

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*'This stockbroker doesn't know what he's doing, sack him quick time.'*

Established at work, £16,000 - £24,999, without a pension

Relatively few took a longer term and more hopeful view that economic growth might increase the likelihood of improved pension gains in the future. Furthermore, while definite differences were apparent between the reactions of participants with experience of pensions and participants without pensions to the recessionary scenario, no comparable differences were apparent between the two groups in the context of economic growth.

Thus, the general response to interim loss was anger and blame, irrespective of the economic climate.

### **5.5.3 Impact of other pension members experiencing interim loss**

Participants were asked to consider whether news that members of other pension schemes had also experienced losses would affect how they viewed their own experience of interim loss. The clear consensus was that others being in the same situation would not lessen the impact of any losses.

As one participant said, 'Other people don't pay my bills'. While it would be a shame if other pension scheme members lost as well, interim pension losses were felt personally, and had personal financial impact that would not be diminished by what happened to others.

*'When that letter comes through your door, when you're reading it in your front room on your sofa by yourself, it makes no difference what your neighbours are reading in their front room by themselves. It's all about your money.'*

Young single, £25,999 - £35,000, without a pension

*'You look at your own personal circumstances, you don't take them people home with you, they're not going to worry about you when they get home.'*

Established at work, £16,000 - £24,999, without a pension

Participants rarely said that knowing others were in the same situation would somehow alleviate their own losses or make a loss easier to accommodate.

### **5.5.4 Summary comments**

The amount of contributions seemed to frame reactions to all forms of interim loss, making absolute loss the most negatively felt, but the default response to interim loss in any form and in any economic context was surprise, anger and blame.

A consistent run of interim losses over several years was regarded as more alarming to participants than an equally large loss in total that was experienced in a single year or intermittently in three years out of five, for example. Consistent losses, year after year, foretold an inability to improve in future as the other two scenarios did not necessarily do.

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Some participants with experience of having a pension showed more understanding of pensions as a form of investment than those who had no experience of pensions. This allowed some of those with pensions to grasp the connection between a recession and falling pension fund values more readily. Differences of this sort, however, were not repeated in reactions to interim loss in other economic circumstances, for example a period of economic growth.

Reactions to different forms and contexts in which interim losses may occur hark back to the reactions described in Chapter 4 to interim loss in general, i.e. the fact of a loss outweighs the circumstances surrounding it. This sets the background for Chapter 6 which deals with possible action that participants feel they might take to avoid or offset interim losses in the value of a pension fund.

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## 6 Loss avoidance measures

### 6.1 Introduction

The previous chapters have dealt with participants' feelings and attitudes toward interim loss. This chapter explores the possible action that participants feel they might take to avoid or offset interim losses in the value of a pension fund, from stopping contributions to waiting to see if a pattern of losses develops. This research was not designed to predict actual behavioural responses to a pension loss, however.

Loss aversion has been identified by behavioural economists as a tendency in financial decision making. Those who are highly loss averse may forego opportunities for gain rather than risk incurring a loss. The presence of loss averse attitudes does not necessarily mean that people will follow a strict loss avoidance strategy, however.

There are a variety of reasons why people might not take loss avoidance measures. These include other emotional and cognitive biases that were powerful enough to prevail over loss aversion, such as status quo bias or procrastination, and poor engagement levels that might involve not reading pension statements. Indeed, the inertia that automatic enrolment seeks to harness to encourage take up of pensions, which operates on the principle that people are opted in unless they opt out, may prevail strongly enough to keep automatically enrolled members in pension schemes and contributing despite interim losses to the value of their pension fund. Crucially though, it is not known what might disrupt inertia or what role, if any, attitudes to loss might play<sup>29</sup>.

### 6.2 Chapter summary

- Stopping contributions was the likeliest action for participants to suggest they might take in response to interim loss, sometimes accompanied by considering alternative means to save for the long term, ideally without the risk of loss. It should be noted, however, that pensions and long term savings had been deemed by these participants to be luxuries or possible uses for money that might unusually be left over after paying for essentials.
- Those who stopped short of saying they would immediately stop contributions most commonly said they would wait up to three years to see if performance improved. As in Section 5.4, consecutive losses were seen as more likely to prompt action than a comparable loss that occurred in a single year or intermittently over a number of years.
- Some participants said that action in response to an interim loss would need to be considered in the light of other personal and household financial circumstances, not in isolation.

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<sup>29</sup> Evidence from experience of 401k plans in the US suggests that contribution patterns are not altered significantly during and immediately following economic downturns, which might have produced interim loss for many scheme members. This finding should be applied cautiously to expectations for NEST because there are a variety of differences between the 401k plans and NEST, including differences in the automatic enrolment processes.

- Participants were also minded to seek information and advice as a response to interim loss. Despite being blamed for such losses, pension providers along with Independent Financial Advisers and the Citizens Advice Bureau were most commonly suggested as appropriate sources. Family, friends and colleagues at work were also mentioned by some as suitable sources, especially if the participant knew someone who was regarded as something of an expert.

### 6.3 Likely reactions to pension plan losses

When discussing what steps they might take as a result of their pension showing interim loss, participants in the initial reconvened groups were prompted with handouts describing options such as ‘stopping contributions’, ‘switching funds’ and ‘not recommending the scheme to others.’ Such formal prompting was deemed unnecessary after it became apparent that participants could spontaneously imagine taking a variety of steps that included those initially covered by prompts. The six options outlined below were most common across both the prompted and unprompted groups:

- stop contributions
  - actively consider alternatives
  - give the pension more time
  - seek advice and information
  - switch funds
  - not recommending the scheme/ denigrating the scheme to others.
- } **Most popular options**

Each of these six options emerged consistently across all groups of participants, with none of the options appealing more to certain categories of participants.

#### 6.3.1 Stop contributions

The most decisive option suggested by participants was also the most popular: stop making contributions. This course of action was raised and considered by participants in all age groups and income groups, and among some with pensions as well as those without. The general feeling was that a loss showed that an unacceptable risk existed to the future value of the pension.

There was also a sense that other means of saving were available that did not carry the same risk of loss. Together, these two feelings made stopping pension contributions an appealing option for some. For others, the inclination to stop contributions appeared to be less carefully thought out: loss of value to a pension fund was an unpleasant surprise and some participants just wanted to remove themselves from the situation immediately.

*‘I’d probably look for other ways of investing my money. I know everything has a risk, but if this is the outcome after a year (a loss of contributions) ... when I’m 65, you know it just isn’t enough money.’*

Young single, £10,600 - £15,999, without a pension

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*'I just want to come out of it straight away. If I had the option to come out of it, I would and I'd just go into a savings account ... because I wouldn't take the risk of making a loss; but that's me, I don't take risks.'*

Young with children, NMW, without a pension

Stopping contributions was also an appealing option as a response to relative loss. As discussed in Section 5.3.2, where investment gains had been lost, questions were raised about the point of saving into a pension. Asked subsequently to consider what action they might take in response to such a loss, some participants said they would stop contributing because they did not like the idea of pensions, having been made aware that investment gains were not guaranteed. While the appeal of stopping contributions in response to relative loss was far from universal, it was not exceptional either.

Some participants would take into account their own or their household's financial circumstances in making a decision as to whether to continue contributing, factoring in the pension savings of a partner, for instance. Where a participant's own pension was not expected to be the main source of income in retirement, stopping contributions in response to a relative loss was perhaps an easier decision to take.

*'I would consider all other factors ... in that situation and then, my husband's pension being the stronger of the two, I would consider freezing (my) pension and saving the money elsewhere.'*

Established at work, £25,000 - £35,000, with a pension

### **6.3.2 Actively consider alternatives**

Many also said that, in response to losses of any kind, they would 'look at other options.' Some suggested that they would look for another pension provider that might perform better. They did this without indicating whether they recognised, or were prepared to forego, employer contributions. As noted in many places in this report, for example. Section 3.1, participants had a generally poor understanding of pensions. It was thought that finding a different pension scheme could offer a way of protecting against interim loss, although all defined contribution occupational schemes carry some risk of interim loss.

Some also suggested that they would look for other ways to save for retirement in the hope of finding a long term savings vehicle with no risk of loss. Common suggestions included high interest savings accounts and investing in property.

*'If I read (the letter) now I would think about other pension companies and think of other ways ... to secure my retirement, maybe invest it in a property because that is always going to be guaranteed, but if I was close to retirement I would be distraught and go mad.'*

Established at work, £16,000 - £24,999, without a pension

Considering alternatives was often mentioned alongside stopping contributions, mainly as something to do after, rather than before, ceasing to contribute. It should be remembered, however, that 76 out of 102 participants were selected in part because they belonged to NEST's target market by virtue of not yet having a pension, as well as being on a low to moderate income, among three other criteria. In addition, few who were unpensioned had any long term savings. Therefore, in the hypothetical situation participants were asked to consider, it is entirely possible that ceasing contributions to a workplace pension scheme might mean the end of saving for retirement.

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### 6.3.3 Give the pension more time

Participants who might consider stopping contributions said their decisions would depend to an extent on the duration of the losses, as findings reported in Section 5.4 suggested they might. Overall, losses experienced over consecutive years provoked greater negative reactions than the loss of a similar total in one year or in intermittent losses in some but not other years. Although some participants reacted to interim losses of any kind by saying they would stop contributions, others, across participants with experience of pensions and those without pensions, said they would give the scheme another year or two to see if losses continued and a pattern of loss was established.

*'Well, depending again on whether this was my first year that I'd lost, if it was my first year I'd probably think 'Right ... regardless, leave it a year'. But if it was on that third one, yeah, I think I'd stop paying into it and look somewhere else.'*

Nearer retirement, £10,600 - £15,999, without a pension

*'I kind of agree with you though because it's only a year and even though you're kind of ticked off yeah, but it's your first year sort of thing, so I would probably give it five years, four or five years and if it's still continuously going down and down then I'd switch.'*

Young single, £10,600 - £15,999, without a pension

Given yearly losses, the length of time participants thought they might continue making contributions was variable. Some talked of waiting four or five years but the most common point for decision making was after three years of losses, by which time participants would interpret consecutive losses as a trend and a negative indication of future performance. This is consistent with Section 5.4.

*'It's the same with children isn't it? You always say one, two, three and if they don't do it, that's it, that's the final blow.'*

Young with children, £16,000 - £24,999, with a pension

### 6.3.4 Seek advice and information

Another commonly suggested behaviour in reaction to interim loss would be to seek advice and information. There were no sub-group differences on this point. Nevertheless, this research could not test whether the interest expressed in taking advice and getting more information would prompt participants to visit pension related websites, call help lines or contact pension providers to request information in times of recession or high market volatility. Retrospective analysis of contact data from such organisations during the three years from January 2007 through December 2009 might provide insights.

Although participants commonly blamed pension providers and fund managers for interim losses, there was little to suggest that providers were seen as poor sources for information about the reasons for an interim loss or the implications of ceasing to contribute to a workplace pension<sup>30</sup>. The three sources of information and advice that participants most commonly said they might contact about interim losses included the pension provider as well as an Independent Financial Advisor (IFA) or the Citizens Advice Bureau.

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<sup>30</sup> Pension providers are not able to give advice, in accordance with regulations.

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A few participants expressed doubts about whether the pension provider could be trusted to give impartial advice, which misunderstood what providers are allowed to do, as noted in footnote 21. A few also doubted if providers would give reliable reassurances on the future of their pension's performance. Overall, however, it was not uncommon for participants to regard the provider's knowledge of their pension scheme and the investment approach being followed as good reasons for contacting the provider to find out what had gone wrong. The inclination to blame providers for interim loss may have contributed to their being seen as an appropriate contact.

Other sources of advice included family, friends and colleagues, usually because someone in this circle was seen as being something of a lay expert on financial matters, occasionally because they were worked in the financial services sector. Rather than asking any friend or colleague for information or advice, some participants suggested they would seek an informed opinion.

### 6.3.5 Switching funds

Some participants reacted favourably to the option of making changes in the way their money was invested, with the aim of reducing the level of loss incurred, while maintaining contributions to a workplace scheme. Unlike the suggestions discussed in the preceding subsections of Section 6.3, this option was not mentioned spontaneously.

In several of the initial group meetings, a handout was used to stimulate discussion of action that might be taken in response to an interim loss. One item that was included covered switching funds within a workplace scheme, and said:

*“You change the type of your pension fund to one with a lower risk of loss. You and your employer continue to make contributions to this new pension fund. The risk of loss is now less, but the potential to gain is also less.”*

This statement alerted participants to an option to change the way in which their money was invested so as to reduce the chance of loss without ceasing to be a contributing member of their workplace pension scheme. Some participants said they would be prepared to switch funds and continue contributing if the chance of loss, as well as the chance to gain, were reduced. For these participants, the motivation for switching was to attain a safer option that would minimise the chance of loss. The continued contribution from the employer was seldom articulated as a reason to pursue switching funds.

*‘This is the safe bet isn't it, you know you're not going to make much but you know you're not going lose.’*

Established at work, NMW, without a pension

### 6.3.6 Word of mouth effects

Another suggestion, albeit less common, was to criticise the pension scheme or refrain from recommending it to others. With social media in wide use, this way of responding to interim losses might be influential, if it could be assumed that recipients would take an interest in a message about pensions.

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*'I don't know about everybody else, but Facebook is quite a big thing these days and that's like my 10 minutes when the kids are in bed catching up with all my friends, and if you're pissed off about something that day, that's usually your 'status', so if I was pissed off about my pension because I'd lost, I'd put 'Don't join this bunch of thieves' on there.'*

Young with children, NMW, without a pension

## 6.4 Summary comments

Participants suggested that they might stop making contributions, consider alternatives to a loss making pension, give a loss making pension up to three years to improve, or seek advice and information as a result of interim losses. Stopping contributions was the most popular response. It is important to note, however, that the loss letter that participants received did not show employer and worker contributions separately. Employer contributions were referred to in other stimulus and briefing material, but not in the loss letters specifically. Therefore, it is possible that participants did not factor in the loss of their employer's contributions when considering ceasing to contribute as a response to interim loss.

Whilst many suggested less radical alternatives to ceasing contributions, it is important to note that, overall, participants suggested doing something rather than nothing at all. Whilst it is unknown how this would translate into actual behaviour in a 'real world' context, these findings suggest that there could be a variety of potential implications for the pension provider, from lapsed savings and persistency rates to increased contact activity, perhaps via call centres and other methods.

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## 7 Prevalence and extent of loss aversion

### 7.1 Introduction

The attitudes, mindsets and reactions to hypothetical scenarios described in previous chapters might suggest that those participating in this research were entirely motivated by preventing losses when considering saving and investing. This chapter discusses the extent to which this is necessarily the case.

As outlined in the introduction, the concept of loss aversion, from economics, says that people find it easier to forego a gain than accept a loss, and may put more effort into preventing a loss than achieving a gain. Prospect Theory contrasts with traditional economic theory, which assumes that a financial gain of a given size is as pleasant or enticing as a loss of the same size is unpleasant or off-putting.

This research deals primarily with attitudes and emotional responses to loss. An experimental model would need to be employed to determine how NEST's target market weights losses and gains in occupational pension schemes. Furthermore, as noted already, this research has not dealt with actual behavioural responses so it cannot be known for certain whether participants who express strong negative reactions to loss will put more effort into preventing a loss than achieving a gain. Finding interim loss to be distressing, for example, does not necessarily predict actions that would be consistent with loss aversion. That is, negative attitudes and emotional responses to interim loss do not necessarily mean that:

- participants in this research weight loss and gains unequally
- participants would take measures to avoid loss.

This research did, however, seek to explore the extent to which those who participated might be motivated to avoid loss. In addition to exploring attitudes, emotional responses and reactions to hypothetical interim loss scenarios, participants were asked to trade off losses and gains in general terms. This was done to try to understand whether they would accept higher chances of losses in return for higher chances of gains.

This chapter draws on data from two exercises carried out by participants.

- Questionnaires completed as the second, reconvened groups were drawing to a close posed a choice among three investment approaches that a pension scheme could take. Participants were asked to select the one with which they would be most comfortable<sup>31</sup>. Appendix B contains this questionnaire, which is referred to as the “post-group” questionnaire to distinguish it from the “pre-group” questionnaire completed before the initial meeting began.

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<sup>31</sup> The purpose of these questionnaires was to provide a picture of individual level response, not to deliver quantitative survey results. The sample design does not permit for any wider generalisation to the target market. That is, the choices indicated by the sample from their questionnaire responses cannot be said to reflect the choices that the target market would make. However, these results may be indicative of the investment preferences of the target market.

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- In the second, reconvened groups, an investment strategy role play exercise involved participants in taking the role either of pension scheme members or pension scheme managers who were responsible for acting in members interests. Appendix L contains descriptions of these roles.

## 7.2 Chapter summary

- In the two different exercises, the most popular investment strategy for pensions combined a medium chance of loss and a medium chance of gain. Although the most loss averse strategy (low chance of loss, low chance of gain) appealed to more participants than the least loss averse strategy (high chance of loss, high chance of gain), the most loss averse strategy was not preferred by all, despite the plethora of strongly negative reactions and attitudes to loss previously expressed. In a trade off with potential gains, a medium chance of loss seemed acceptable to some participants in return for a medium chance of gain.
- Those on very low income, at National Minimum Wage level, appeared to be somewhat more likely than those earning more to prefer an investment strategy that minimised the chance of loss, as were those without pensions, in contrast to those who had experience of a pension.
- Younger single people without children were somewhat less likely to be attracted to the investment strategy with the lowest chance of loss, but they were no less likely, and might possibly be more likely, to react negatively to a hypothetical interim loss.

## 7.3 Degree of loss aversion

In an extreme case of loss aversion, choice would be driven entirely by aversion to loss; a choice among options would result in the one that offered most protection against loss being selected, even if this meant gaining less.

### 7.3.1 Preferred investment strategy for a pension

Of the three investment approaches outlined for participants in the “post-group” questionnaire, which was completed as the reconvened groups were drawing to a close (see Appendix B), the approach that was most popular involved a medium chance of losses and a medium chance of gain. The least popular option promised higher gains even if this meant a high chance of losses.

As shown in Table 7.1:

- 43 per cent of participants without a pension chose to accept limited gains in order to have just a small chance of some losses
- 53 per cent were most comfortable with moderate gains and a medium chance of some losses
- 4 per cent said they would like the chance of higher gains even if this meant a high chance of losses<sup>32</sup>.

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<sup>32</sup> These percentages have internal validity only. That is, they are applicable to the sample only and should not be used to generalise about the target market for the Personal Accounts scheme.

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Responses showed that participants, on the whole and including those who were pensioned and unpensioned, would feel most comfortable with an investment strategy that did not promise the lowest level of loss offered by the available investment strategies. Previously, when discussing financial loss, participants had expressed views that suggested they were highly loss averse. When trade offs were posed between the chance of loss and the promise of gains, a moderate chance of loss felt comfortable to many participants when linked to a possibility of achieving more than limited gains. Those on very low incomes, however, may be the exception, as suggested in Table 7.2, but data from a wider and more representative sample would be needed to draw firm conclusions.

Unpensioned participants, who were the primary focus of pension reform and are the target market for NEST, appeared to be more loss averse than those in the pensioned group, insofar as the strategy most likely to protect against loss was more popular with unpensioned than pensioned participants, as indicated in the first row of Table 7.1 Nevertheless, the ‘middle way’ that combined moderate gains with moderate chances of loss was the most popular of the three options among both pensioned and unpensioned participants.

**Table 7.1 Investment approach preferences by pension status**

		Total	Pension status			
			Unpensioned	Pensioned	Difference	
Base: all participants in group Percents down the columns*		(n = 99) 100%	(n = 74) 100%	(n = 25) 100%	Unpensioned minus pensioned	
Question: Thinking about the kind of pension scheme we've been talking about, if you were to join such a scheme, which of the following investment approaches would you personally be most comfortable with? (choose one)						
<p style="text-align: center;">↑</p> <p style="text-align: center;">Least loss averse strategy</p>	Most loss averse strategy	I would happily accept <b>limited gains</b> - and therefore a much more modest pension pot at the end - if it means I have just a <b>small chance of some losses</b> along the way and/or a smaller pot at the end	37%	43%	20%	+23%
		I would happily accept <b>moderate gains</b> - and therefore a slightly more modest pension pot at the end - if it means I have just a <b>medium chance of some losses</b> along the way and/or a smaller pot at the end	56%	53%	64%	-11%
		I would like the chance of <b>higher gains</b> - and therefore the chance of a bigger pension pot at the end - even if it means a <b>high chance of some losses</b> along the way and/or a smaller pot at the end	7%	4%	16%	-12%

\* Percentages down the columns may total more than 100% due to rounding

As mentioned above and indicated in Table 7.2 below, it appears that those on very low incomes, i.e. National Minimum Wage, were more favourably disposed toward a pension investment strategy with a low chance of loss, even if this meant a low chance of gain.

The figures for income groups in Table 7.2 must be interpreted with great caution because of the small number in each group, i.e. between 24 and 26. The National Minimum Wage income group was the only one in which more participants, 52 per cent, chose the low gains option than chose the other two options combined. In addition, while the overall proportion choosing the higher gains strategy was very small, it rose into double digits, 15 per cent, in the highest income group, £25,000 - £35,000. No one in the National Minimum Wage income group chose this strategy.

**Table 7.2 Investment approach preferences by income group**

		Total All participants responding	Pension status			
			NMW	£10,600 - £15,999	£16,000 - £24,999	£25,000 - £35,000
Base: all participants in group Percents down the columns*		(n = 99) 100%	(n = 25) 100%	(n = 24) 100%	(n = 24) 100%	(n = 26) 100%
<b>Question:</b> Thinking about the kind of pension scheme we've been talking about, if you were to join such a scheme, which of the following investment approaches would you personally be most comfortable with? (choose one)						
<p><b>Most loss averse strategy</b></p> 	I would happily accept <b>limited gains</b> - and therefore a much more modest pension pot at the end - if it means I have just a <b>small chance of some losses</b> along the way and/or a smaller pot at the end	37%	52%	21%	29%	46%
	I would happily accept <b>moderate gains</b> - and therefore a slightly more modest pension pot at the end - if it means I have just a <b>medium chance of some losses</b> along the way and/or a smaller pot at the end	56%	48%	75%	63%	38%
	I would like the chance of <b>higher gains</b> - and therefore the chance of a bigger pension pot at the end - even if it means a <b>high chance of some losses</b> along the way and/or a smaller pot at the end	7%	0	4%	8%	15%
<b>Least loss averse strategy</b>						

\* Percentages down the columns may total more than 100% due to rounding

This exercise also allowed comparisons to be made of the preferred investment approaches of participants at different stages of life. Again, Table 7.3 must be interpreted with great caution because of the small sizes of the four life-stage groups, but it does suggest that the most conservative investment approach (low chance of loss and low chance of gain) had least appeal to those who were young, single and without children, compared to those who had dependent children, were older and established at work, and were coming close to retirement.

**Table 7.3 Investment approach preferences by life stage**

		Total All participants responding	Pension status			
			Young, single, no children	Young, with children	Established at work	Nearer retirement
Base: all participants in group Percents down the columns*		(n = 99) 100%	(n = 26) 100%	(n = 24) 100%	(n = 25) 100%	(n = 24) 100%
Question: Thinking about the kind of pension scheme we've been talking about, if you were to join such a scheme, which of the following investment approaches would you personally be most comfortable with? (choose one)						
<p>Most loss averse strategy</p> 	I would happily accept <b>limited gains</b> - and therefore a much more modest pension pot at the end - if it means I have just a <b>small chance of some losses</b> along the way and/or a smaller pot at the end	37%	23%	42%	36%	50%
	I would happily accept <b>moderate gains</b> - and therefore a slightly more modest pension pot at the end - if it means I have just a <b>medium chance of some losses</b> along the way and/or a smaller pot at the end	56%	65%	54%	56%	46%
	I would like the chance of <b>higher gains</b> - and therefore the chance of a bigger pension pot at the end - even if it means a <b>high chance of some losses</b> along the way and/or a smaller pot at the end	7%	12%	4%	8%	4%
Least loss averse strategy						

\* Percentages down the columns may total more than 100% due to rounding

Among those who were young, single and without children, being less loss averse seemed appropriate to some for two reasons: they had fewer obligations and dependents so a loss would be less harmful, and they had more time in which to try to make up a loss.

*'I've got no kids to support so I feel if I risked it and lost I'd be able to obviously rebuild it back up ... I can afford to lose but I'd be willing to take a gamble to gain as much.'*

Young and single, £16,000 - £24,999, with a pension

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Despite such apparently rational calculations, which might lead young singles without children to consider accepting investment strategies that were not primarily intended to avoid loss, there was no consistent evidence that young people, with or without children, would be more understanding or accepting of interim losses if they happened to experience them. Here are two illustrative comments, the first from a young single person without children and the second from a young person with children.

*'I'd want to close the pension and invest my money where it guaranteed a small increase; it's a lot better than a possible loss.'*

Young and single, £25,000 - £35,000, without a pension

*'I would do everything! [in response to interim loss] Stop the contributions, I would switch my funds somewhere else and I wouldn't recommend (the scheme) to anyone else.'*

Young with children, £25,000 - £35,000, without a pension

Previous research has found that younger people have greater appetite for risk<sup>33</sup>. Indeed the pensions industry, through 'lifestyling', recognises that as people move closer to retirement their tolerance for risk should reduce<sup>34</sup>. This research suggested that that young people, though generally more prepared to accept a higher degree of risk, as noted in previous research, they might be no less likely to react to loss. Further research would be needed to understand whether young people would be more likely than other age groups to cease contributions if an interim loss were to occur in reality.

### 7.3.2 Choosing an investment strategy via role play in the reconvened groups

In the role play exercise participants were asked to carry out a task that involved choosing an optimum investment strategy, and articulating the rationale for adopting it, from the following three options:

- high chance - high chance of loss with greatest chance of a big gain
- medium chance - some chance of loss with some chance of a modest gain
- low chance - low chance of loss with low chance of a small gain.

The managers of a pension scheme, role played by half the participants in each discussion group, were asked to agree on their choice and argue for it. The members of the pension scheme, role played by the other participants, were asked to agree on their choice and argue for it. 'Managers' were asked to do what was best for members, and members were asked to consider how they would like their money invested, but 'managers' and 'members' were not required to agree on one option.

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<sup>33</sup> DWP (2009) Research Report 669 'Individuals' attitudes and likely reactions to the workplace pension reforms

<sup>34</sup> Lifestyling recognises that people have less tolerance for risk the closer they are to retirement. Lifestyling provides an automatic switching facility from funds with higher volatility over the longer period to ones with less volatility as retirement approaches.

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Choices were mixed across the discussion groups, which had different profiles according to age, income, dependent children and experience of pensions. Nevertheless, there was a distinct slant away from the option that included a high chance of loss; more favoured options were those with only “some chance” or a “low chance” of loss. Just one group chose an investment strategy involving a high chance of loss in order to optimise the chance of a big gain. As noted in Section 5.3.4. protecting contributions from loss was the focus of arguments used to support the choices made in this exercise.

The preference for the ‘middle way’ - a medium chance of loss with some chance of a modest gain - broadly mirrored the distribution of individual choices of an investment strategy captured by the questionnaire and set out in Figure 7.1.

Despite ‘members’ and ‘managers’ being given different remits in selecting an investment strategy, there was no clear difference between the strategies that the two chose. It is worth noting, however, that managers in one group who had selected a low risk investment scheme expressed concern that members might be disappointed with the associated low gains. These participants recognised the opportunity cost of opting to limit the chance of making a loss.

*‘The only fear I would have is that when you see you’re low - going for the bottom one (in terms of chance of loss) - when you see you’re low gain, that may mean you’ll be disappointed.’*

Nearer retirement, £25,000 - 35,000, without a pension

### 7.3.3 Loss aversion and employer contributions

Previous qualitative research found that people would accept investing employer contributions differently to worker contributions and that they were willing to expose employer contributions to greater investment risk than their own<sup>35</sup>. This was touched on in this research in order to explore whether participants had different feelings or attitudes about loss with regard to the value of employer contributions and member contributions.

The role play of scheme managers and members revealed that some participants did spontaneously choose to invest employer contributions more aggressively, i.e. with greater risk of loss, than members’ contributions. The view amongst these participants was that it was more acceptable to expose employer contributions than worker contributions to a higher chance of loss. One group of participants, role playing as scheme managers, said they wanted to minimise the chance of loss to worker contributions and to protect themselves as managers against the type of loss to which members would be most sensitive.

*‘We’ve said that as scheme managers, the money that the members give, we would put 50 per cent of it in the low risk and the 25per cent in the others (medium and high risk options). So the employer’s 50 per cent we play with, but we don’t play with your [the members’] money.’*

Young single, £25,000 - £35,000, without a pension

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<sup>35</sup> Attitudes towards investment choice and risk within the personal accounts scheme: Report of a qualitative study, DWP, 2009.

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The impact of framing employer and worker contributions on reactions to an interim loss is discussed in more detail in Chapter 8. These findings suggest, however, that the mental accounting participants often reported using to manage money for household expenditure was akin to their mental accounting of a pension loss.

## 7.4 Rationalising loss aversion<sup>36</sup>

Because this research was qualitative and exploratory, it cannot provide conclusive explanation for the investment approaches chosen and therefore the degree of loss aversion in the sample. Some hypotheses for further development and testing are discernable, however, although they are not necessarily mutually exclusive.

### 7.4.1 Taking the middle option

Many participants chose the medium gain, medium loss option as their preferred investment strategy for a pension, despite their surprise and anger in the face of a hypothetical interim loss. There are a number of ways in which this apparent contradiction between the strong negative reactions to loss and the less than maximum extent to which some participants sought to avoid it might have been rationalised. Two of these are considered in this section.

#### Inability to trade off loss and gain

Some chose the middle option simply because they were comfortable with some chance of gain and with some chance of loss - not as low as in the most loss averse option and not as high as in the high gain option.

*'I'm in the middle. I won't lose that much and I won't gain that much, so I'm comfortable.'*

Young with children, £25,000 - £35,000, without a pension

There were also some participants who described themselves as 'in the middle', and who felt that a small or medium degree of loss was palatable if there were a chance of moderate gains. Participants in this group, often younger or un pensioned, acknowledged that minimising losses affected the potential for growth of a pension pot, and thus potential income in retirement.

*"I chose the middle one (investment option), I think probably because I'm probably one of the younger ones here. I thought that if you've got a bit more time you're not that worried about taking a chance."*

Nearer retirement, £16,000 - £24,999, with a pension

The feeling among these participants was that low levels of returns were unsatisfactory and that they were conscious of needing "a half decent return" to be financially secure in retirement.

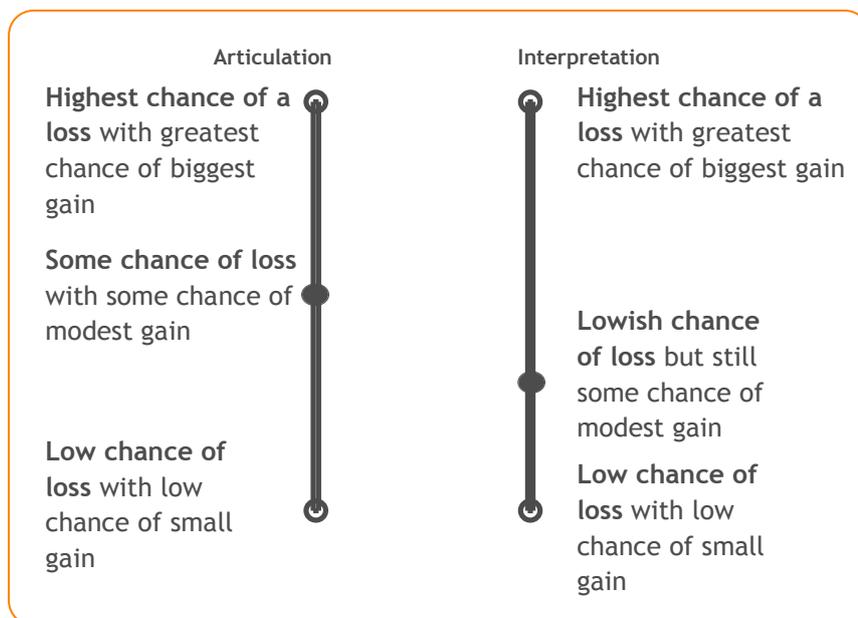
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<sup>36</sup> In addition to the possible reasons set out, there is potential for a research effect. During the role play exercise, the medium option was in the middle. It is possible that this mid way option was more attractive for reasons of framing. However, the individual exercises (the questionnaires which provided the numeric information) obscured the middle option in the question design.

Some others who preferred to accept a medium chance of loss in order to achieve a medium chance of gains appeared to have downplayed the chance of losses actually being incurred and focused on the chance of gains. Such a shift in expectations is illustrated in Figure 7.2.

*‘You might lose a little bit, but when you do gain, you gain quite a bit.’*  
 Young single, NMW, without a pension

**Figure 7.1 Interpretation of the midpoint**



In the sense illustrated in Figure 7.2, such participants did not weight the probability of loss and gain equally. Although the medium investment option was intended to be a mid-point in terms of the likelihood of loss, it is possible that some discounted the possibility of loss and thus gave themselves permission to select the option that gave a medium chance of gains, despite their attitude to loss.

### **Making contributing worthwhile**

On balance, participants preferred to limit the chances of incurring pension losses, but they also needed to ensure that sufficient gains were in prospect to justify joining a pension scheme and continuing to make contributions, instead of relying on a savings account, for instance. As outlined in Section 5.3.2, if investment gains are not made, this raises questions as to why anyone would contribute to a pension. Furthermore, as outlined in Section 4.4.1, there is an expectation that investment gains achieved by a pension fund should at least be higher than those delivered by interest on a savings account. For some participants, choosing the medium option might seem the best way to limit the chance of loss while achieving sufficient gains to make contributing to a pension worthwhile.

### **7.4.2 Taking the most loss avoiding option**

Those opting for pension investment strategies with the smallest chance of loss and the smallest chance of gain appeared to have done so because the idea of interim loss was very uncomfortable, even when there was a trade off against potential gains.

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*'Is it only me, but the fact that (there is) even ... a low chance of losing money was frightening me off in the first place?'*

Nearer retirement, £25,000 - £35,000, without a pension

*'Pensions are not something you want to gamble in the long term ... we all believed in taking a low risk investment and offering our investment in low terms of losing money.'*

Young with children, £25,000 - £35,000, without a pension

A consideration for those who felt this way was the immediacy and tangibility of financial loss, including an interim pension loss. As mentioned in Section 4.4.4, those with the lowest incomes and with dependent children felt that they could not afford to lose any money, even on an interim basis and from funds that had been put beyond short term use.

*'I'd like to be secure; I don't like taking risks unnecessarily. Maybe if I had the money and could put a bit aside and take a risk on that I'd do it, but I need to have security'*

Young with children, NMW, without a pension

### **Low expectations for gain**

In general, unpensioned participants' expectations for gain were modest. For these people, taking a conservative investment approach is not only about seeking to avoid losses, it also sits comfortably with expecting to achieve only modest gains. Because expectations for gain are modest, nothing is being conceded in exchange for a low chance of loss.

*'We went for the low chance purely because we knew that at the end of it, we wouldn't have lost. So you may only have a small gain but in theory we've got less chance of a loss ... we're not too greedy.'*

Young and single, £25,000- £35,000, without a pension

### **Misunderstanding investment gain**

In line with their generally poor understanding of pensions, it is possible that some participants chose the investment strategy options involving a low chance of loss because this was perceived as comparable to a savings account in terms of safety and what they might gain. That is, they perceived they stood the most chance of conserving their contributions and making a bit of money on top. Gains of such modesty might be easier to think of as being similar to interest, rather than investment gain.

### **Managing fear of pensions**

Some expressed a degree of cynicism about pensions (see Chapter 3), having heard about people losing their money in pensions after years of contributions. Although the examples given by participants, for example, Maxwell, were not cases of interim loss but of fraud or the collapse of a scheme due to mismanagement, it is possible that, for some, taking the option most likely to protect against loss was motivated by a need to allay this fear. So, if they could not wholly avoid exposing themselves to a chance of loss, the preferred option was to avoid exposing themselves as far as was possible.

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## 7.5 In summary

Participants, overall, were loss averse insofar as they were more motivated by protecting against loss than ensuring the highest chance of gain. However, while the ‘middle’ option was generally preferred by the unpensioned group in the sample, many did opt for the option that would protect the most against loss and this was particularly the case amongst those with the lowest earnings.

Strongly negative attitudes and reactions to examples of interim loss were not uniformly borne out in the investment strategy choice participants made because a medium gain, medium loss strategy was commonly preferred to a low gain, low loss strategy. Several possible reasons for this have been discussed in Section 7.4 but, on the basis this study alone, the participants’ mindset on this matter was not clear and may merit further investigation.

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## 8 Managing reactions to loss

### 8.1 Introduction

As described in Chapter 7, there is evidence to suggest that some participants would react to interim loss in the value of a pension with loss avoidance behaviour or by giving consideration to taking such action. This chapter looks at what might moderate how loss is experienced and, as far as possible, whether loss avoidance action can be mitigated.

Five possible ways in which it might be possible to moderate the experience of loss and mitigate loss avoidance action are discussed:

- Explaining why loss occurred;
- Offering appropriate reassurance about future performance;
- Personalising the pension statement;
- Separating employer and worker contributions; and,
- Providing more generic information on pensions.

### 8.2 Chapter summary

- Three key suggestions were volunteered by participants around what could be done to soften the blow of losses, and each one appeared consistently across the groups.
- Firstly participants asked for an explanation of the losses. They wanted to know what had happened to ‘their money’; not technical explanations of investment strategies.
- Secondly, and linked to an explanation of past performance, was a desire to be told in simple terms what was being done to prevent losses in the future and to recoup the amount that had been lost.
- Lastly, there was a desire to see pension statements personalised, or at least made more helpful to members, by giving a named contact within the provider’s organisation from which information about a loss could be obtained. Participants felt put off by advice in the mocked up statement they received to contact an Independent Financial Adviser.
- It was also apparent, as touched on in Section 7.3.4. that separating out employer contributions from worker contributions in pension statements would soften adverse reactions to loss if this allowed participants to discover that the loss was not in excess of the employer’s contribution and had, therefore, not undermined the value of personal contributions. The preservation of personal contributions was of paramount importance to those participating in the research.

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### 8.3 Explaining why loss occurred

When presented with a mocked up statement showing a loss to their hypothetical pension, it was common for participants to think that they were owed an explanation of why the loss had occurred and an answer to the question, “Where has my money gone?”. The need for an explanation was especially acute because of participants’ limited understanding of pensions as investments, as distinct from savings, and perceptions of ‘my pension pot’ as a tangible, segregated cache of money rather than part of a larger pool of investments, that changed in value according to trends in financial markets. Feelings of being short-changed in terms of understanding as well as money were evident.

*‘... You kind of want it broken down. Okay, so £220’s gone, but why, where to, how ...?’*

Young single, £10,600 - £15,999, without pension

*‘I’d want to know where has the money gone and why it has gone.’*

Established at work, NMW, without pension

*‘A justification yeah, because I think that generally in life when people don’t understand something, whether it’s money or relationships or whatever, it’s hard to accept it, so if you have a justification then you can get your mind around what’s actually happened, then you can go through that process of accepting what’s happened.’*

Young single, £10,600 - £15,999, without a pension

Though not a commonly expressed view, some wanted to understand exactly where their money had been invested once they learned that their pension fund had lost value, either absolute or relative loss.

*‘(You should have) a breakdown of where your money has gone (so) you can see where they’ve invested the money and which companies have lost.’*

Nearer retirement, £25,000 - £35,000, without pension

The demand for explanation suggests that pension statements should try to avoid downplaying losses or providing only superficial or self serving details of investment performance. Participants wanted explanations that they could understand, that is, clearly worded and without defensive evasion. There was no clear consensus among participants about the appropriate level of detail, however. Some suggested a full breakdown of performance data with charts of past performance and indicators of future performance. Others preferred a concise explanation that avoided what was seen as a potential for providing excessive data.

It should be noted that past performance was widely seen as a predictor of future performance. Evidence of previous gains was generally reassuring because it was interpreted as a sign that there would be gains in the future and because it allayed fears that an interim loss signalled an underlying tendency for losses to be made.

Explaining how and why losses had occurred was clearly important to participants, and as noted, the need for explanation was both generic to pensions as investments and specific to the loss shown in a particular time period. Whether explanations alone would affect the propensity of these participants, or NEST’s target market as a whole, to engage in loss avoidance behaviour is beyond the scope of this research to tell.

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## 8.4 Offering appropriate reassurance about future performance

In addition to wanting to know why a loss had occurred, participants commonly expressed a hope that pension statements would include reassurance about future performance. What would constitute effective reassurance was less clear, and the issue of appropriate reassurance did not arise spontaneously, i.e. participants did not qualify wishes for reassurance with caution about the potential for improvement being overstated.

*'I'm not going to pay in unless you can give some positive forecast of growth in the future.'*

Nearer retirement, £25,000 - £35,000, without pension

Participants generally emphasised their wish either for a proactive plan to prevent repeated losses or for projections showing likely future gains on the current value of their pension 'pot.' Less commonly, they wanted a guarantee that no future losses would occur. Others said that explaining the fluctuating nature of the value of pensions would, in itself, provide some reassurance about the future.

Those who asked for a plan of action to reverse losses had often assumed that the current investment strategy was flawed, as evidenced by a loss having occurred. Therefore, the logical solution was for the fund manager to do things differently and thereby prevent future losses. Some felt that a loss had to be due to mistakes made by the fund manager, which needed to be rectified. Others, who had some appreciation of the effect that market movements could have on the value of a pension, were less inclined to say that mistakes had been made by specific individuals, but in the absence of an anticipated upturn, they still wanted their money to be invested differently.

*'(It should say) we're going to act on the mistakes of why we lost the money this year.'*

Young single, NMW, without a pension

*'Maybe have an idea of how they're going to invest your money to maybe make it back ... I'd want to see what are they going to do, cleverly, to potentially make that money back.'*

Young single, £10,600 - £15,999, without a pension

*'Just say 'we invested it in Brazilian coffee and we lost money' ... and we are not going to invest in Brazilian coffee any more ... we're going to invest in oil that's just come up in Brazil, or something like that. So we know what they invested in, they made a loss. They're not going to do that anymore, they're going to invest in something else.'*

Nearer retirement, NMW, without a pension

The final comment above was relatively uncommon, however, in the specificity of the reassurance for which it called. Generally, participants thought that reassurances of future gains would be effective whether they came from expectations for an upturn in the market or from changes in investment strategy. The important thing was that the pension provider had reason to be confident of future gains and was working to avoid future losses.

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The expected time horizon for forecasts seemed fairly short term but was often unspecific in referring to the years immediately following a loss. It was rare for reference to be made to the long term outlook or to the final value of the pension.

*'Give us some predictions, and ... put it on paper that in the next few years, if this happens, then you would get this much back, or if that happens, then you would get that much back, and everybody knows that if you see it on paper you would think "oh okay then, I might just stick it out".'*

Established at work, £16,000 - £24,999, without a pension

As well as forecasting future gains, showing evidence of previous gains may also provide reassurance to the target market. A few participants explicitly acknowledged that it could be difficult to predict future performance and some felt that detailing past gains, even if not to their pension, for example, if it was the first year of their pension, would encourage them that the loss was a one off and that there was potential to gain in the future.

*'Yeah so if they said "This might be a one off or this has been a bad year but next year we know it's going to be better." I know they can't really predict it, but if they give us an idea.'*

Young single, NMW, without a pension

*'(They should) encourage you that they have made loads of gains over this time and stuff, maybe you would see it as, okay maybe it was just unfortunate that one year, but if they sent you a letter like that, to me it's just doom, doom and gloom, there's nothing positive in it.'*

Young with children, NMW, without a pension

Setting out a plan to prevent future losses, forecasting better performance in future or detailing previous gains might not be sufficient reassurance. There were those who wanted to be guaranteed that there would be no future losses to the value of their pension. For these participants, the emphasis was on avoiding loss rather than assuring future gains. For a few, who were not confined to those nearing retirement, such a guarantee would need to encompass the lifetime of the pension; for others, a guarantee of no losses during the next few years would be adequate reassurance.

*'If a 25 year pension was forecast not to lose any money in 25 years then probably I would stay. If ... over 25 years the worst scenario would be that you would break even, then okay, fair enough.'*

Young with children, NMW, without a pension

Particularly among participants without pensions, some felt it would be useful for pension statements to include short notes about the nature of investments, the likelihood of short term fluctuations in markets and the value of a pension, and taking a long term outlook of a pension's value.

*'You know, the life circle; if you've been around that long you'll know that things will go down but there will be better times. Put it in different wording, but that's basically what you're saying there. Although things may be bleak at the moment...'*

Nearer retirement, £16,000 - £24,999, with a pension

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## 8.5 Personalising the pension statement

Some participants wanted the pension statement to be more personal, more responsive to needs that were felt to be common among members and more supportive of those who were not experienced in dealing with pensions. Participants thought this would provide a degree of reassurance, albeit a different type to that given by outlining a plan for or forecasts of future performance of their pension.

The most frequently mentioned way to personalise the statement would be to provide the name and contact details of someone who could give advice or explain the situation that the statement documented. As in Section 6.3.4 where it was reported that some said they would seek information and advice from providers upon learning of a loss, there was little realisation that providers cannot give advice.

In general, there was an expectation amongst participants that they should be able to seek information or advice from someone knowledgeable about their individual circumstances, and that it was the pension providers' responsibility to facilitate this. One participant even felt that the pension provider themselves should call members who had experienced a loss.

*'It says if you want to have a look at your options ... you should contact a financial advisor. It should say you should contact your financial advisor, such and such. You should be given one, someone that you can phone and rely on.'*

Young with children, £10,600 - £15,999, without a pension

*'I just want them to name it, I mean bearing in mind if this statement has come from the pension management then they are possibly my financial advisor and if they're not then they should know who it is and I would want to know that they know and it should say 'Please contact your financial advisor John Smith from ABC Pensions'.'*

Established at work, £16,000 - £24,999, without a pension

*'I just think something personal, just like apologies about the loss saying that they'll receive a personal phone call out of courtesy within the next 48 hours or something just to let them know that, alright they're pissed off because they've made a loss but, you know, someone is going to contact them just to have a chat with them, so they will get a phone call, so a bit of a comfort blanket, you know.'*

Young single, NMW, without a pension

The mocked up statement sent to participants had recommended contacting a financial advisor if 'you wish to look at your options further or review the progress of your investment' - typical wording taken from a real annual pension statement. This was deemed to be unsatisfactory, on the whole; participants felt they were being dismissed by the pension provider. They would have preferred to be given the name and contact details of someone who had some responsibility for managing their pension or some understanding of the situation reported in the statement.

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The important thing was having a named contact within the provider's organisation to give a feeling of human responsibility to often faceless organisations. As noted in Chapter 6, however, the inclination to blame the provider or a fund manager for the loss may have heightened demand for a named contact within the provider's organisation.

Another way of personalising the letter that appealed to some participants was an apology for the loss incurred. An apology was particularly pertinent to those who assumed that the loss resulted from a mistake made by a fund manager. Although the occasional participant wanted to know that someone was being held accountable for the loss, others just wanted an apology as part of a more personal and sympathetic tone, even if the loss was assumed to have been a direct result of a mistake.

*'If it was mistakes they'd made, you'd almost want to see, this sounds really horrible, but like someone was punished for it. If there's like losses, if it's someone in a position, then they get someone else in there who can do a better job, you know?'*

Young with children, £16,000 - £24,999, with a pension

## 8.6 Mental accounting of employer contributions

### 8.6.1 Attitudes toward the value of employer contributions in relation to interim loss

Previous qualitative research found people would be willing to have employer contributions invested differently than their own and willing to subject employer contributions to greater investment risk than their own<sup>37</sup>. In addition, research has indicated that workers might see employer contributions as 'free' money<sup>38</sup>. These theories were explored further in this research in order to understand the extent to which people have different attitudes to loss when it regards their employer's contribution and, most particularly, whether framing the loss as coming from employer contributions might mitigate loss avoidance reactions (see Chapter 7 for more on loss aversion and employer contributions).

Section 7.3.4 presented evidence showing that some participants, when role playing as pension scheme managers, were inclined to 'invest' money from employer contributions more aggressively than money from worker contributions. That is, they were prepared to accept greater chances of loss in investing employer contributions. In this section, attention turns to whether framing a scheme's investment performance in terms of employer contributions is likely to affect sensitivity to loss and, potentially, the motivation to engage in loss avoidance behaviour.

Throughout the groups, two almost equally common but divergent views emerged about employer contributions and participants' sense of 'owning' them. These two views can be summarised as follows.

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<sup>37</sup> Attitudes towards investment choice and risk within the personal accounts scheme: Report of a qualitative study, DWP, 2009.

<sup>38</sup> Attitudes towards investment choice and risk within the personal accounts scheme: Report of a qualitative study, DWP, 2009. It should be noted that this research did not explore this in any detail. It should also be noted that this research was with the working age population and not the target market for the Personal Accounts scheme.

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Some participants confirmed previous research by saying they would view employer contributions as ‘free money’ or a ‘bonus’ that did not come out of their pay. As a result, they would not be as distressed by losses in the pension’s value that appeared to come from their employer’s contributions as they would be by losses of their own contributions.

*‘I think, personally, it would soften the blow for me knowing that the majority of (any loss) was my company’s money, because I don’t see that as part of my salary.’*

Young single, £16,000 - £24,999, with a pension

*‘Say if the employer gave £220 and that’s what was lost, you wouldn’t feel so bad about it because at least it wasn’t from your actual money that you were saving, so I mean you’d still feel pissed off, but not as pissed off as if it was your money.’*

Young with children, NMW, without a pension

*‘When it’s your own money ... there is still that divide and that divide is subconsciously very clear in your mind, and as soon as your own money is lost you have a much sharper reaction to the loss.’*

Young with children, £16,000 - £24,999, with a pension

Others said they would see employer contributions as part of an overall remuneration package that they had earned just as they had earned their basic pay. As a result, they would view a loss to employer contributions in the same way as loss to their own contributions.

*‘Who goes to work because of the love of it? No one. We go for the money. So if your company turned around and said ‘Right we’re going to put money into an account for you, blah, blah, blah’ then that’s what you expect at the end of the day, that’s the reason you’re doing it, is for the money.’*

Established at work, £10,600 - £15,999, without a pension

*‘It’s still my money; they’re just paying it on my behalf.’*

Established at work, £25,000 - £35,000, with a pension

These two views emerged with roughly equal prominence during the discussion groups. Both points of view were equally evident among pensioned and unpensioned participants. That is, there was no sense that those with some experience of a pension had developed different views about contribution loss as a result of possibly having benefited from employer contributions.

### **8.6.2 A potential role for framing**

Although there was not a consensus on whether employer contributions would be viewed as offsetting possible pension loss, there does appear to be a consensus on the psychological utility of a framing tool which would show employer and worker contributions separately on pension statements.

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When participants were asked how they might react if the value of employer and worker contributions were shown separately in pension statements, and framed in such a way as to suggest the loss was of the contributions their employer had made, rather than to their own, the response was overwhelmingly positive.

*'If they were to show in the breakdown, this is what you invested and this is what your employers have invested, and the deficit comes from their pot, then that might be a little bit more acceptable.'*

Established at work, £16,000 - £24,999, without a pension

Although the idea of framing employer and worker contributions in this way tended not to arise spontaneously and had to be described to participants before they could react to it, it was generally regarded as a good idea, once it had been considered.

*'If it's your own money you've got more to lose if that makes sense, I'm not saying because it's someone else's it doesn't make you feel so bad, but you know that isn't affecting an individual's pocket, that's affecting a company's pocket.'*

Young with children, NMW, without a pension

## 8.7 Managing expectations

Many participants wanted their expectations for the performance and outcome of defined contribution occupational pension schemes, as described to them, to be managed from the outset. As noted in previous chapters, few participants, and the un pensioned in particular, understood that interim loss could occur and on learning that loss could occur, requests for information about this possibility were common. Nevertheless, insofar as this was explained to participants as part of the research process, knowing about the possibility of interim loss did not lessen emotional responses, attitudes and reactions.

Participants were asked whether a loss in the value of their pension would be more acceptable if the chance of loss had been clearly explained before they joined. For some, a clear explanation of the chances of losses occurring would increase their sense of being in control, although there is no guarantee that interim loss will never occur in an occupational pension scheme. Such an explanation might also help some to manage their expectations of pension performance and their reactions if a loss were incurred at some point.

*'It should be told to people in normal average language and explained to them exactly what it's all about and what's going to happen. Then maybe if there was a loss then people would understand it.'*

Established at work, £16,000 - £24,999, without a pension

Other participants said that they would be unlikely to want to be in a pension scheme if the chances of loss had been clearly set out; choosing to contribute to a scheme in which members knew they could lose money seemed irrational to many.

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Given the evident level of negative reactions to loss, emphasising the chances of loss that pensions involve could encourage NEST's target market to opt out during the opt-out period or cease contributing.

*'(If they made it clear people could lose money) people ain't going to touch it with a bargepole, they will not touch it.'*

Nearer retirement, £25,000 - £35,000, without a pension

## 8.8 Trust in providers of pensions and related services

In the latter stages of the reconvened discussion groups, a short amount of time was given to exploring who participants trusted to have their best interests at heart in financial matters.

In general, participants' confidence and trust in the financial services sector, particularly banks, had been undermined by the economic crisis of 2008 - 2009. A common sentiment was 'a few years ago I would have trusted the banks'. Banks were criticised for investing recklessly, being profit driven at the expense of their customers' interests and taking commission irrespective of whether they made the customer money or not.

*'Yeah, they're the ones that have took more risks over the past couple of years and lost a lot for people, haven't they? People just think you can go and put your money in a bank and it's safe, and obviously they've proven that it's not.'*

Young with children, NMW, without a pension

To a lesser extent, it appeared that trust in government had also been eroded during the 2008 - 2009 period, and a variety of views existed about government's role in helping to create and to cope with the economic crisis. Although its impact on participants' thinking was not clear, it might be useful to know that the House of Commons expenses scandal had been headline news immediately before and during the time that the groups met.

Some participants appeared to have a deep seated suspicion of government's motives in initiating pension reform and the scheme, fearing it might portend abolition of the State Pension. Suspicion also existed of government's ability to implement NEST successfully, although it was presented as a being independent of government.

The characteristic that appeared to inspire most trust was an established brand or track record, with the Co-Operative group being cited as an example of an organisation that was trustworthy and driven by motives other than profit, despite its role as a bank.

*'The longer they've been about, the more you tend to trust them. If they've been about a long time ... maybe there's a logic in that kind of thing.'*

Young with children, £10,600 - £15,999, without a pension

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## 8.9 Summary comments

Five possible tactics for managing loss aversion and mitigating loss avoidance were discussed in this chapter. While all five might have some positive impact on loss avoidance and help in managing reactions to loss, the initiatives that appear to be most in demand were:

- explaining why loss occurred
- providing reassurances about what was being done so that losses would not be repeated in future and the value of losses recouped
- framing interim loss as coming from the employer's contributions or position the loss as being offset by the employer's contribution. Explaining why loss occurred was in general demand, and clear, transparent information would be welcome, although references to past performance might be assumed to predict future performance despite caveats.

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## 9 Conclusions

This final chapter summarises the insights from the research and highlights possible implications for the Personal Accounts scheme.

### 9.1 The target market and financial planning

This research was the first to look specifically at the financial thinking and planning of the target market for the scheme. The findings echo those from other studies of the financial planning behaviour of low earners and some of the findings from studies of the wider group the reforms will target, which includes those earning over £35,000 who are not the focus of NEST.

Many of the findings from this research attest to the lack of understanding participants had of pensions in general, and specifically of pensions as a form of investment rather than a form of savings akin to an interest bearing savings account. The idea that the value of a pension might go down was shocking news for many participants, who commonly expected that values would rise gently in line with contributions. Typically, the amount of contributions was the reference point for the expected value of a pension.

This research confirms widespread use by participants of ‘mental pots’ or apportionment money management. This suggests that the target market may include many apportioners, in a higher proportion than in the working population as a whole. This is consistent with previous research that identified a possible relationship between lower income and apportionment money management.

Participants reported spending most of their income on things they perceived as essential, and they rarely regarded saving for retirement as an immediate necessity. Participants generally saw a pension or long term saving for retirement as one among many ‘luxuries’ that was out of reach because it competed for money that was rarely ‘left over’ after paying for necessities.

The research also provides fresh insight into the extent to which affordability is subjective. While many reported not being able to save for retirement due to lack of money or the nature of the demands on their income, affordability appeared to be a mindset at least partly determined by attitudes to retirement and saving for it generally.

### 9.2 Emotional responses, responsibility, control and learning

The research provides a detailed picture of the emotional responses to interim loss, as well as what drives them.

Loss in the value of a pension was generally felt as a tangible and immediate loss, as though real ‘spending money’ had been taken away from participants. The main emotional responses to interim loss were surprise and anger. Anger arose not just at the loss itself but from a sense of betrayal because contributions made in ‘good faith’ had been lost, perhaps due to incompetence by fund managers in the view of some. Participants also tended not to consider that the losses might be made good in the medium to long term. The context of automatic enrolment might exacerbate surprise and anger at an interim loss, while also reinforcing a tendency to adopt a passive rather than an active investor mindset.

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The research showed that, overall, there was little sense of personal control or responsibility for the hypothetical losses participants experienced, just as there was little understanding of a pension as an investment. Participants seemed to feel that the losses had been ‘done to them,’ against their expectations and sense of fairness, and for some, with little apparent recourse except for ceasing contributions. Furthermore, participants felt that it was the responsibility of the pension provider to ensure that losses did not occur in future. The possibility of switching to a fund with a lower risk profile and continuing to make contributions did not occur to participants spontaneously<sup>39</sup>. This was only discussed after it had been described as an option.

Although explanations of how and why losses might occur were called for by participants in response to the surprise of experiencing an interim loss, the deliberative approach used in this research also revealed that providing information about the possibility of losses did not necessarily cause participants to be more supportive of contributing to a pension. Some said that understanding in advance that pension funds could lose value, even on an interim basis, would make it more difficult to justify saving money into a pension.

Nevertheless, some participants wanted pension statements, or information accompanying them, to provide understandable information about how losses had occurred, what was being done to improve investment performance, and a named contact within the provider’s organisation to pursue for clarification of concerns raised by the statement. Further research or market testing in practice would be needed to see if such an approach would have the desired effects.

Participants without a pension tended to respond somewhat more negatively to interim loss than participants who had experience of a pension. Participants with a pension were also somewhat less drawn to pension investment strategies that involved the lowest chances of loss, and the lowest chances of gain, among the strategies offered in the exercises used during the research. Such differences between pensioned and unpensioned participants were far from dramatic or consistent, however, and low income also appeared to play a role in participants’ inclination to react negatively to interim loss.

It is possible, therefore, that the target market’s emotional responses to interim loss will be moderated over time by experiencing membership of a workplace pension scheme. With the new scheme’s membership potentially being made up predominately by those on low incomes, some parts of the target market may remain highly loss averse, however, regardless of experiencing a pension.

### 9.3 Balancing emotional responses and loss aversion

Having negative feelings about interim loss does not necessarily confirm loss aversion. This research has shown that, despite some strong, negative feelings about interim pension loss, when given a choice involving different chances of gain as well as loss, participants did not necessarily choose an investment strategy most likely to protect against loss. Overall, participants seemed to prefer a strategy that went some way toward protecting against the highest chance of the highest levels of loss and to forego the highest chance of large gains as a result.

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<sup>39</sup> The experience of the Swedish scheme and evidence of retail investors fund choices indicates that, where fund choices are made, they are not always in the best interests of the investor in terms of the outcome produced. See Cronqvist and Thaler (2004) Design Choices in Privatized Social-Security Systems: Learning from the Swedish Experience.

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A middle way, involving medium chances of loss and gain, tended to be more popular than minimising the chances of loss or maximising the chances of gain. Furthermore, the second most favourable investment approach, and the most favoured amongst the lowest earners in the sample, was the option most likely to protect against loss. In addition, participants reacted more negatively to absolute loss, i.e. loss of contributions, than to relative loss, i.e. loss of some or all of the value of previous investment gains. A high proportion of the target market might, therefore, be more comfortable with an investment approach that protected contributions and minimised the chances of absolute loss, even if that meant foregoing the chance of a better investment gain.

## 9.4 Possible behavioural responses

Loss avoidance is the most extreme loss averse reaction. There are several ways in which the target market for NEST might respond to loss, with stopping contributions being the most drastic loss avoidance measure.

In this research, participants demonstrated a willingness to take loss avoidance action if an interim loss occurred. Stopping contributions was the main response that participants anticipated making upon experiencing a hypothetical loss. Less commonly and usually after ceasing to contribute, some also thought they might consider alternatives to a loss making pension or seek advice and information to understand why the loss occurred, and how the money might be recouped. This could have an impact on contact rates with pension providers. Alternatively, some would give a loss making pension up to three years to see if a consistent pattern of losses was evident.

There are good evidenced based reasons to believe that many people, regardless of the responses given in this research, would not act dramatically upon experiencing a pension loss. Not everyone will read their statements, for example, and more than a few, therefore, may remain unaware of interim loss. This research created an environment in which people could not remain unaware of interim loss, but real life may be different.

Evidence on inertia, showing that not taking action is often the default position for joining a pension scheme but also for opting out of a scheme once enrolled, and cognitive and emotional biases such as the 'status quo' bias<sup>40</sup>, informed the introduction of automatic enrolment as part of pension reform. Inertia may also prevail in the face of interim pension loss. Evidence from 401k plans in the US suggests that people did not act to stop or change their contributions following volatility due to the recent recession<sup>41</sup>. It remains to be seen in a UK automatic enrolment environment whether loss aversion impulses, which could lead to behaviour such as ceasing to contribute to a personal account that experiences a loss, will be strong enough to disturb the inertia that automatic enrolment seeks to harness.

While less radical alternatives than ceasing to make contributions were also suggested, it is important to note that, overall, participants suggested doing something rather than nothing. It is unknown how this impetus to do something about interim loss would translate into actual behaviour in the real world, but these findings suggest that there could be a variety of potential implications for the pension provider, from lapsed contributions and reduced persistency rates to increased contact activity via call centres and other channels.

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<sup>40</sup> Kahneman, D., Knetsch, J. L. and Thaler, R. H. (1991), Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias. *Journal of Economic Perspectives*, 5, 1, pp. 193-206.

<sup>41</sup> Investment Company Institute (2010) Defined Contribution Plan Participants' Activities.

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## 9.5 Rules of thumb for loss aversion?

Behavioural economics has found that people tend to use a range of mental short cuts or ‘rules of thumb’ (heuristics) when faced with complex financial decision making. These include:

- the availability heuristic states that, when faced with unfamiliar possibilities, people will tend to judge how likely each is by their ability to recall something similar<sup>42</sup>
- the representativeness heuristic states that people tend to form opinions regarding future events by comparing them with other events or things with which they are familiar<sup>43</sup>
- the anchoring heuristic states that people tend to select an initial reference point as the basis for a decision and then adjust from it<sup>44</sup>. This may take the form of extrapolating from a past trend. It may cause people to place too much weight on historical factors when taking a decision and not enough weight on other factors. It is felt to be one reason why investors are known to chase performance, even though this is may be a poor investment strategy.

The anchoring heuristic, in particular, resonates with participants’ ‘three strikes and you’re out’ rule of thumb, used as a way of deciding whether to respond to interim loss. Participants appeared to adopt this rule of thumb as they found losses in three consecutive years to be worse than a loss of the same total amount in a single year or in intermittent years that were not consecutive. A consecutive pattern of losses conveyed the impression that losses could not be averted, and this was alarming to participants.

This could have implications for communications and investment approaches designed to meet the needs of the target market. It might, for instance, point to a need to protect against consecutive loss or devote special effort to explaining, guiding and reassuring members if losses were to occur three years in a row. In addition, if a loss occurred in the first year and was primarily due to a combination charge<sup>45</sup> rather than investment performance, for those adopting a ‘three strikes and you’re out’ rule, this first year of loss might count as one of those three strikes.

## 9.6 Mental accounting and framing effects

The research has found that contributions made, and in particular, worker contributions, are viewed as sacrosanct. While not everyone in the sample perceived employers’ contributions as ‘free’ money, there was broad consensus on presenting employers and workers contributions separately on annual pension statements and framing loss to have come from the employers’ side. Further research and analysis would be needed to test which presentational devices work best and to explore this area in more detail. However, this research does indicate that, should this be feasible, it might help towards mitigating loss avoidance measures and managing loss aversion responses.

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<sup>42</sup> Ricciardi 2004.

<sup>43</sup> Kahneman and Tversky 1974; Ricciardi 2004.

<sup>44</sup> Kahneman and Tversky 1974.

<sup>45</sup> The Personal Accounts scheme is expected to initially have a combination charge made up of an annual management charge (AMC) of 0.3 per cent and a small contribution charge of around 2 per cent.

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There was also some evidence that participants might accept different investment strategies being followed with employer and worker contributions, such that the chances of loss would be lower for worker contributions and the chances of gain would be higher for employer contributions.

## 9.7 Appetite for information, but potential adverse effects

When asked what might mitigate loss avoidance reactions, some participants suggested that more information should be provided about pension performance and the possibility of interim loss. As noted in Section 9.2, however, some participants admitted that it would be harder to justify contributing to a pension if the possibility of interim losses were known in advance. Therefore, having the desired information might not necessarily make members feel positive about their pension and the contributions they make to it.

This confirms other research which has looked at the impact of increases in financial literacy on financial decision making. Overall, increasing people's financial literacy does not mean that they will change their financial behaviour<sup>46</sup>, and even people who are very financially literate can make investment decisions that are not in their best interests in terms of fees and returns<sup>47</sup>. Furthermore, other research suggests, as does this study, that communications may not convey the message or achieve the effect that the communicator intended<sup>48</sup>. The communication challenge, therefore, will be to manage expectations about interim loss. That is likely to involve enhancing understanding of how pensions work without unintentionally alarming scheme members or disrupting the inertia on which automatic enrolment relies.

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<sup>46</sup> FSA (2008), Financial Capability: a behavioural economics perspective and FSA (2008) Evidence of impact: an overview of financial education evaluations.

<sup>47</sup> Choi, Laibson and Madrian (2006), Why Does the Law of One Price Fail? An experiment on Index Mutual Funds.

<sup>48</sup> CFEB (2010) Transforming Financial Capability.

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# Appendix A:

## Discussion guide

### Objectives of first group

- An understanding of what loss means to our target group
- To explore expectations about loss - what do people actually expect?
- To explore how loss is subjectively experienced. For instance, is it different for different people? How and why?
- To look at the emotional responses associated with loss. For example, shame, embarrassment, anger, fear, regret
- To explore whether what loss means to people differs in different contexts. For example, if others have experienced comparable loss, if there has been a stock market crash, in an economic downturn, in a period of prosperity, etc

**PRE TASK** - Participants asked to bring along something that symbolises a personal ‘money-related loss’ to them. This could be a personal possession, a newspaper cutting or a financial statement.

**PRE-GROUP** - Participants to fill in short pre-questionnaire before group begins (**material 1**)

### Initial group

#### Introductions (10 mins)

- Moderator to introduce the research - we’re here to talk about your expectations for pensions savings and how you might feel and react if the money you saved were to go down.
- We are doing the work for PADA, an agency set up by the Government to help more people save for their retirement.
- Explain re-convening and that this group is a bit of a warm up to the next. Part of the purpose of this group is to get you up to speed on some of the things we are interested in your views on.
- Reassure that they will be given all the information they need and it’s not a test of how much they know!
- Assure confidentiality
- Check OK to record.
- Introduce people in ‘viewing facility’
- Participant introductions

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## Me and my money (mental pots) - 10 minutes

"I want us to start off by thinking about money - how we spend it, how we save it and the different ways we might think about and organise it".

- Explain task - participants come up with list of what they spend their money on (bills, holidays, family, going out, savings etc)
- MODERATOR NOTE: draw up on flipchart as they shout, then group together according to respondent suggestions (e.g. kids, clothes, going out, rainy days)
- Thinking about each of these categories (themes), can you tell me a bit about how you much you plan/ organise your money or not for each of these? Probe around:
  - Thinking about them differently (important, nice to have, source of worry, etc)
  - Using different bank/post office accounts etc
  - Putting money 'to one side' (perhaps physically, in their wallet/ purse, around the house, etc)
  - Different people in household responsible for different categories
  - Anything else
- Do you think about your money in terms of short/ medium/ long term?
- How would you define short/ medium/ long term?
- Looking at these categories, are there any which are short / medium/ long term?  
FLIPCHART

## Expectations in retirement (10 mins)

- Guided fantasy exercise
- Close your eyes, etc, and think about your retirement (and try to be as realistic as possible!). How do you imagine it? What kind of things will you do? How will you spend your time? How will you be spending your money? Same as before? Less than before? Will you have holidays? Run a car? Etc
- When participants open their eyes, each one to write or make a mental note of a couple of points about how they imagined their lifestyle/ income in retirement (for example, 1 holiday a year, running a car, etc)
- Where do you think your income in retirement will come from?
  - The State pension
  - Savings/ personal pension
  - Other

## Getting to grips with savings/ investments/ pensions (30 mins)

"So one way you might achieve the kind of standard of living you want in retirement might be through savings [MODERATOR NOTE: potentially adding - "a couple of you mentioned a pension"]".

- Can you describe what you think a pension is? FLIPCHART
- Do you think there is potential to gain money/ for the money you put in to increase in a pension?
  - Probe around how they expect a pension pot to grow
    - Simply because of the money they put in

- 
- Interest
  - How it is invested
  - The choices they made
  - What the 'market'/ stocks and shares do
  - Other
  - Do you think there is any potential to lose money in a pension?
  - If yes, how?
    - The people who run the pension are incompetent/ bad in some way/ etc
    - Government taking it away (or something like that!)
    - How it is invested
    - The choices they made
    - What the 'market'/ stocks and shares do
    - Other
  - Can you tell me what role you think the people saving in a pension should play?
    - Probe for the extent to which they feel they have choice, control and responsibility
  - Expectations of pensions savings exercise. Using (material 2) in mini-groups (split into 2 x groups of 3):
  - Imagine you were saving £50 a month in a pension, what would you expect the pot of money to do over time?

MODERATOR NOTE: Give both mini-groups an outline of a graph with time on one axis and money on one axis and ask them how they imagine the pot of money to perform. Participants can use example graphs if this helps. If it's easier people can describe rather than draw their expectations

- Come back together and discuss expectations - FLIPCHART
- Do you see any difference between savings and a pension? FLIPCHART

MODERATOR NOTE: Read through text from moderator hand-out and probe around comprehension.

- Do they understand why putting money under the mattress won't cover their retirement?
- Do they understand why a savings account is likely to be inadequate?
- Do they understand that a pension is invested?
- Do they understand that a pension might make gains at different rates/ that the gains are not necessarily the same every year?
- Do they understand that with a pension, they might lose the money it gained or even the money they put in in the first place?

MODERATOR NOTE: Explain that you might keep returning to this as discussions progress.

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## Explore initial attitudes to loss (30 mins)

### Part 1: financial symbol

"We're going to move on to think about the potential for loss in a pension and how you would feel about it. First of all, it would be good to talk about your views and feelings about money related loss. You were asked to bring in an object of some which relates to this".

- Discuss the object
- Probe on why people brought that symbol in?
  - How did the experience/situation make you feel? FLIPCHART
- Note on the flipchart any related feelings (anger, disappointment, embarrassment, regret, etc)
- Initial exploration of whether how people feel/experience loss in a money context, whether this is different for different people and why
  - Probe on any differences in people's responses using flipchart

### Part 2: Exploring feelings about/ reactions to loss

#### Scenario exercise/ third party questioning

"Our focus is on losses that might be experienced during a pension. We're now going to look at some of the ways in which people might experience loss in a pension and get your views on these".

- Introduce and read out each 'scenario' (material 3 - PENSIONS SCENARIOS)
- Explore reactions to each scenario:
  - How do you think these people feel?
- How would you feel? (anger, disappointment, embarrassment, regret, hope it wouldn't matter in the long run, etc)
- FLIPCHART AND KEEP FOR RECONVENED GROUPS! MODERATOR NOTE: Explain purpose of sorting exercise - to explore what is a 'bad loss' and whether some losses are better/more acceptable than others. MODERATOR NOTE: explain that two of the scenarios are loss of gains and two are loss of money put in. Acknowledge that we understand that neither is desirable but want to understand their views on each.
- Explain sorting exercise and hand out cards (material 3): - imagine a line on the table. One end of the line is very bad/unacceptable losses. The other end is less bad/more acceptable losses. Individually, I want you to place the scenarios on the scale.
  - Explore any differences between participants
  - What makes these examples more acceptable - FLIPCHART
  - And these examples less acceptable - FLIPCHART

MODERATOR NOTE: explain that usually employers also contribute to employee's pensions, so as well as you putting money in from your wages they put money in as well.

- Were you aware of this?
- Would you see the money you put in differently to the money your employer put in?
  - Why/ why not?
  - Probe: Is it a right / something you are entitled to? Is it 'free money'?

- 
- How would you feel if the loss was equal to some or all of the money your employer put in?
    - Would you be as bothered about this as you would be if it were some or all of the money you personally put in?
    - Probe: would they feel the loss as one/ coming from one pot which is theirs? Or as two different pots, one that they are bothered about and one which they are less bothered about.
  - Thinking about these loss examples, is there anything which you think might make a difference to how you would feel if you were in this situation?
  - Probe extent to which the following make a difference:

MODERATOR NOTE: for each one get them to imagine a mid-point on the line, and say whether it would make a loss more or less acceptable (move to the left or right)

- Whether you'd made money before (i.e. you'd made a previous gain)
- There had been many losses before
- Lifestage (e.g. being young and single vs. nearer retirement)
- If other people lost as well
- If you were told beforehand there may be a risk of losing
- The way you were told
- Context (how the economy is generally doing i.e. recession)
- You expected it
- Hand out 'investment options' (material 4) and explain task - ask them to choose between 3 investment options
  - Probe around why people have chosen their investment option

#### Close and next steps (5 mins)

- Brief explanation/hand-out (material 5) around Scheme and how it will work

MODERATOR NOTE: ensure respondents do not come away thinking it is government backed or guaranteed

- Hand out homework diaries and explain task (material 6): imagine you and your employer are paying £1,200 a year into a pension fund that could reasonably be expected to give you £3,000 per year in retirement - think about how this might effect your life, what sorts of things you might spend the money on
- Explain that they will receive a letter in the week updating them on their investment after one (or five) year/s
- Re-cap on time/date of next group
- Incentive

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## Reconvened group

### Objectives of the reconvened group

- An understanding of whether there is loss aversion amongst the target group
  - Is the target group loss averse generally or are only some groups loss averse?
  - How this compares to the wider population (comparison group)
  - Would loss of employer contributions be perceived differently to loss of own contributions
- An understanding of the degree of loss aversion
  - Is there a base level of loss aversion amongst the target group?
  - Are some more loss averse than others? If yes, who?
  - How loss averse is the target group? What is the prevalence of actual loss avoidance?
- An understanding of how degrees of loss aversion may impact on future behaviour
  - We hypothesise that those who are more loss averse might seek loss avoidance strategies (see diagram on full ‘outcomes’ document). We also hypothesise there might be a time element to this. For instance, if loss is continual or is frequent.
- What drives loss avoidance behaviour (other than loss!)
  - An understanding of whether loss avoidance action can ever be mitigated in different circumstances
  - What could be said/ done, during/ beforehand?
  - Does it matter who you suffered the loss with? For example, perception differences between, say Northern Rock and someone like the Post Office?
  - Who do people listen to about loss?

**PRE TASK** - Participants will have been asked to imagine what difference their pension fund may have made to their lives, then would have been sent ‘loss letters’ and asked to read those, consider the information and use the ‘emotion tree’ to record their emotions/feelings. In addition, participants would have been asked to record what they would do upon receiving this letter - i.e. what, if any at all, action they’d take. (**Material 7**)

### Re-introductions - 5 mins

- Moderator to introduce the research and the purpose of the evening
- Recap on last time - context is long term and pensions

### Reactions to loss letters - 15 mins

- Now, can you take out the tree pictures we sent you with your loss letters. Could some of you talk me through which figures you circled, and why? i.e. how you felt when you opened the letter?
- FLIPCHART
- How did other people feel? FLIPCHART TILL MOST/ALL PEOPLE HAVE RESPONDED.

MODERATOR NOTE: refer back to original ‘reaction’ flip chart from initial group - discussion will vary on findings, but will highlight and explore differences and commonalities.

- 
- Explain that the money was paid from their salary before they got it into their bank account and probe on:
    - To what extent do you feel you lost or will miss the money?
    - Do you feel in any way less connected to the money since you never really had it in the first place?
    - How does this affect the way you feel about the loss?
  - How would you feel if the contributions to your pension were from both you and your employer?
    - Would this make a difference to how you felt opening the loss letter?

### Views of / attitudes towards different 'types' of loss - 30 mins

- Thinking about the loss in your letter, and how you felt about this, what could make the loss more acceptable? What might change the feelings you have about it? WRITE SUGGESTIONS ONTO CARDS

MODERATOR NOTE: prompt by writing on flipchart so they have time to absorb and probe emotions around each:

- Being told you'd made money before (i.e. you'd made a previous gain)
- If the loss was the first/ second/ fifth/ tenth you'd experienced
- Being told the loss was of money gained, not the money you put in, for the last year/ for the last 3 years/ for the last 5 years/ for the last 10 years
- Being told the loss was of the money you'd put in for the last year/ for the last 3 years/ for the last 5 years/ for the last 10 years
- Being told other people lost gains/ the money they put in as well
- Being told beforehand there may be a chance of losing gains and or the money they put in

MODERATOR NOTE: introduce mocked up headlines of stock market falls and recession (material 8)

- How would seeing these kinds of headlines make you feel about any losses you had seen in your pension plan?
- Imagine you've opened your letters at home one evening - think back to how you said you felt when reading them - and imagine you also see these headlines on the paper next to you.
- How do you feel about the loss now - better, worse, more optimistic, gloomier?
- And now think about if the loss had occurred when it wasn't a recession/ economic downturn. How do you feel about it now? Is it any less acceptable/ understandable?
- Probe around, outside of a recession or economic downturn, the reasons why they think the loss might have happened.
  - Their money has been badly managed by them
  - Someone else has badly managed their money
  - Anything else

- 
- Do you feel the actions you take have an impact on how well your money does?
    - Probe around the extent to which they feel responsible for how the money performs
  - If I said ‘investor’ to you, who or what do you think I might mean?
    - Probe around whether they see themselves as investors or as members of a pension scheme

MODERATOR NOTE: Refer to ‘moderator briefing note’ [re definition of interim loss’]. Ensure you have this in your mind when leading this session.

Handout and read through participant briefing note (**material 9**).

Hand out scenario of someone who is 35 and has been in the pension scheme for 10 years (**material 10**). Then show cards with variations on the loss with a brief explanation - (**material 11**). **Explain that the amount lost isn’t really different altogether but what we want to understand is whether feeling the loss in one go, or over consecutive years, or over a number of years but not consecutively is the most upsetting/ annoying. Which of these do they have the strongest reaction to and why:**

- The value of his pension went down £1,500 in one year
- The value of his pension went down £500 three years on a row
- The value of his pension went down £500 three years out of five, but went up in the other two
- Sorting exercise - could you sort these scenarios on a scale according to which example would have the most ‘devastating’ impact on you - most devastating on the left and least on the right.

MODERATOR NOTE: give pack to each respondent so they do the exercise individually rather than collectively. Then discuss whether it was amount, frequency, duration or relativity that was the most ‘devastating’.

What impact would these losses have in the following situations:

- Older person (specify an age of 60) with scenario 1 (£1,500 in one year)
- Less years of contribution (has been contributing for 5 years) with scenario 1
- Imagine that you and your employer are paying in about £1200 each year altogether. How much would you expect your pension to gain/ grow with a single year?
- Assuming you knew that you might make a loss in your pension, how much might you expect to lose in a single year?
- Can you tell me how you would feel and how you might react if you lost the amount you expected to gain?

MODERATOR NOTE: Hand out material 12 on inflation scenario. Discuss as per prompts on scenario

**What impact would ‘loss’ have? - 40 mins**

- Ask participants to get homework out and refer to it.

- 
- What would you do in ‘real life’ as a result of the letter?
    - Spontaneous discussion around what action, if at all, they’d take.
    - Probe around:
    - Seek advice? If yes, from who?
    - Contact their pension provider/ complain
    - Wouldn’t recommend the scheme to anyone else
    - Would actively discourage friends from joining up
    - Take an interest in how their money is invested/ start to ask questions they didn’t before
  - Why would you do that?
  - What would you hope would happen as a result?

MODERATOR NOTE: if the following options did not come up spontaneously, explore the following:

- Prompt on the following (these options will be on cards with a brief explanation) (**material 13**):
  - **Switch funds**
  - **Stop contributions**
  - **Would not recommend scheme to anyone else**
  - **Would actively discourage friends from joining up**
- And what would you do in response to each of the four scenarios outlined above?
  - Would your response be different in each of these situations?
- Which if any of these actions do you think you might consider?
- Is there anything the pension provider could do or say to prevent you from stopping contributions/ moving funds?

Imagine you were told up front (maybe by the pension provider, or you might have heard from friends and family) that the money you put in won’t necessarily grow each year on year - you might lose money the pension pot has gained or even the money you put in in the first place. What effect would it have on your decision whether to join the scheme or not?

- What about if they told you that you whilst you might lose money at some points, you might also make this up by the end of your pension - but this isn’t guaranteed?
- Hand out instructions for **role play** and explain task (**material 14**): split group into half: one half to be members who’d stop contributions, the other half to be a financial advisor, who would try to persuade the other person to stay in.
- (We’d have a handout (**material 15**) to give the ‘IFAs’ on key arguments for staying in if finding difficult)

Can each team feed back the key points they’ve made? FLIPCHART

---

### Break - 5 mins

- Short break in which we ask participants to take 2 minutes to fill in a short questionnaire with quantitative questions (as suggested in proposal)
- Including 'Post' measure of DWP Attitudes to Risk/Loss questions material 16

### SCHEME MANAGEMENT ROLE PLAY - 15 mins

- Break into two teams - one is the team who are managing the pension scheme, the others are scheme members. Hand out explanation of role play material 17

MODERATOR NOTE: Control groups (with pensions) should be asked to pretend it's their existing private pension provider rather than the PADA scheme

- Managers are not there to make money for themselves but should just act in the best interests of members; to manage their money in a way that they think is best for the members of the scheme.
- Member team to decide how they would like their money invested on their behalf
- Managers to explain their investment strategy - overall balance of risk versus return, expectations of potential losses (e.g. none, very rarely, occasionally but should only be short-term etc) and hoped for gains (minimal, modest, ambitious etc)
- Members to feed back how they would like the funds as a whole to be invested.

### Mitigation of loss avoidance behaviour - 20 mins

- For those of you who chose to stop contributions or opt-out at the very start, can you just close your eyes and think about what could possibly persuade you not to stop contributions or opt-out?
  - Could it be something that was said in the letter?
  - Something you read in the papers?
  - Something your employer said or did?
- What did you think of? PROBE ANY REFERENCE TO TRUST OR REASSURANCE
- When you're discussing these kind of decisions - savings, bank accounts, possible pension schemes etc - who do you trust to invest your money? Who/why do you trust the most to have your best interests at heart?

MODERATOR NOTE: flipchart up suggestions and then order them on a scale in terms of most/least trusted. If not already on there, add: post office, a company like prudential or Scottish widows, a non-profit making scheme such as NEST (the scheme being set up by the government to help people save for their retirement).

- Where would these organisations go on this scale? Why?
- To what extent would the scheme's provider make a difference?
- Thinking about [ORGANISATIONS LISTED ON FLIP CHART], who do you think is more/less likely to make a loss? Why?
- Lastly (you'll be relieved to know!), could you go back to your loss letters.

- 
- Now, imagine you are the person responsible for designing these letters, can you go through them and think about how you might change them or redo them so they come across as trusting and reassuring, and if possible in a way that persuades people of the real benefits of saving for their retirement, even if there might be some ups and downs along the way.
  - You can scribble thoughts on your letters or just keep them in your head if you'd prefer.
  - What sort of suggestions did you come up with?
    - Probe around frequency of letter: how often would participants like to receive a letter?
  - Why would that make a difference - and what sort of difference do you think it would make?
  - Probe around whether participants expect to see employer contributions broken out separately? Would they prefer this? Why/why not?

#### **Round up and close - 5 mins**

- Thank them for their time and efforts
- Outline that we are doing 16 of these groups around the country and that the results are going to feed back into the team that run the scheme, and will help them make decisions that are in the interests of people who join it.
- Distribute incentives

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## Appendix B:

### Pre and post questionnaire

#### Pre questionnaire

We would like to get an initial impression of your thoughts on the subject we are going to be talking about before we start our discussions. It isn't a test so please just answer the questions below as best you can, based on your personal experiences, thoughts and feelings.

**Q1. I would describe myself as...**

*Please indicate which of the following best applies to you by marking an 'X' in the right-hand column (you may only select one).*

Reasons	Mark statement that best applies to you with an 'X'
1 ...someone willing to take only a small amount of risk of losing money	
2 ...someone willing to take some risk of losing money to improve the chance of making money	
3 ...someone willing to take a higher risk of losing money to get the chance to make a lot of money	

**Q2. Please read the list of different financial products below.**

*Please indicate which of the following you have either in your own name or jointly with someone else by marking an 'X' in the right-hand column.*

	Mark with an 'X'
1 A bank account	
2 A mortgage	
3 A credit card	
4 A storecard	
5 A Child Trust Fund that you manage	
6 An ISA	
7 An instant access savings account	
8 A personal loan	
9 A secured loan	
10 Longer term savings	

- 
- 
- 11 Stocks and shares

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  - 12 A savings scheme such as Christmas Hamper a voucher scheme or savings stamps

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  - 13 A credit union account

---

  - 14 None of these

---

**Q3. Different people have different approaches to how they like to organise their lives. For each of the following, please give me a score out of 10 each time, where 1 means you are not that sort of person at all, and 10 means that you are definitely that sort of person. So, to what extent are you the sort of person who....**

	Please give score out of 10
1 Avoids planning and always does things spontaneously	
2 Likes to feel that they are in control of their life	
3 Makes sure they have money put aside for emergencies	
4 Really enjoys spending money	
5 Just takes each day as it comes	
6 Focuses on their work and doing well	
7 Expects to be much better off in the future	
8 Makes plans for the future	
9 Feels they are entirely responsible for what happens to them in the future	
10 Has so much going on at the moment that they cant really think about the future	

**Q4. Thinking about your current situation, which of the following, if any, would you say are the MOST important to you at this moment in time?**  
*Please indicate only those that are really key priorities for you at the moment by marking an 'X' in the right-hand column.*

	Mark priorities with an 'X'
1 Buying or moving house	
2 Clearing debts	
3 Starting a family	

		Mark priorities with an 'X'
4	Doing well at work or getting a new job	
5	Learning a new skill	
6	Building up some savings	
7	Having a good social life	
8	Paying off your mortgage	
9	Becoming or being your own boss	
10	Having more time to relax and enjoy yourself	
11	Saving for later life	
12	Putting money somewhere to make it grow	
13	None of these	

**Q5. We all have different things that we would find very hard to give up if our finances were a bit stretched.**

*Below is a list of things people may like to spend their money on, please indicate by marking an 'X' in the right-hand column which of them you would find really hard to give up or scale back on?*

		Mark with an 'X'
1	Your social life	
2	Running a car	
3	Shoes or clothes	
4	Going on holiday	
5	Being able to treat family or friends	
6	Spending on a hobby or interest	
7	Spending on the house or garden	
8	Being able to put money aside for a rainy day	
9	None of these	

---

## Post-questionnaire

Now you have had a chance to think about and discuss the subject of pensions and loss, we would like to get a final impression of your thoughts on the subject. It isn't a test so please just answer the questions below as best you can, based on your personal experiences, thoughts and feelings.

### Q6. I would describe myself as...

*Please indicate which of the following best applies to you by marking an 'X' in the right-hand column (you may only select one).*

Reasons	Mark statement that best applies to you with an 'X'
1 ...someone willing to take only a small amount of risk of losing money	
2 ...someone willing to take some risk of losing money to improve the chance of making money	
3 ...someone willing to take a higher risk of losing money to get the chance to make a lot of money	

### Q7. What score would you give yourself out of 10 for your overall knowledge of financial matters.

*Where 1 means that you know nothing at all, and 10 means that you know a lot about financial matters?*

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Score out of 10

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### Q8. And could you give me another score out of 10, this time for how confident you feel generally dealing with financial matters?

*Again, 1 means that you don't feel at all confident and 10 that you are very confident.*

---

Score out of 10

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**Q9. I'd now like you to think a bit about later life and not being in paid work and what that might be like.**

*Please read the following statements and mark with an X in the right-hand column the ones you agree with?*

	Mark with an 'X' statements you agree with
1	I will do all the things I don't have enough time to do now like hobbies or seeing friends
2	I expect to live in a very similar way to how I live now
3	I really don't want to think about it
4	I can't imagine what it will be like
5	I expect I will have to watch what I spend more closely
6	I'm really looking forward to being retired
7	None of these

**Q10. There are lots of reasons why people might not have money put aside for their retirement, or perhaps not as much as they could do. Are any of the following KEY reasons in your case?**

*Please indicate the reasons that are key in your case by marking an 'X' in the right-hand column.*

	Mark key reasons with an 'X'
1	Its a struggle to cope just with basic day to day expenses
2	I would rather enjoy a good lifestyle now
3	I don't want to make the wrong decision
4	I don't feel I know enough about which would be the best option for me
5	Retirement is too far away to think about
6	The State provides a financial safety net in retirement
7	I just haven't got round to it yet
8	There always seem to be other things to spend money on like holidays or the family
9	My partner has enough pension and/or savings for both of us
10	I expect my house to make me enough money
11	If I have savings I might miss out on means tested benefits later

		Mark key reasons with an 'X'
12	I expect to carry on working	
13	I don't trust banks and financial advisors	
14	I am saving for other things	
15	I have never really thought about it	
16	Don't know	
17	None of these	

**Q11. Thinking about your current situation and current retirement plans, would you say that you were worried or confident about the future?**

*Please indicate by marking an 'X' in the right-hand column.*

		Mark with an 'X'
1	I am confident	
2	I am worried	

**Q12. Would you say that you currently have plans in place for funding your retirement?**

*Please indicate by marking an 'X' in the right-hand column.*

		Mark with an 'X'
1	Yes	
2	No	

**Q13. On the scale of 1 to 10, how confident do you feel that you can make the right decisions to provide for your retirement?**

*Where 1 is not at all confident and 10 means that you are very confident?*

Score out of 10

**Q14. Here is a list of some things that other people have said when asked about later life and managing money.**

*For each one, please indicate how much you agree or disagree by giving a score out of 10 where 1 means you strongly disagree and 10 that you strongly agree.*

	<b>Please give score out of 10</b>
1	I am confident that I will have enough put by to live on in retirement
2	If I have to work beyond State Pension Age I will think I have failed
3	Dealing with pensions scares me
4	I should have started saving sooner for my retirement
5	Anything I have for my retirement I have sorted out myself
6	I am putting away as much as I can for my retirement
7	I try to avoid thinking about retirement
8	Pensions are the best way to save for retirement
9	The Government should play more of a role in making sure people have enough to live on in retirement
10	I cant imagine myself as a pensioner
11	It is a good idea to have some savings in a pension so you cannot keep dipping into them
12	Its not worth saving for retirement as I might not live that long

**Q15. Thinking about the kind of pension scheme we've been talking about, if you were to join such a scheme, which of the following investment approaches would you personally be most comfortable with?**

*Please indicate which of the following best applies to you by marking an 'X' in the right-hand column (you may only select one).*

	<b>Mark statement that best applies to you with an 'X'</b>
1	I would happily accept limited gains - and therefore a much more modest pension pot at the end - if it means I have just a small chance of some losses along the way and/or a smaller pot at the end
2	I would happily accept moderate gains - and therefore a slightly more modest pension pot at the end - if it means I have just a medium chance of some losses along the way and/or a smaller pot at the end
3	I would like the chance of higher gains - and therefore the chance of a bigger pension pot at the end - even if it means a high chance of some losses along the way and/or a smaller pot at the end

---

## Appendix C:

### Pension scenarios: relative and absolute loss

Material 3

#### Real-life pension scenarios

- Stewart is 27, married with no children
- He earns £17,500 per year
- In total, **8%** of his salary (£1,400 per year) goes into a pension
- Payments of at least £1,400 per year have been made towards his pension for the last **8 years**
  
- In 3 out of the last 5 years, Stewart lost some of the money he paid in
- So now Stewart is left with **less** money than he has contributed over the past 8 years

Material 3

#### Real-life pension scenarios

- Stewart is 27, married with no children
- He earns £17,500 per year
- In total, **8%** of his salary (£1,400 per year) goes into a pension
- Payments of at least £1,400 per year have been made towards his pension for the last **8 years**
  
- For the first 6 years the pension made gains of at least £75
- But, over the last 2 years, all these gains were lost and no new gains made
- So now Stewart is left with **only** the money he has contributed over the last 8 years

---

## Real-life pension scenarios

- Brian is 42, married with no children
- He earns £21,000 per year
- In total, **8%** of his salary (£1,680 per year) goes into a pension
- Payments of at least £1,680 per year have been made towards his pension for the last **15 years**
  
- From 2002 to 2006, Brian lost some of the money he paid in
- So now Brian is left with **less** money than he has contributed over the past 15 years

## Real-life pension scenarios

- Brian is 42, married with no children
- He earns £21,000 per year
- In total, **8%** of his salary (£1,680 per year) goes into a pension
- Payments of at least £1,680 per year have been made towards his pension for the last **15 years**
  
- For the first 10 years the pension made gains of at least £100
- But, over the last 5 years, all these gains were lost and no new gains made
- So now Brian is left with **only** the money he has contributed over the last 15 years

---

## Appendix D:

Pension investment choices: preferred balance between chances of gain and loss

Material 4

### Investment options

Loss (£)	High chance	Low chance	Medium chance	
Gain (£)	High chance	Low chance	Medium chance	
Description	Highest chance of loss with greatest chance of biggest gain	Low chance of loss with low chance of small gain	Some chance of lost with some chance of modest gain	

---

## Appendix E:

### Pension statement letters

#### Groups A-H

Name  
Address line 1  
Address line 2  
City  
Postcode

Date

#### Personal Pension Plan Statement

Dear Mr Smith;

Scheme Name: Opinion Leader Research Plan  
Plan Holder: Mr John Smith  
Plan Number: 0001

Thank you for investing with Opinion leader. We enclose the yearly statement for your pension plan.

If you want to look at your options further or review the progress of your investment, you should contact a financial advisor.

If you require further assistance, please contact our Pensions Helpdesk on telephone number 020 7861 3952 or e-mail [eimison@opinionleader.co.uk](mailto:eimison@opinionleader.co.uk).

Yours sincerely,



Alan Terry  
Pension Fund Manager

---

## Yearly Statement for your Personal Pension Plan

Your plan aims to provide you with an income during your retirement, with the possibility, if you wish, of a tax-free lump sum. This statement shows what your plan is worth now and the contributions that have been made. Please keep this statement safe.

### Contributions into your plan

Total contributions into your plan over the last 12 months: £1,320

Total contributions since your plan started: £1,320

### Your Plan Summary

Value of your plan now (at 01/11/09): £1,100

Difference between the value of your plan and the total contributions paid into it so far: -£220

This plan is based on an annual salary of £16,500 and a pension contribution of 8% (£1,320) per year

This plan shows an absolute loss of £220 i.e. it is currently worth £220 less than the amount of money that has been paid into it.

Pension plans should be seen as long-term investments, and so performance over the past 12 months should not be seen as a prediction of what could happen in the next 12 months and in future years.

- Your pension at the age of 65 will depend on a number of things, such as how your investment grows, interest rates when you retire and if all contributions are made as planned.
- What you get back depends on how your investment grows.
- Your retirement fund could be more or less than this.

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## Groups I-P

Name  
Address line 1  
Address line 2  
City  
Postcode

Date

### Personal Pension Plan Statement

Dear Mr Smith;

Scheme Name: Opinion Leader Research Plan  
Plan Holder: Mr John Smith  
Plan Number: 0001

Thank you for investing with Opinion leader. We enclose the yearly statement for your pension plan.

If you want to look at your options further or review the progress of your investment, you should contact a financial advisor.

If you require further assistance, please contact our Pensions Helpdesk on telephone number 020 7861 3952 or e-mail [eimison@opinionleader.co.uk](mailto:eimison@opinionleader.co.uk).

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Alan Terry', with a long, sweeping flourish extending from the end of the name.

Alan Terry  
Pension Fund Manager

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### Yearly Statement for your Personal Pension Plan

Your plan aims to provide you with an income during your retirement, with the possibility, if you wish, of a tax-free lump sum. This statement shows what your plan is worth now and the contributions that have been made. Please keep this statement safe.

#### Contributions into your plan

Total contributions into your plan over the last 12 months: £1,320

Total contributions since your plan started: £6,600

#### Your Plan Summary

Value of your plan now (at 31/12/09): £6,660

Difference between the value of your plan and the total contributions paid into it so far: +£60

#### Plan Summary 2005 - 2009

	2005	2006	2007	2008	2009
Amount paid in	£1,320	£1,320	£1,320	£1,320	£1,320
Total value of plan on 31 December	£1,470	£2,940	£4,420	£5,540	£6,660
Gain or loss in the last 12 months	+£150	+£150	+£160	-£200	-£200
Overall gain or loss since the start of your plan	+£150	+£300	+£460	+£260	+£60

This plan is based on an annual salary of £16,500 and a pension contribution of 8% (£1,320) per year

This plan shows an absolute gain of £60 i.e. it is currently worth £60 more than the amount of money that has been paid into it.

Pension plans should be seen as long-term investments. Performance over the past 12 months should not be seen as a prediction of what could happen in the next 12 months and in future years.

- Your pension at the age of 65 will depend on a number of things, such as how your investment grows, interest rates when you retire and if all contributions are made as planned.
- What you get back depends on how your investment grows.
- Your retirement fund could be more or less than the value of your contributions.







## Appendix H:

### Variations on loss by amount, duration and frequency

Material 11

Amount	Duration	Frequency
Lost £1500 in one year	Lost £500 for each of the last three years	Lost £500 for three year out of last five years

Material 11

<p><b><u>Amount – an amount lost over a single year</u></b></p> <p><b>Lost £1500 in one year</b></p>	<p>Discussion points:</p> <ul style="list-style-type: none"><li>• What difference would this make <i>to you personally</i> if the amount was more or less than this?</li><li>• Would your reaction be the same if the amount was £200/£500/£1000?</li></ul>
------------------------------------------------------------------------------------------------------	-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

So, in Bob's case, this would mean that his pension pot would be down from £17,000 to £15,500

<p style="text-align: center;"><b><u>Duration – an amount lost over consecutive years</u></b></p> <p style="text-align: center;"><b>Lost £500 for the last three years in a row</b></p>	<p>Discussion points:</p> <ul style="list-style-type: none"> <li>• What difference would this make <i>to you personally</i> if you kept losing money for less or for longer?</li> <li>• Would your reaction be the same if you lost for 2/ 5/ 7 years in a row?</li> </ul>
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So, in Bob's case, this would mean that his pension pot would be down from £17,000 to £15,500 after 3 years

<p style="text-align: center;"><b><u>Frequency – Loss experienced over a number of years but not consecutively</u></b></p> <p style="text-align: center;"><b>Lost £500 for three year out of last five years</b></p>	<p>Discussion points:</p> <ul style="list-style-type: none"> <li>• What difference would this make <i>to you personally</i> if you lost money more or less often in a given period?</li> <li>• Would your reaction be the same if you lost for 2 of the last 5 years/ 4 of the last 10 years/ 8 of the last 10 years</li> </ul>
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So, in Bob's case, this would mean that his pension pot would be down from £17,000 to £15,500 after 3 years

# Appendix I:

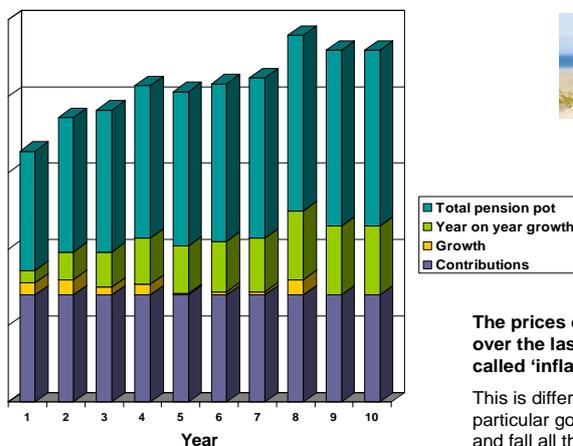
## Inflation loss scenario

Material 12

### Charmaine

- Charmaine is 43, married with 1 child
- She earns £11,000 per year
- Charmaine has always earned about this much – though the equivalent of £11,000 would have been less 10 years ago. It was worth around £9,000
- In total, **8%** of her salary has been paid into a pension for 10 years
- Her current payments, are about £1000 a year.
- Over the last 10 years, Charmaine has seen losses and gains in her pension. Overall, it's now worth a bit more than she put in
- But, because prices have gone up, the money she put in is actually worth less. It hasn't gone up in line with prices.
- That is, she could buy fewer tins of beans with it now than she could with the same amount of money then

Material 12



**The prices of all of the above have gone up over the last 10 years. General rise in prices is called 'inflation'.**

This is different from a rise in the price of a particular good or service. Individual prices rise and fall all the time in a market economy, reflecting consumer choices and preferences, and changing costs.

Pensions should beat rises in prices but, if your pension didn't go up more than prices, would you see that as a loss? As the figure for the last two years of Charmaine's pension hasn't gone down, would you still see that as losing?

---

## Appendix J:

Possible actions that could be taken  
in response to pension statement letters

Material 13

### Stop contributions

You and your employer stop making any payments to your pension fund.

The pension fund can continue to make losses or gains on what you and your employer have already contributed up to now.

Material 13

### Switch funds

You change the type of your pension fund to one with a lower risk of loss.

You and your employer continue to make contributions to this new pension fund. The risk of loss is now less but the potential to gain is also less.

Material 13

### Would not recommend scheme to anyone else

Having learnt about the loss you have made on your pension fund, you decide that if family, friends, co-workers or anyone else asked your advice on pensions, you would not recommend this scheme to them

## Would actively discourage friends from joining up

Having learnt about the loss you have made on your pension fund, you decide to share your experience with your friends, telling them not join up to this pension scheme

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## Appendix K:

### IFA role-play exercise

Material 14

#### Independent Financial Advisor

**An independent financial advisor** is someone who advises people on how to manage their money

- Imagine that you are an independent financial advisor
- It is your job to advise individuals on their pension schemes
- The group you will be advising wants to stop making contributions to their pension scheme
- You are making an argument in support of staying in the pension scheme
- Please discuss together all the reasons that you think might help support an argument for staying in the pension scheme

Material 14

#### Employee wanting to stop making contributions to pension scheme

- Imagine that you are an employee who has just received the letter about the loss to your pension fund
- You decide that you want to stop making contributions to your pension scheme
- You are meeting a group of independent financial advisors who will be making an argument in support of staying in the pension scheme
- Please discuss together all the reasons that you would put to the advisors about why you want to stop making contributions

## Appendix L:

### Scheme manager and member role-play exercise

# Pension Scheme Managers



Imagine you are the **manager** of a Pension Scheme.

You have to look after all the money paid into the scheme, and do what's **best for your members**.

## How will you invest the money?



**HIGH CHANCE** - Highest chance of loss with greatest chance of a big gain.



**MEDIUM CHANCE** - Some chance of loss with some chance of a modest gain.

**LOW CHANCE** - Low chance of loss with low chance of small gain.



**Think of a plan and explain why you made your choice to the members.**

# Pension Scheme Members



Imagine you are a member of a Pension Scheme.

The managers are planning what to do with all the money paid into your scheme.

## How should they invest the money?



**HIGH CHANCE** - Highest chance of loss with greatest chance of a big gain.

**MEDIUM CHANCE** - Some chance of loss with some chance of a modest gain.



**LOW CHANCE** - Low chance of loss with low chance of small gain.



Think of a plan and explain why you made your choice to the managers.