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Dear Sir or Madam

Review of automatic enrolment – initial questions

Introduction

We greatly welcome the focus on engagement in the initial scoping questions of the Government's review of auto-enrolment. We would like to applaud the success of the first phase of auto-enrolment in using behavioural insights to get people to begin saving for their retirement. Automatically opting individuals into retirement saving has worked on an impressive scale. The pensions industry also deserves significant credit for enrolling millions of people and hundreds of thousands of employers into private pensions with few technical problems.

In this initial phase, it made perfect sense to focus on the central objective of enrolling people into schemes selected by their employer and having the funds flow into the capital markets on a timely basis. That being accomplished, one has to acknowledge that many individuals are saving at the minimum level and show little interest or emotional connection to their workplace pension fund, despite its importance for their quality of life in older age. Findings from the Pension Policy Institute[1] show median employee contribution rates in DC schemes are decreasing, with newly enrolled employees generally contributing at minimum rates (giving rise to concerns that they could opt out as contribution rates go up). Furthermore, even contributions through auto-enrolment of 8% of band earnings, mandatory from April 2019, may not be sufficient for people to achieve an acceptable standard of living in retirement.[2] We believe the second phase of auto-enrolment needs to focus on fixing this very different set of challenges, and we welcome the Government's proposal to review this area. We believe this work should be focused on governance, choice and communication, with the overall objective of getting the UK population to feel personally engaged with their pension savings.

We would suggest that there needs to be a wholesale shift in the culture around pension savings. This Call for Responses rightly asks how engagement can drive "greater personal

[1] Pensions Policy Institute. (November 2016.) *The Future Book: Unravelling workplace pensions*, p29. Available online at: http://www.pensionspolicyinstitute.org.uk/publications/reports/the-future-book-unravelling-workplace-pensions,-second-edition-2016 [accessed 22 March 2017].

[2] A median earner contributing 8% of band earnings into a pension scheme every year from age 22 until State Pension age would only have a 50% chance of achieving the same standard of living in retirement that they experienced in working life (using private and State Pension income). (Pensions Policy Institute, *The Future Book: Unravelling workplace pensions*.)

ownership" for pension savers. However, engagement activities alone will not give savers a sense of ownership if there is little transparency and accountability around the exercise of the ownership rights associated with their savings. Individual savers' money underpins the entirety of capital markets but the control of that money sits within a small number of opaque and unaccountable financial institutions. These institutions are not duty-bound to act in the best interests of savers and the incentives that guide their behaviour largely do not encourage them to do so. Most people will be auto-enrolled into DC pension schemes in which they bear the risk and costs of investments. They therefore have a very real interest in their schemes' investments, such as shareholdings in large companies, performing well over the long term.

Despite this, they are not treated as the customers of their pension schemes: they usually have little choice about which provider manages their money, as this is chosen by their employer, and they receive little meaningful information about how their money is invested. They are not able to switch providers (without losing their employer's contribution) and by the time they are in a position to discover poor performance, doing so would no longer be helpful to them. They have no forum for offering comments on how ownership rights are being exercised on their behalf. Even if engaged savers take the time to approach their pension providers to ask direct questions about how their money is being managed, they often receive vague and boilerplate responses that do not give them the answers they seek. We believe that allowing savers the freedom to choose their own pension provider, as in the Australian pensions system, would create a more customer-centric outlook by pension providers and stimulate industry innovation.

The agents who act on behalf of savers are often incentivised to act in ways that do not benefit the long-term interests of either savers or companies. Shareholders have extensive rights to scrutinise company decision-making and hold directors to account for the way they manage their companies, but pension savers have no such right to scrutinise the performance and decision-making of their pension funds. This seems inconsistent given that few investors have their entire life savings in a single company, but many pension savers are reliant on a single fund. We do not suggest that all savers will want to take an active approach to scrutinising and managing their savings. Some will always prefer to pay in their contributions and think no more about it. However, this should be a choice rather than a necessity. In the meantime, the active scrutiny of the savers who are engaged and interested in how their money is managed can provide an important function for the rest of the market by making institutional investors accountable, increasing transparency and helping to engender a culture in which savers' interests are put first.

Automatic enrolment has radically changed the relationship between the working population and its retirement provision, bringing seven million more savers into a workplace pensions arrangement. Through its impressive work on auto-enrolment, the Government has placed itself in an ideal position to shape an industry-led pensions system renowned for its excellent governance, consumer choice and transparency. We strongly encourage the Government to look at a broad and ambitious definition of engagement in this review to create the next, much-needed, shift towards a population of pension savers who are connected to their pension savings and the role those savings play in the wider economy, increasing transparency and helping to engender a culture in which savers' interests are put first.

Finally, we would like to mention that we are about to begin a six-month programme of work focused on barriers to innovation in the pensions industry and we will be pleased to share the findings with the Department in due course.

Theme 2 – Engagement

1. What examples are there of effective communications and engagement tools that have delivered:

a) **sustained workplace pension saving over the long term, and**
b) **increased levels of savings resulting from changing contribution rates?**

Effective communications

Evidence suggests that communicating with savers in a clear and engaging way can increase active participation in pension saving. For example, Heineken ran a concerted and innovative campaign in 2011 to inform members about their new DC pension scheme. This involved a range of communication media including personalised support packs, DVDs, webinars, face-to-face presentations and management briefing packs. 95% of Heineken employees signed up voluntarily, with 97% of those making an active investment choice - an astonishing level given that in most schemes, roughly this many people do not make an active choice.[3]

Nationwide recently used a similar focus on member communications, coupled with a behavioural tactic of automatically opting members in at the highest rate of contributions, to generate a significant increase in contributions. Ian Baines, Nationwide's Head of Pensions, said: "Raising contributions in a short space of time would have caused a negative reaction", so they spent six months "really raising the bar in terms of people's general awareness of pensions." This included running programmes and competitions about how pensions can allow people to live full lives and follow their dreams after retirement, helping individuals to form an emotional connection with their retirement savings.[4]

As a result of this work, Nationwide saw an immediate 10-fold increase in the percentage of members paying more than the core contribution and, a year and a half in, 84% were making additional contributions – up from 9% before the changes were made.[5] Baines commented: "It's important to bear in mind that while providing facts and figures is important it is the emotional button you have to hit. People have aspirations and you can help them tap into that and put plans in place for the future. Such behavioural nudging is so simple but it can work tremendously well. People know that pensions are important but they just need a bit of help in getting things right."[6]

The success of this approach was mirrored by a Quantas campaign that saw 24% of its members responding to make an active choice about their pension (against an average response rate of 6% in Australia). Jane Perry, chief executive of Qantas Super, a superannuation scheme for the Australian airline, told delegates at the National Association of Pension Funds' Investment Conference that segmenting the membership and relating the message to those groups is the best way to reach them in time. Perry said the fund used member interest – in particular its employees' love of travel – to target communications that

[3] HR Magazine. (September 2011.) Available online at: http://www.hrmagazine.co.uk/article-details/heineken-receives-95-voluntary-sign-up-to-dc-pension-scheme [accessed 22 March 2017].
[4] Pensions Insight. (February 2017.) Available online at: http://www.pensions-insight.co.uk/how-nationwide-encouraged-staff-to-pay-more-to-get-more/14747311.article [accessed 22 March 2017].
[5] Engaged Investor. (February 2017.) Available online at: http://www.engagedinvestor.co.uk/how-nationwide-encouraged-staff-to-pay-more-to-get-more/14747311.article [accessed 22 March 2017].
[6] Professional Pensions. (November 2016.) Available online at: http://www.professionalpensions.com/professional-pensions/feature/3000348/how-nationwide-raised-contribution-levels [accessed 22 March 2017].

would drive firm action, running a competition to encourage with a prize of four business-class return flights.[7]

Other tools - increased transparency and aligning pension investments with saver values

The Nationwide programme indicates that feeling an emotional connection with their pension savings may motivate individuals to contribute beyond the minimum levels required. Findings from the Great British Money Survey 2015 indicated that a significant majority of respondents felt concerned about the ethics of where their money was invested, as well as the potential financial risks of investing companies with carbon-intensive business models. 72% of people said they wanted to invest in things that give a good return and don't harm the future, and 70% of people said they would be unhappy if they discovered their money was invested in unethical businesses. 66% of people agreed that investments in fossil fuels are getting more risky, and this rose to over 80% among 18-34 year olds.[8]

Indeed, the increased interest among millennials – those born between 1980 and 2000 – in the real-world impact of their pension investments has been reflected in numerous research reports from BNY Mellon, Schroders, Morgan Stanley and others. The Schroders Global Investor Study 2016 found investors aged 18 to 35 gave environmental, social and corporate governance factors the same importance as investment outcomes when choosing their investments. Global research by BNY Mellon[9] has found that millennials would allocate 42 per cent of their pension portfolio to ethical, impact and social finance, but 95 per cent of millennials surveyed said they were offered only poor and limited options in these areas, or no options at all. The Morgan Stanley Institute for Sustainable Investing found that, compared to the overall individual investor population, millennial investors are nearly twice as likely to invest in companies or funds that target specific social or environmental outcomes.[10]

The research on millennials we mention above is particularly worth noting, as engaging savers early in their working lives should create a greater positive impact on savings over the long-term. The Pensions Policy Institute notes that "early engagement in pension saving can allow more opportunities for preparation and long-term planning. Starting pension contributions at younger ages also makes accruing sufficient savings easier. Compound interest, in which returns are accrued upon contributions and any prior returns, makes contributing from younger ages particularly advantageous. For example, if a 21 year old contributed £50 a month continuously, they could accrue a pot of £135,305 by age 65 (nominal amount, before charges), whereas someone contributing from age 31 would need to contribute 90% more than that amount, £95.42 a month, to accrue £135,305 at age 65".[11]

Legal & General's October 2016 survey found 95% of scheme members would like their employer to provide more communication on their scheme's philosophy, actions, where their money is invested, and the impact it is having. Only half currently believe they receive ample communication. After assessing what choices are important and whether they have been

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[7] Pensions Expert. (March 2015.) Available online at: http://www.pensions-expert.com/DC-Auto-enrolment/Make-it-personal-Qantas-s-key-to-engagement-success [accessed 22 March 2017].

[8] Abundance. (2015.) *Consequences*. Available online at: http://docs.abundancegeneration.com/Abundance%20Consequences%20GBMS%20Report%20June%202015.pdf [accessed 22 March 2017].

[9] BNY Mellon. (October 2015.) Generation Lost. Available online at: https://www.bnymellon.com/us/en/our-thinking/generation-lost.jsp [accessed 22 March 2017].

[10] Morgan Stanley Institute for Sustainable Investing. (February 2015.) *Sustainable Signals*. Available online at: https://www.morganstanley.com/sustainableinvesting/pdf/Sustainable_Signals.pdf [accessed 22 March 2017].

[11] Pensions Policy Institute. (November 2016.) Engagement of young adults with pension savings. Available online at: http://www.pensionspolicyinstitute.org.uk/briefing-notes/briefing-note-85---engagement-of-young-adults-with-pension-saving [accessed 22 March 2017].

given options, 72% consider they would be likely to move or recommend to their employer moving to a responsibly investing pension. 84% would prefer a pension that uses investments to encourage companies to be more responsible. When deciding amongst different pension options, 76% would opt for the one that is a more responsible investor.[12]

Yet individual pension savers are not entitled to receive meaningful information on how their pension savings are being invested and have no right to scrutinise decisions made on their behalf. A June 2015 YouGov survey[13] found that only 3% of those surveyed said that they felt their pension provider listened to their concerns and acted upon them, with 7% saying that their provider responded in a timely manner to their queries. 49% of respondents said that the only communication they received from their provider was the annual statement. Indeed, it is very difficult, or even impossible, for savers to obtain this kind of information even when they directly approach the fund. ShareAction has seen numerous examples of engaged savers actively corresponding with their fund to ask intelligent questions about how their money is being managed and being rebuffed with vague and boilerplate responses. This seems particularly counterproductive given that it would be easy to make pensions seem interesting and relevant to savers' everyday lives by giving them accessible information about the high street companies their money is invested in and the real-world impact their savings are having.

ShareAction has drafted legislation which requires pension schemes to account to savers for their investment and stewardship decisions, and a right for savers to access meaningful information about how their money is being invested and managed. In summary, the legislation would place the trustees or managers under a general requirement to account to their beneficiaries for all actions taken in the performance of their investment functions and to act transparently in that regard. It would require trustees or managers to comply with any reasonable request for information (where information is not readily available elsewhere) made by or on behalf of a beneficiary, including by an independent governance committee, about decisions being made in key four areas: first, the selection, retention and realisation of investments; secondly, the stewardship of investments; thirdly, the selection, appointment and monitoring of investment managers and other agents to whom powers are delegated; and, fourthly, the selection and monitoring of investment funds in which the trustees or managers have invested or are considering investing. We enclose a copy here.

Looking around the world for emerging best practice we see schemes conducting surveys, focus groups, webinars and holding open meetings or AGMs to find out what beneficiaries are thinking. The Dutch ABP scheme, for example, has a participants' council and seats for member representatives on the board but also holds open meetings with beneficiaries to inform the scheme policies, including the responsible investment policies. In 2013, beneficiaries discussed investment questions that ABP faced with staff and trustees at three locations around the country. For example, if a Dutch Pension fund invests in an American company should it support bonus payments that are extremely high by Dutch standards but not unusual in the USA? They reported that: 'Although those opinions were sometimes poles apart, there was always substantial agreement on one thing at the end of these sessions, namely the value of such an exchange of views.'[14]

[12] Legal & General. (November 2016.) LGIM launches multi-factor fund that also addresses climate risk. Available online at: http://www.legalandgeneralgroup.com/media-centre/press-releases/press-releases.asp?newsid=2973 [accessed 22 March 2017].
[13] Not available online but we can provide a copy on request.
[14] ShareAction. (June 2015.) *Realigning Interests, Reducing Regulation*, p38. Available online at: http://action.shareaction.org/page/-/ReducingRegulationReport.pdf [accessed 22 March 2017].

2. In an individual's automatic enrolment journey, what are the most and least effective touch points when appropriate engagement can help reinforce personal ownership of pension saving? What form should that engagement take, who should deliver it and how?

2015 research from Citizens Advice found that while many people find thinking about the future difficult, "serious reflection on pensions choices and financial plans for older age can be prompted and could be encouraged at important financial moments including: claiming or discontinuing a benefit, house-buying, divorce, and changes to employment such as ill-health and early retirement, redundancy or changing job." The report suggested that "organisations that people interact with at these times – including mortgage lenders, employers and welfare agencies – are important potential partners in getting consumers more engaged in pensions decisions at points of other important financial changes in their lives". The report commented that in many cases, this would be a matter of building on the good practice that already exists, such as the impartial pensions guidance offered by some employers.[15]

2016 research by the Fawcett Society supports the idea of there being specific triggers which prompt individuals to start taking pension saving seriously and identified these (with particular application to female savers) as: starting work, age milestones and having children (although this increased costs of childcare could also have a detrimental effect on pension savings for women).[16]

We would recommend that the Government explores ways of using these triggers to increase engagement with pensions: in particular, ensuring that providers and/or employers provide clear, accessible and interesting introductions to pension saving for new employees when they join, especially those who are joining early in their career and being enrolled into a pension scheme for the first time. The website of the Dutch APG scheme provides many excellent examples of how member information can be made engaging, using language such as 'Energy savings equal to the annual electricity consumption of all inhabitants of the city of Utrecht' to illustrate the reduction in the environmental footprint of the scheme's real estate investments.[17]

3. What are the challenges and barriers to sustained or timely engagement for different cohorts and individuals, and how can they be overcome?

We will not answer this question in much depth, as it falls outside of ShareAction's scope. However, we would recommend The Pensions Policy Institute's 2017 report *Consumer engagement: barriers and biases,*[18] which explores the reasons behind people's decisions and the lessons behavioural economic theory offers policy-makers, particularly in relation to engagement in pension decisions. We note that forthcoming reports in this series are due to cover how behavioural interventions might work alongside other policy levers (defaults, compulsion, consumer protection and safety nets) to help people to achieve better outcomes from pensions.

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[15] Citizens Advice Bureau. (March 2015.) *How people think about older age and pensions*. Available online at: https://www.citizensadvice.org.uk/Global/Migrated_Documents/corporate/how-people-think-about-older-age-and-pensions.pdf [accessed 22 March 2017].

[16] The Fawcett Society. (April 2016). Closing the Pension Gap: Understanding Women's Attitudes to Pension Saving. Available online at: http://www.fawcettsociety.org.uk/wp-content/uploads/2016/01/Pensions-full-V2.pdf [accessed 22 March 2017].

[17] APG. (2015.) *Responsible Investment Report.* Available online at:https://www.apg.nl/en/apg-as-asset-manager/vvb2014?overzicht [accessed 22 March 2017].

[18] Pensions Policy Institute. (February 2017.) *Consumer engagement: barriers and biases.* Available online at: http://www.pensionspolicyinstitute.org.uk/publications/reports/consumer-engagement-barriers-and-biases [accessed 22 March 2017].

We would like to highlight one finding in particular from the report, which is that certain behavioural factors (such as inertia, availability heuristics, information overload and risk aversion) can lead to an overreliance on default funds. The report notes that default funds often are the best option for scheme members, particularly if they have been designed with scheme members' needs and risk tolerance in mind. However, they will generally not be the best option for all members, particularly those with higher levels of financial capability. This suggests that different levels of engagement may be appropriate for different individuals, in order to deliver the best outcomes for them.

The report observes that in order to reflect the differing needs of scheme members, some pension scheme providers encourage members to select a level of engagement which is most appropriate to their needs and capabilities. Aon, for example, developed three categories of investor:

- 'Do it for me investor': members who lack the time, ability or simply the desire to make investment decisions for themselves.
- 'Help me do it investor': members who want to be involved in investment decisions but require some guidance.
- 'Give me full control investor': members who want full control over their investment decisions.[19]

We would agree that categorising scheme members in this way makes it more likely that they will receive an appropriate amount of information and will be engaged at the most appropriate level. As we commented in the introduction to this response, we do not suggest that all savers would ever want to take an active approach to scrutinising and managing their savings. However, those who are interested in how their money is being managed should be given the opportunity to take a more active role. We would recommend that the Government explores how employers and providers can take a more nuanced approach to engagement.

4. What are individual attitudes to workplace pension saving and what influences those attitudes?

Not answered.

Summary of recommendations

We would recommend that the Government explores the following as part of its auto-enrolment review:

- Looking at how employers and providers can develop tailored engagement strategies that reach members on a personal, emotional level. In particular, looking at taking a more nuanced approach to engagement, taking account of different areas of interest and knowledge among their employees or members.
- Taking active steps to educate current and future pension savers about where their money goes.
- Giving savers the right to receive a response to reasonable requests for information, including the reasons for decisions made by the scheme. This right should cover information about a scheme's investments.
- Requiring schemes to publish an annual report that sets out: accessible information in plain English on the scheme's equity and other holdings; how decision-makers

[19] Ibid, p34.

have considered an assessment of key strategic risks and how they are being managed to protect members' long-term outcomes; and a clear statement of the scheme's approach to Responsible Investment and good stewardship, and how this approach has been implemented. Requiring fund managers to supply the investment information outlined above to trustees in a short consumer-friendly report, which trustees could put on their website.

- Requiring schemes to have better mechanisms for obtaining and taking account of member views. This would be intended not only to raise levels of member participation and engagement but also to hold providers accountable on the outcomes they achieve for members. These should include:
    - conducting regular surveys of member views on key issues relating to the management of the scheme and investment policies. Giving savers the right to be consulted on key scheme policies, including investment policies, and the right to trigger a review of policies if sufficient numbers request it.
    - mandating member representation on master trust boards and independent governance committees. Any suitably qualified member of a multi-employer pension scheme should be free to stand for election, with the opportunity to do so openly advertised. Member-elected board members should be paid to perform this role and have a legal right to time off work to fulfil their duties as a scheme board member. Employers should be compensated by the scheme for an employee's time spent on scheme business.
    - requiring schemes to hold a well-advertised annual member meeting, facilitating members to attend in person. The meeting should be web-cast so that members can listen and ask questions wherever they live. This would enable savers to ask questions about the management of the scheme and engage in a dialogue with decision-makers.
    - creating a member panel, which scrutinises the management of the scheme. The scrutiny of the NEST Members' Panel extends to facets of the scheme including administration, handling of customer services, investment choices and performance, costs/value for money, confidence of beneficiaries to make investment choices, saver satisfaction with expected levels of retirement income and the amount they actually receive.
- Using the European IORP II Directive as an opportunity to clarify the Law Commission's findings on fiduciary duties in statute - where environmental, social and governance factors are financially material to savers' long-term outcomes, schemes must give appropriate weight to them in investment decisions; schemes may also, in certain circumstances, give consideration to members' quality of life and members' ethical and moral views in their investment and stewardship decisions.
- Consulting on allowing savers the freedom to choose their own pension provider.