Pensions for the Next Generation: Communicating What Matters

This report explores the opportunity to shift the attitudes of young British savers towards their pensions. It proposes easy and low-cost solutions that will help switch millennials on to the power of their savings and the need to start saving enough for retirement today.
Authors

Hannah Gilbert & Bethan Livesey.
Additional research by Nandi de Haas.

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Design by Colette G. St-Onge, ShareAction. Illustrations by Nick Stewart, Hands Up, and Gareth Edwards, Studio ROKIT.

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https://shareaction.org
info@shareaction.org
+44 (0)20 7403 7800

Contact us about this report

Bethan Livesey
Head of Policy
bethan.livesey@shareaction.org
+44 (0)20 7403 7802
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Executive Summary

It is frequently argued that trying to engage people with pensions is a lost cause. People are said to be disinterested and/or incapable of understanding more about their pensions. The low engagement levels of today’s workplace pension members certainly tells us that the ways in which the system is currently seeking to engage them is not working. However, it may not be telling us that engagement is a lost cause. The typical pension communications are legalistic and jargon heavy, and they fail to resonate with people emotionally. Only 19% of UK workers report being happy with the current communication strategies about their employee benefits. But evidence suggests people do care about where their money goes. The pensions industry is missing a trick.

As a result of pensions’ auto-enrolment, millions more people are saving into workplace pensions. Whilst this is a huge success for pensions policy, there is now a next stage goal for policy makers: moving from wider coverage to higher contributions and thus to the promise of decent living standards in retirement for people currently of working age in the UK.

A major new study of pensions across the OECD and G20 countries shows the UK’s system delivering the lowest income replacement levels of any country in the study. In short, contribution levels into workplace pension schemes in the UK are far from where they need to be to support most people to achieve their retirement ambitions.

The aim of this report is to explore what our pension sector might do to encourage higher contributions and greater commitment to saving, especially amongst the millennial generation. We set out a vision for how the pensions sector could innovate to deepen the connection, responsibility and sense of ownership that people feel toward their pensions. It invites policy-makers to refocus attention on the needs and interests of younger savers following a period in which the freedom and choice agenda for those over 55 years of age has dominated pensions policy.

To address the challenge of low contribution levels, the government is introducing higher contributions from both employees and employers from April 2018. By April 2019, the minimum contribution from employees will be 5%, with 3% from employers. There are two potential risks at this next stage of auto-enrolment. The first is that more people opt-out of pension saving as contribution rates increase. If this happens, it will undo some of the early success in driving up coverage. The second risk, in tension with the first, is that mandatory minimum contribution rates, though higher, remain too low to deliver a decent quality of life for UK workers in their retirement.

One way to manage the risk of higher opt-outs is to sell in the benefits of pension saving more actively, in other words to seek to increase people’s engagement with their pensions. The government appears to recognise this opportunity and need to focus on saver engagement. Indeed, member engagement gets attention in the DWP’s recently published review of auto-enrolment.

Seeking to engage people about their pensions is not without its risks. Inertia is undoubtedly a powerful driver and heavily responsible for the success of auto-enrolment to this point. Nevertheless, we believe there are opportunities to get the best of both worlds: higher and rising default contributions, which harness the power of inertia, combined with efforts to support members in developing a “stronger sense of long-term personal ownership” (DWP 2017). Ultimately, it seems right to aspire to the informed consent of members in workplace defined contribution (DC) pension schemes given the inevitable risks they bear in such a product.
It is frequently argued that member engagement is a lost cause. The low engagement levels of today’s workplace pension savers certainly tells us that the ways in which the system is currently seeking to engage them is not working; but it may not be telling us that people are either irrevocably indifferent or incapable. The typical pension communications are legalistic and jargon heavy, and they fail to resonate with people emotionally. Only 19 per cent of UK workers report being happy with the communication strategies about their employee benefits.

The industry is missing a trick. There is substantial evidence that UK pension members, especially younger savers, are interested in the impact of their savings on the world around them.

The UK’s major auto-enrolment providers already have responsible investment policies in place covering their default funds, and many of them are substantially involved in addressing a wide range of environmental, social and governance risks on topics that resonate strongly with UK pension members. To date, the motivation for such responsible investment policies and practices has been better management of long-term financial risks, and this can only be applauded. Nevertheless, it seems that there is a real opportunity to re-imagine pensions communications in ways that take advantage of existing responsible investment practices and lead to stronger engagement with pensions by the
All of the pension providers we examined refer to their online platforms as the primary source of information for members about retirement planning, investment choice and scheme governance. It is troubling, therefore, that we also found only a small minority of members are registered to use their pension providers' websites: active registrations for auto-enrolment pension providers' platforms are typically under 10 per cent (ranging from less than 2 per cent to 20 per cent of members).

Disappointingly, our research finds pension providers to be largely unconcerned about the very low numbers of members actively registered to use the online platforms through which most information about their pensions is made available. We find that other than a welcome pack and annual statement, most pension providers do not actively reach out to members until five or ten years before their retirement date. All of the pension providers we examined refer to their online platforms as the primary source of information for members about retirement planning, investment choice, and scheme governance. It is troubling, therefore, that we also found only a small minority of members are registered to use their pension providers' websites: active registrations for auto-enrolment pension providers' platforms are typically under 10 per cent (ranging from less than 2 per cent to 20 per cent of members).

We also found pensions providers are currently disinclined to survey members about their views on how their money is invested. If pension providers sought to find out what people are interested in, for example through surveys, roadshows or annual meetings, this would equip those providers to communicate in ways that engage their members. Member surveys also offer one of the most obvious ways to support schemes in meeting their fiduciary duties, which the UK Law Commission has clarified includes consideration of members' non-financial interests.

Our research reveals real scope for digitally enabled innovation in the area of pension communication. More than half of millennials want to do their financial planning on a smart phone. Pension providers could invest in digital tools, including apps, to achieve greater engagement and two-way communication with their members. Pensions information could be more available and shareable via social media, allowing people to seek information from colleagues and friends, and to respond to social norms they perceive as relevant to them. Successful apps such as Instagram and Snapchat work through sharing of images. People’s pensions are invested in the real world and there could be associated, shareable imagery for many of these investments. Outside of workplace pensions, there is significant innovation underway in the fintech space, demonstrating how financial services can be made more relevant, empowering, and useable.

Alongside action to engage UK pension members by communicating more imaginatively about the investments in pension providers’ default funds, the pensions industry could also seek to meet the growing public demand to make intentionally impactful investments. Whilst it is not impossible to imagine impact investments being appropriate for default funds of DC schemes, given the immaturity of the social impact investment market, such investments are more likely to be appropriate as an alternative fund available to a member to choose.

However, if pension providers were to launch such pensions with purpose fund choices today, our research suggests that it is unlikely these would secure substantial interest from members given millions of people who have recently been enrolled into workplace schemes.
As a result of auto-enrolment, millions more people are saving into workplace pensions. Whilst this is a huge success for pensions policy, there is now a next stage goal for policy makers: moving from wider coverage to higher contributions and thus to the promise of decent living standards in retirement for people of working age in the UK. The key barriers to successful take-up of impact investment options by members relate to the current failure of the pensions industry to support more people in feeling empowered about pension saving in general.

We recommend that:

- Auto-enrolment pension providers be required to report annually on the percentage of member registrations on, and active usage of, their online platforms. Members who have not registered should be proactively encouraged to do so, and providers should report on their strategies to increase both saver engagement in general and member contributions in particular.

- Auto-enrolment providers seek to engage scheme members by communicating about investment impacts that they know to be of interest to their members. Such communications to members could draw on the responsible investment and stewardship activities that are already undertaken in providers’ default funds.

- Auto-enrolment providers embrace the opportunities posed by digital and social media. Pension providers should seek to present information in visual and emotionally engaging ways. All auto-enrolment providers should have an app and an active digital presence which seeks to make pension saving aspirational and engaging for members.

- Auto-enrolment pension providers survey members for their views on how and where their money is invested. The results of these surveys should inform communications, including tailoring them to members’ specific interests. The results of such surveys should be publicised to members.

- Auto-enrolment providers offer a short list of choices of alternative funds beyond the default fund, using accessible language to describe these options. Pension providers should engage with those members who are interested in achieving deeper social impact with their assets to design a fund option that encompasses social impact investment. Providers should undertake testing to determine how such an option could best encourage higher contributions.

- The DWP should prioritise action to increase pension saver engagement and financial inclusion. This could include exploring the
role of employers in enabling or inhibiting member engagement and the costs and benefits of giving people the freedom to choose their own pension provider. The Minister for Pensions could sponsor an industry-led advisory group on member engagement and financial inclusion to examine mechanisms and policies that could help achieve deeper engagement with pensions, higher contributions, and stronger long-term outcomes for UK pension members.
Background, Aims, and Method

Background and aim

As a result of pensions auto-enrolment, millions more people are now saving into workplace pensions. Government figures show the policy has brought 9 million people into the pensions system, most for the first time (TPR 2017a: 2). It has reversed the decline of workplace pension savings and pulled into pension saving groups of people who were previously missing out. In 2016, 78 per cent of eligible employees (16.2 million people) were participating in a workplace pension, up from 55 per cent in 2012 (DWP, 2017a: 4).

The policy is not perfect. As recognised in the Government’s review of auto-enrolment, there are still significant gaps in its coverage. Workers who remain vulnerable to missing out include those in multiple low paid jobs and people earning less than £10,000 a year. And although auto-enrolment has reduced under-saving from 45 per cent (14 million people) to 38 per cent (12 million people) there is still a way to go (DWP, 2017a: 6). However, in terms of increasing pensions coverage, the policy has been a success.

There is now a next stage goal for policy-makers: moving from wider coverage to higher contribution levels and, thus, to the promise of decent living standards in retirement. A major new study of pensions across the OECD and G20 countries shows the UK’s system delivering the lowest income replacement levels of all the countries examined. In the OECD as a whole, the income replacement rate for retired workers is equal to 63 per cent of earnings; in the UK, this figure stands at just 29 per cent (OECD 2017: 11).

As these OECD figures would suggest, contribution levels into workplace pensions schemes in the UK are low and far from where they need to be to support most people to achieve their retirement ambitions. The aim of this report is to explore what our pension sector might do to encourage higher contributions and greater commitment to saving, especially amongst the millennial generation. We look, in particular, at the potential to drive up saving levels by tapping into people’s interest in the real-world impacts of the investment made by their pension funds during the long journey to retirement, the so-called “accumulation” phase. In doing so, we examine barriers that exist to overcoming the current widespread disengagement of UK pension members with workplace pensions products and providers.

This report sets out a vision for how the pension sector could innovate in ways that deepen the connection, responsibility and sense of ownership that people feel toward their pensions. It invites policy-makers to refocus attention on the needs and interests of younger members following a
The key intended audiences for this report are:

- Policy-makers with an interest in better outcomes for UK pension members.
- Policy-makers with an interest in driving capital towards investments that make a positive impact on lives and living standards in the UK.
- The pensions industry, particularly those involved in auto-enrolment.

In addition, this report should be of interest to UK pension members themselves and to employers contributing into and administering workplace pension schemes.

Methodology

The project builds on the work and relationships that ShareAction has established over a ten year period with a variety of pension providers and industry stakeholders. It focuses on defined contribution (DC) pensions, especially the largest providers in the auto-enrolment sector.

The research included desk research on:

- The legislative and regulatory framework for DC pensions, including the Law Commission’s 2017 report on Pension Funds and Social Investment.
- Surveys of social attitudes to savings conducted by a wide range of pension and finance industry stakeholders.
- The social impact investment space, including the work undertaken by the National Advisory Board on Social Investment and the Advisory Group on Growing a Culture of Social Impact Investment.

This first phase of desk research developed a framework and questions to support primary research including interviews with the following groups:

- Nine large UK auto-enrolment providers.
- Senior HR managers and finance directors from a sample of ten UK employers, including large firms and SMEs.
- Four employee benefits consultancies.

We also drew on a survey of pension savers on the ShareAction database (1015 respondents).

Interviews were conducted on the understanding that respondents would not be named in the report. In this report we use the term “pension provider” to cover all types of scheme in the auto-enrolment landscape, whether set up as master trusts or contract-based schemes.

In the OECD as a whole, the income replacement rate for retired workers is equal to 63 per cent of earnings; in the UK, this figure stands at just 29 per cent.

The OECD

In the OECD as a whole, the income replacement rate for retired workers is equal to 63 per cent of earnings; in the UK, this figure stands at just 29 per cent.
Automatic Enrolment: Where Are We Today?

Auto-enrolment policy is built on insights from behavioural economics, which recognise that people tend to go with the flow of pre-set, default options. The policy, which was designed to reverse the long-term decline in private pension savings, introduced a requirement on employers to enrol employees in a qualifying pension scheme, with a minimum contribution by both employee and employer (see box). Under auto-enrolment, employees can opt-out of the scheme chosen by their employer but usually may not choose a different scheme in which to place their own and their employer’s contributions.

The assumption underlying auto-enrolment policy, namely that people enrolled into a scheme by their employer would tend to stay in that scheme, has proven accurate. Indeed, opt-out rates stand at an average of 9 per cent which is considerably lower than anticipated (DWP, 2017a: 4).

Next step: from broad to deep

However, if we want a pension system that delivers the more ambitious goal of meeting people’s expectations of an adequate income and positive quality of life in retirement, then pensions policy must do far more than increase enrolment into workplace pension schemes. People also need to be saving substantially more into their pension schemes. The Government has acknowledged this and is acting on it: from April 2018, minimum employee contribution will rise to 3 per cent (plus 2 per cent going in from the employer) and in 2019 minimum employee contributions will rise again to 5 per cent (plus 3 per cent from the employer).

There are two potential risks at this stage of the process. The first is that more people opt-out of pension saving as contribution rates increase. If this happens, it will undo some of the early success in driving up coverage. The second risk, in tension with the first, is that mandatory minimum contribution rates, though higher, remain too low to deliver a decent quality of life for UK workers in their retirement.

The minimum contributions made under auto-enrolment are made up of three factors: the member’s contribution, the employer’s contribution, and tax relief.

The minimum total contribution (2%) currently consists of the following:

- Employer: 1% of qualifying earnings
- Member: 0.8% of qualifying earnings
- Tax relief: 0.2% of qualifying earnings

From April 2019, the minimum total contribution (8%) will look like this:

- Employer: 3% of qualifying earnings
- Member: 4% of qualifying earnings
- Tax relief: 1% of qualifying earnings

Some consider 15 per cent of salary a ‘sensible’ contribution target. The Government is prudent to raise minimum contribution levels in stages, but contributions must eventually rise well above the current planned increases. The Pensions and Life Savings Association suggests that contribution levels should be at least 12 per cent of earnings (PLSA 2016: 6), split in some combination of contributions between employee and employer. A range of other expert organisations in the sector cite even higher savings rates as necessary to achieve the income replacement in retirement that people aspire to.
For example, Hargreaves Lansdown considers 15 per cent of salary a “sensible” contribution target (Hargreaves Lansdown 2017).

These aspirations are in stark contrast to the realities for most people. Most newly enrolled workers are saving at the minimum contribution rates (DWP, 2017a: 6). The influx of these new savers has actually brought medium employee contribution rates in the private sector down from 4.5 per cent in 2012 to 2.4 per cent in 2016 (DWP, 2017a: 6). Although DWP figures show that 54 per cent of eligible employees had a contribution rate of 2 per cent or above (DWP, 2017a: 5), under-saving is still a significant problem. Auto-enrolment has reduced under-saving from 45 per cent (14 million people), but it still stands at 38 per cent (12 million people) (DWP, 2017a: 6). And although rates of opting-out have been impressively modest, they are not irrelevant at 9 per cent on average (DWP, 2017a: 4).

The big question for policy-makers is how to ensure opt-outs stay low whilst contributions rise over the next two years. One school of thought, articulated by many in the pensions industry, is that saver inertia should be allowed to continue to do its magic undisturbed. Indeed, DWP recently publicised research that it said showed people would be happy to increase contributions (Phillips 2017). However, an examination of the questions posed to respondents suggests that this conclusion may be ambitious: people were answering the question ‘If both I and my employer increased the amount of money we saved into my workplace pension each month, this would be a good thing for me’ (Ipsos 2017: 3). As argued below, it may be a step from this to people actively contributing more: auto-enrolment itself is based on the insight that people do not always do the ‘good thing’.

It does not seem implausible that ramping up contributions could prompt more people to opt-out of their workplace schemes. Recent research from Aviva shows that 12 per cent of interviewees will consider opting out when contribution levels reach 5 per cent (Aviva, 2017). And research from NOW: Pensions finds that 24 per cent of auto-enrolled member surveyed said they “definitely will” or “might” opt-out when minimum contributions hit 8 per cent in 2019 (Now:Pensions, 2016). Hopefully, a much lower percentage than this will ultimately choose to opt-out. After all, opt-outs in the first stage of auto-enrolment have also been lower than surveys suggested they might be prior to the roll out of the policy. Nevertheless, this is an unsettling finding for policy-makers keen to ensure widespread financial inclusion in the UK’s workplace pensions system.
Auto-enrolment has been introduced during a period of wage stagnation in the UK economy. There are many competing pressures on people’s pay packets including paying off student loans, consumer credit, rent, saving for a deposit on a home, and paying off mortgage debt. For many workers, living costs have been rising faster than earnings, with the result that there is considerable pressure on people’s incomes (MRM 2017). These challenging circumstances increase the risk that people are tempted to opt-out when higher pension contributions start to be deducted from their pay. For many workers, opting out of pensions may mean the difference between paying their bills and falling into debt.

Auto-enrolment’s strength has been that it harnesses people’s strong bias towards defaults, but there are other biases to consider that may influence members’ behaviour. For example, behavioural economists find that many of us have a propensity to focus on avoidance of short-term losses, even at the expense of substantial longer-term gains (Hodgson 2017). We also have difficulty in empathising with the needs of our future selves and we tend to be overconfident when considering the likely level of future retirement income and our future earnings (Spencer, N., Nieboer, J. and Elliot, A. 2015: 21). Once people start to see more money deducted from earnings for their pension, the immediate benefits of take-home pay today could outweigh the longer-term perceived benefits of saving more for retirement.

In summary, there would seem to be a risk that as contributions rise towards a level required for an adequate old age pension, a growing proportion of people opt-out of their workplace scheme.

Increasing engagement levels may help address the risk of opt-outs

One way to manage this risk of higher opt-outs is to sell-in the benefits of pension saving more actively, in other words to seek to increase people’s engagement with their pensions. The Government appears to recognise this opportunity and need, with David Gauke, the former Secretary of State for Work and Pensions remarking in 2017 that the industry should encourage new members to “awaken from inertia at a younger age” (Gauke 2017). Member engagement gets attention in the DWP’s review of auto-enrolment, which looked at “strengthening the engagement of individuals with workplace pensions so that they have a stronger sense of long-term personal ownership and are better enabled to understand and maximise savings” (DWP 2017b). An interesting point made in that review is that “prior to the implementation of auto-enrolment, evidence showed that variation in how individuals think and feel about pensions…were not closely associated with different pension savings behaviours” and attempts to change saving behaviour by increasing engagement had negligible effect. However, the review notes that, in a context in which people are already saving, engagement can play an “important role” to complement an inertia-based approach (DWP, 2017a: 155).

What does an engaged pension member look like?

Engaged members exhibit behaviours such as reading communications about their pension scheme, actively registering on their provider’s online platform, consolidating their pension pots, periodically exploring the information on their provider’s website (including annual reporting and other disclosures about their scheme, its governance and assets), checking on savings levels, increasing (or decreasing) contributions, switching out of the default fund, and seeking to understand how and where their money is invested.
For the purposes of this report, we define engagement with pensions as scheme members taking an active interest in pension saving and developing the capacity for a “stronger sense of long-term personal ownership” (DWP 2017b). Engaged members exhibit behaviours such as reading communications about their pension scheme, actively registering on their provider’s online platform, consolidating their pension pots, periodically exploring the information on their provider’s website (including annual reporting and other disclosures about their scheme, its governance and assets), checking on savings levels, increasing (or decreasing) contributions, switching out of the default fund, and seeking to understand how and where their money is invested. In this report, we consider whether positive associations with pensions could mean that people are less likely to opt-out of the system as minimum contribution levels rise in the next stage of the auto-enrolment journey. The critical challenge is how to engage members effectively, and cost-effectively. We examine possible approaches to meeting that challenge in the next two chapters.

Coupling an active attempt to increase saver engagement whilst raising minimum contribution levels was the approach adopted by the Nationwide Pension Scheme. The Nationwide scheme sought to harness the power of the default by automatically deducting higher contribution levels from payroll. However, they did not do this in isolation. Ian Baines, Nationwide’s Head of Pensions, said: “Raising contributions in a short space of time would have caused a negative reaction”. So they focused in parallel on “really raising the bar in terms of people’s general awareness of pensions” (Jones 2017). This included running communications programmes and workplace competitions focused on explaining how pensions allow people to live fuller lives and follow their dreams after retirement. This approach aimed to help staff at Nationwide form a more emotional connection with their retirement savings. Following this engagement campaign, Nationwide saw a ten-fold increase in the percentage of members paying more than the core contribution. Eighteen months in, 84 per cent of Nationwide scheme members were making additional contributions – up from 9 per cent before the higher automatic deductions were made (Scott 2017a). Whilst some will draw a conclusion from this example that the critical success factor was the higher automatic payroll deductions, in our view it is likely to have been the combination of higher default deductions and a well-designed member engagement campaign.

The freedom and choice agenda has been a major development in pensions policy, allowing people to access their pensions near to retirement and spend or invest it as they prefer, subject to new requirements to secure guidance. It is notable that freedom and choice is predicated on assumptions about people’s capacity to make important decisions. By contrast, auto-enrolment is based on inertia and on decisions being made by others on a saver’s behalf. If the Government is committed to giving people freedom to make investment decisions and choices at the end of their working life, it is arguable that more needs to be done to support people to make better choices when that day comes as a result of being engaged and empowered much earlier in their pensions journey. It is also arguable that the decisions people make during the ‘accumulation’ stage of pensions are more straightforward than those that will face them at decumulation. If people are engaged earlier in their pensions journey, they may feel more capable and confident when facing the more complex decisions at retirement. If this can be achieved, it could support an increase in saving levels (as we will discuss) and help people to make the best possible decisions at, or near, retirement.

It is notable that freedom and choice is predicated on assumptions about people’s capacity to make important decisions. By contrast, auto-enrolment is based on inertia and on decisions being made by others on a saver’s behalf.

There is another argument in favour of action to increase engagement with pensions. In a DC system, the scheme member bears the investment...
risk, and there is no guaranteed income for them in retirement. In these circumstances, it seems right, on principle, that pension providers should seek to inform and educate members as far possible. Inertia has certainly been a powerful lever to bring people into the pensions sector, and will continue to deliver great benefit, but it seems right to aspire to the informed consent of members given the inevitable risks they bear in a DC product. A parallel for this thinking around informed consent is the incoming General Data Protection Regulation, better known as the GDPR. For any organisation to make use of someone’s personal data, this new regulation requires that the person’s consent must be “freely given, specific, informed and unambiguous” (GDPR: Art 4(11)). Whilst acknowledging the power and value of harnessing inertia through defaulting people into pensions, it would seem appropriate for policy-makers to design a system that seeks, as far as possible, to engage and inform members about their pensions, given that money is taken out of their pay cheques and allocated to an equity-heavy investment product whose value may go down as well as up.

It is frequently argued that member engagement is largely a lost cause. People are simply not interested or capable of understanding their pensions, it is often said. But this lack of apparent interest sits in the context of a system that, at present, makes only modest efforts to innovate in the arena of member engagement. For many, the communication they receive from their schemes continues to be legalistic and jargon heavy, with different providers in the market place causing additional confusion by using different terminology for the same features and topics. The low engagement levels of today’s UK pension members tells us that the ways in which the system is currently seeking to engage them is not working; but it may not be telling us that member engagement is fundamentally a lost cause.

Indeed, for some providers, we already see an appetite for innovation. It is these providers who will raise the bar for the industry and wider society. Our research starts from the basis that the current lack of engagement is a springboard for change. We aim to show that there are opportunities for policy-makers and industry in going on this journey, and real benefits to doing so.
Pensions for the Next Generation

What do people say they care about?

If policy-makers want to drive up engagement as a way of helping people connect with, and value, their pensions, it makes sense to look at what people say they are interested in. Numerous surveys show that working people, especially younger people, are interested in aligning their workplace savings with their values.

- 84 per cent of pension scheme members say they would prefer a pension that uses investments to encourage companies to be more responsible (LGIM 2016).
- 68 per cent of 25-34 year olds say it is important that people use their money for the good of society and the wider world (PwC 2016).
- Almost half of people surveyed say they want their pension invested in organisations that reflect their social and environmental views, rising to 55 per cent of the millennial generation (Big Society Capital 2017a: 8).
- 70 per cent of UK adults ‘felt it important for pension providers to invest in companies that concentrate on avoiding unethical practices’ and 49 per cent would like their employer ‘to choose a provider which makes a specific point of investing ethically, even if this fund would achieve lower returns on investment’ (NAPF (now PLSA) 2014: 8).

These findings and survey results highlight what people say they are interested in. In ShareAction’s experience of helping people engage with their pensions, discussions with people about how and where their money is invested can be more interesting and empowering to them than the technical financial aspects of pension savings. However, overwhelmingly, it is the latter type of information that people are given by their pension provider, notably in their annual benefit statements. Nearly half of people, 49 per cent, said the only communication they received from their pension fund provider was their annual statement (YouGov 2015). At the same time, only 19 per cent of workers report being happy with current communication strategies on their employee benefits (Thomsons, 2016: 38).
For most people, saving early is key to a decent pension when they finally retire. Consider a basic rate taxpayer investing £250 a month (along with the tax relief they receive) into a pension fund that delivers 6 per cent annual compound growth until they reach 65. The member who started saving into a pension at age 25 would have a pot worth £622,340, compared to a pot half that size for a person who started ten years later (unbiased.co.uk 2017). The Government’s recent review of automatic enrolment found that of the 12 million people currently under-saving 13 per cent (1.6 million people) fell into the lowest income brackets (earning less than £25,000 per annum) and that 36 per cent of the youngest cohort of members are undersaving (DWP, 2017a: 6). For these people, saving earlier will make pension saving more manageable.

If the value of saving early is clear, the challenge is how to motivate people in their first years in the workplace to attend to pension saving alongside other financial commitments and pressures they will face. One way to distinguish pension saving is to highlight and illustrate the ownership it gives people of real assets, including companies they know by name, whose brands and activities are both visible and meaningful to the member’s day to day life, their community and the economy they are a part of. As discussed overleaf, this approach seeks to help people overcome the behavioural biases we flagged in chapter two.

What is responsible investment?

Responsible investment is an approach to investment which takes into account environmental, social, and governance (ESG) risks. It is characterised not only by addressing these risks in investment strategy, but also by activities such as actively engaging with investee companies on their ESG practices and seeking to steward them over the long-term. Many studies have found a positive link between responsible investment strategies and investment returns. For example, a 2015 meta-study by the University of Hamburg and Deutsche Asset & Wealth Management of around 2,250 academic studies found that ‘the business case for ESG investing is empirically very well founded’ (Friede et al 2015: 210).

Responsible investment by pension schemes: a neglected opportunity for engagement

What if a starting point for communicating with members was information about what happens to the money they are saving and how that money is generating wealth and wider change in the world? The survey results cited above suggest that people could become interested in their savings if these impacts were communicated in an engaging way.

From ShareAction’s work promoting responsible investment strategies in the UK’s pensions sector, we know that many UK pension schemes are already undertaking activities and making investments that align with what people are seeking. In particular, almost all of the UK’s major automatic enrolment pension providers are committed to responsible investment in some form (see box). This is appropriate, as responsible investment is a prudent approach to long-term investment and risk management which should in any case apply to pension scheme default funds (99.7 per cent of members from master-trust schemes and 94 per cent of members of contract-based schemes are in default funds [PPI 2017a: 5]).
The responsible investment activities already undertaken by pension schemes provide an under-utilised opportunity for communicating with members about themes that interest them and might help them feel a more emotional connection to their pension. Such a connection may help people to overcome some of the barriers posed by the difficulty of connecting with pension saving, for example its perceived irrelevance to present day concerns and its complexity.

Big Society Capital’s 2017 research showed that pension members care about many of the issues that would be covered by any robust responsible investment policy. Examples of such issues include companies’ activities in respect of tax planning (54 per cent of pension members expressed interest in this topic); whether companies are paying the Living Wage (39 per cent) or zero-hour contracts (34 per cent) (BSC 2017a:10). If providers are addressing these types of concerns in their responsible investment practices, they already have a body of work to draw on in seeking to engage the members of their schemes.

NEST is a good example of an automatic enrolment provider with a substantial level of activity underway that is driven by its responsible investment policy. NEST’s external asset managers undertake some of this activity, and some is undertaken directly by NEST staff. NEST prepared an extensive, impressive responsible investment report in 2017 (NEST 2017). However, it is still presented in a rather formal way. Overall, the activity NEST undertakes to ensure that the companies in its portfolios manage ESG risks well, and operate ethically, is not a visible part of NEST’s communication to its members. NEST’s responsible investment activity is motivated by a desire to protect the best financial interests of NEST’s members, which is excellent. But the opportunity to engage NEST’s members about what happens to their money in more accessible, visual and emotionally satisfying ways has yet to be grasped.

Innovations in communication to members

We believe there is real scope for innovation in the way DC pension schemes communicate with their members. Information on responsible investment could be fed through to members in ways that can be quickly absorbed and link directly to smartphone enabled opportunities to raise contributions on an ongoing or one-off basis.

Behavioural theory suggests that effective communication helps people engage emotionally with information (Klontz 2017). Evidence also suggests that younger members want information to be conveyed to them by digital means (YouGov 2017: 24). We believe the UK pension sector’s work on responsible investment could form the basis for more engaging and personalised communications with members of schemes, based on members’ profiles, characteristics and

Case study: NEST’s Delivering Change 2017 Report

NEST’s second annual responsible investment report includes information on its approach to ESG risks and members’ wider concerns, for example, how NEST’s corporate voting and engagement supports better corporate performance. The report highlights some key voting measures in relation to executive pay and climate related risks. For example, NEST voted against the executive pay policy at Shell as they felt that Shell did not fully meet the terms of the shareholder resolution in 2015 relating to executive incentives. In terms of influencing industry behaviour, NEST describe working with fund managers to exclude controversial weapons. NEST also share a case study of how they sought to integrate ESG into their high yield bond procurement with J.P Morgan. NEST outline future priorities for their work.
stated preferences. That need not require pension providers to invest differently, though being a best-in-class responsible investor is likely to help. Rather, what we propose is that pension providers communicate with their members about the issues that matter to them based on investment activities that are already part of what the provider is doing. Visual presentation of information about the assets people own and the stewardship underway to protect those assets, combined with the use of digital push notifications on pensions apps, could transform the way people engage with pensions.

Areas for development

More than half of millennials want to do their financial planning on a smart phone (Dilworth 2017). Pension providers could explore making use of digital media, particularly on phones, for communication with members, for example:

- Visual imagery: Successful apps such as Instagram and Snapchat work through sharing of images. People’s pensions are invested in the real world and there could be associated imagery for many of these investments. Triodos Bank already explores this through its ‘Know where your money goes’ map and pictures (https://www.triodos.com/en/about-triodos-bank/know-where-your-money-goes/)
- Legal and General Investment Management’s ‘Future World Fund’, a multi-factor global equities index fund that incorporates a low carbon ‘tilt’, is available as a default fund option. This fund seeks to actively manage climate risk and makes higher allocations to positive green investments. LGIM has sought to communicate the aims of this fund in a clear and visual way through videos (http://update.lgim.com/futurefund).
- A neat example from the retail investment world is the WHEB impact calculator for their Sustainability Fund. Investors in this fund can enter the value of their investment and the calculator will use infographics to show the positive energy, waste and water impacts resulting from their investments over the past year (WHEB 2017).
- Many younger people seek news and information from peers and via social media. Evidence shows that they are more likely to talk to friends and family before making financial decisions (YouGov 2017: 25). This suggests that pensions information should be more available and shareable via social media, allowing people to seek information from peers and to respond to social norms they perceive as relevant to them.
- The ‘tomorrow’ app (tomorrow.me) brings together important but often difficult areas of planning for families and makes them possible within one app. Available in the US, it allows people to create a will, buy life insurance, and set up trusts. The app also includes help with financial planning. Like pensions, these are tasks that people often put off, despite recognising their importance.

Case study: Mercer’s personalised videos on pensions

Mercer has been working with a number of employers who are committed to engaging their staff more actively about their pensions. As part of this, Mercer has been testing personalised videos, which arrive in staff members’ inboxes and can be read either at their desk or on their phone. These 90 second videos provide tailored information on exactly how much the saver and their employer has contributed over the year, and what kind of life-style in retirement that is likely to deliver. The video ends with an immediate opportunity to take action by setting up a higher contribution level. The results have been striking: 65 per cent of employees sent a personalised video clicked and viewed at least some of it; of those who did, 45 per cent clicked to take action after watching.
• In the energy sector, another area that has had high levels of disengagement, renewable energy supplier ‘Ecotricity’ sends emails to update customers on the tangible impacts of their money, for example emails headed ‘You built this!’ to detail new wind farms.
• Innovations in apps for personal finance include Moneybox, which allows people to round up the change from purchases and sweep the extra over to savings. Engaging people with their pension savings in this way could regularise people making small additional savings, allowing people to build up to higher contributions at times when they can afford it, and keeping pensions in mind on a more regular basis. Providers could send positive stories relating to investments through as app notifications with a nudge to make a small one-off contribution. Only two of the nine large UK pension providers we interviewed have an app of some kind, and these apps had low user ratings.

Communicating through the lens of responsible investment would not involve a radical shift in activity by the large auto-enrolment pension providers, but it would involve a shift in mindset about interacting with members. A further potential benefit of making this effort would be the scope to increase trust in a widely distrusted area. Many consumers feel frustrated and apathetic towards big business and financial services firms (PwC 2014 and Edelman 2017). “Greater transparency on products and services” scored most highly (46 per cent) as a mechanism to rebuild consumers’ trust (PwC 2014). Pension funds invest in companies whose operations impact communities, consumers and employees in ways that can be positive, negative or neutral. By responsibly investing its funds, a pension provider can drive real-world positive changes in investee companies, build greater trust in its own brand, and support people in building up bigger pension pots that meet their retirement aspirations.

The above suggestions are currently far from the norm in the pensions sector, albeit there is anecdotal evidence that providers are starting to look harder at the challenges around saver engagement. Our research found that, other than the welcome pack and annual statement, most pension providers do not actively reach out...
to members until five or ten years before their retirement date. If written annual statements are the main source of communication people have with their pension provider, it is perhaps not surprising that many have not switched on to the importance of pensions. The information in such statements, and the language, is generally complex and technical and thus difficult to engage with. Whilst the information provided may be important, it is not hooking people in to their pension. People find financial projections hard to connect with, and research shows that people do not easily relate to an unknown, intangible future self (Spencer, N., Nieboer, J. and Elliot, A. (2015); PPI 2017b: 16). There is very limited emotional ‘pull’ to the information on the annual benefit statement, even though behavioural science suggests connecting emotionally is an important factor in getting people’s attention.

Pension providers do provide digital information. All of the pension providers we spoke to refer to their online platforms as the primary source of information for members about retirement planning, investment choice and governance of their schemes. In effect, the online platform is the key portal to member engagement. It is troubling, therefore, that we also found only a tiny minority of members are registered to use their pension providers’ websites: active registrations for pension providers’ platforms were typically under 10 per cent (ranging overall from less than 2 per cent to 20 per cent of members). One pension provider was unable to tell us what proportion of members had registered on its site.

Finding out what people care about

One significant step forward would be if pension providers sought out what savers are interested in, for example through surveys, roadshows or annual meetings. This would mean they are better equipped to communicate to people in a way that engages them. Master trusts are required by law to have processes to understand members’ views (although this is not specifically related to investment matters) (Regulation 29, Occupational Pension Schemes (Scheme Administration) Regulations 1996).

It is also, arguably, one of the most obvious ways in which a scheme can meet its fiduciary duty, which the UK Law Commission has clarified includes consideration of wider ‘non-financial’ concerns (Law Commission 2017).

Throughout our interviews, a recurring theme put forward by interviewees is that only a minority of members care about where their money is invested. However, this did not appear to be based on any analysis of what members had to say. None of the pension providers we interviewed regularly surveys members for their views on how and where their money is invested, although one had done so in the past year and another had done so in relation to its ethical products. Six of the providers we interviewed have put in place either customer panels or member forums in which a range of topics are discussed, but none of
These discuss how and where members’ money is invested as a standard agenda item.

It is difficult to argue that a survey from a pension provider will lead to greater engagement, given that current low levels of engagement probably mean that many people will not complete it, whilst those who do may not be representative of the members as a whole. However, ways to address this hurdle may be by working initially with focus groups or encouraging employers to survey their staff. The employers we interviewed stated that they do not survey staff for reasons including concerns around cost; a view that investment choice is personal; and an expectation that they would not be able to achieve consensus amongst their staff as to what issues are the highest priority. Four of the seven small and medium employers we interviewed felt that if they did survey staff, and thus awaken appetite within staff for investment choices aligned with their personal values, the employers would not be able to meet that demand as pension providers would not be interested in their views. We are not aware of any mechanism for employers with the same pension provider to identify and connect with other employers who may share the same interest. If there were such a mechanism, the benefit would be that pension providers and employers could more readily identify themes that support member engagement.

At the employer level, even large employers with several thousand employees consider it too difficult to segment people around thematic areas of interest. However, as research shows, people’s interests can coalesce around certain high level themes. This is evident in separate research by Big Society Capital and Ethex into what people care about in terms of how their money is invested:

<table>
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<tr>
<td>health and social care (48%)</td>
<td>improving health and social care (31%); old age support (26%)</td>
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<tr>
<td>environmental projects (44%)</td>
<td>protecting the environment (24%); renewable energy (23%)</td>
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<td>national infrastructure (41%)</td>
<td>affordable housing (20%)</td>
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Table 1: Summary of key trends in what people say they care about in investment

Surveying people based on the Sustainable Development Goals (SDGs)

One existing framework which may provide a rationalised way to seek members’ views is the UN Sustainable Development Goals (SDGs). Some of these 17 goals could provide a taxonomy that is accessible to members. It would not be necessary to cover all of the goals, but a provider may wish to choose a number which already fit with its investment priorities. The SDGs are increasingly being used in pensions investment. For example, Dutch pension fund managers PGGM and APG Asset Management have developed taxonomies to identify investment opportunities that will deliver financial returns and tangible progress towards the SDGs. Other asset owners, including Swedish and Australian funds, are collaborating with PGGM and APG as they move from investment principles to develop a common process and language to report on measurable impacts (Rundell 2017). It seems likely that the SDGs will increasingly become part of the way in which investment is characterised and impact is measured. Talking to members about the SDGs and seeking to understand which of these most interest individual members could be a valuable engagement tool.

Members’ thematic preferences could also form the basis for disclosure of stewardship and voting activities. For example, imagine a survey of members in 2018 asks them which of four SDGs they are most interested in and a member picks one on gender equality. In 2019, when the pension provider sends information to that member, it could be framed through the lens of ‘you said you cared about gender equality: here’s what we’ve been doing recently as an investor to promote gender diversity on boards and through company operations and supply chains’.
The type of information conveyed would not necessarily involve additional activity (for a pension provider that is already undertaking responsible investment) but it would use narratives that have greater resonance with members.

The wider value of survey evidence

In response to the idea of surveying members, some people we interviewed asked what providers are supposed to do with results. First, there is no expectation that providers should be beholden to members’ views: trustees, in particular, are afforded wide discretion in law to make decisions in the interests of members. But beyond tailoring communications in a way that could be meaningful for members, survey results also have value in informing providers’ approach to investment and active ownership. They could also, as we will discuss later, help providers design alternative choices of funds that will encourage members to save more. Three-quarters of members surveyed by ShareAction said neither their employer nor their pension provider had asked for their opinion on how and where their savings are invested. It cannot be said that all people will express an interest in an area covered by responsible investment. For some people, this will not be a switch-on. However, for these people there may be other areas which would help them build an emotional connection to saving, such as their personal retirement plans. The key is seeking to understand what people engage with and how their pension can be better framed to communicate with them in these terms.

Barriers to change

In the current auto-enrolment system, the employer makes all key decisions about the workplace pensions: choosing the provider, choosing the default fund, and setting its contribution rate (subject to statutory minimums). This sends a signal to members that their employer ‘has it all covered’ and has made the best choice for them. This may lead people to underestimate the importance of taking responsibility for their retirement and for finding out more about their pension. Our research found that, when it comes to better communication, many employers currently feel inhibited:

- The majority of the employers we interviewed felt pensions are a personal issue for employees. Whilst larger employers said they felt responsible for providing generic information on risk and return and the benefits of saving early, none of the four smaller employers we interviewed considered it their responsibility to raise issues concerning retirement saving at all.
- None of the employers, large or small, felt that it was their place to discuss how and where pensions are invested.
- The majority of the employers expressed caution about communication that may be construed as giving financial guidance or advice. This reflects the FCA’s finding during its Financial Advice Market Review of “a broad misconception that employers will be exposed to regulatory liability if they offer support to help their employee” (FCA 2016: 43). The finance director of one medium-sized employer expressed frustration that their company is restricted from talking to staff about pensions even in general terms.

Employers may have selected a DC contract-based scheme for auto-enrolment in order to stay
at arm’s length from governance of pensions. We identified contract-based providers who positively sell to employers how little responsibility or role they will have in a contract-based scheme.

If employers do not see it as their role to communicate about pensions, or are nervous in so doing, they are highly unlikely to transmit demand for information about pension investments to the providers. We found that pension providers and employee benefits consultants focus on providing whatever the employer wants (at a cost). They are not seeing demand for more, or different information about investments from employers. If employers’ uncertainty about, or disinterest in, communicating on pensions means the providers of pensions pay little attention to how they might better connect with scheme members, then this is a real problem.

The employer and responsible investment

As highlighted earlier, pension providers we interviewed have policies, albeit of variable quality, on responsible investment. However, our research also showed that this is not a topic that is emphasised to either employers or members. Given their lack of exposure to investment risk (in DC schemes) it is perhaps not surprising that employers lack interest in risk management tools, such as responsible investment. However, this becomes a problem when employers are the effective conduit for demand to providers. It results in little incentive for providers to innovate or excel in this area.

Most employers we interviewed felt that scheme procurement and administration of the scheme was the limit of their role. Investment strategy or choice is considered the provider and the member’s responsibility.

Most employers we interviewed felt that scheme procurement and administration of the scheme was the limit of their role. Investment strategy or choice is considered the provider and the member’s responsibility. We identified a widespread lack of awareness among employers about whether responsible investment is applied to the default fund of their pension provider.

For all these reasons, it seems that employers are not yet an effective conduit to transmit demand for responsible investment, or information about it. This is regrettable because there is good evidence that, where employers do take an interest, it drives attention by providers to these issues and opportunities.

The wider barrier presented by employers

This goes to a wider issue with the current pension system. A recurring theme in our research was the employer’s role in the way in which members perceive and interact with their pensions. For example, with the exception of a select group of particularly ‘enlightened’ employers, the employer may be a barrier to:

- communications between members and providers;
- members understanding their responsibilities in relation to pensions (they assume that their employer has got it ‘all covered’); and
driving and transmitting demand for innovation in terms of responsible investment and alternative investment choices.

Our findings align with those of the OFT in 2013 when it reviewed the DC workplace pension market and found that the buyer side is one of the weakest it had seen and that “many employers lack the capability and/or the incentive to ensure that members of their schemes receive value for money in the long term” (OFT 2014: 14). Whilst some employers provide their employees with good pension provision and take an active role in driving up engagement and saving, many lack the capacity or incentive to do more than act as an administrator of contributions from payroll.

The most important considerations for employers when choosing a pension for employees as found by Pensions PlayPen, and reinforced in our research, are: ease of set-up (for example, integration with the payroll system); cost to the employer and the member; and quality of customer support for the employer (Pensions PlayPen 2016). Large employers may have in-house pension managers, with investment expertise, human resources and external consultants to advise them on pensions or even to design bespoke pension arrangements for them. However, small and micro employers may be no better informed than their employees. For most such employers, auto-enrolment is a compliance issue, with one small employer remarking “the accountant told us which one to go for”. Another small employer we interviewed expressed exasperation at trying to deal with their pension provider, but did not have the time to investigate other options further.

What matters to employers picking a pension provider for their employees?

- Ease of initial set-up
- Cost to employer
- Cost to member
- Support to employer as client

None of the employers we interviewed said their pension scheme currently played a role in talent engagement or retention. Two large employers expressed disappointment that their pension is not a benefit valued by employees, and another employer remarked staff “would rather have a gym membership”. If a benefit is a cost to employers and is not perceived as being valued by employees, an employer is likely to select a low cost plan that causes the least amount of hassle to the organisation.

Only half of the employers we interviewed intend to review their pension provider periodically, and none of the small employers. A typical response was, “we would consider it if our staff were unhappy”. However as only two of the employers we interviewed surveyed their staff about their pensions it is not clear how they would be able gauge their employees’ satisfaction or otherwise. This lack of switching, as found by the OFT, creates a complacent market, with little incentive for providers to compete to offer better terms to employers.

In the current system, an employer has a huge amount of power over their employees’ pension. But the above suggests that many do not recognise this. Furthermore, as we have explained, few employers saw assessing providers’ investment strategy or investment choice options as part of their role. As the employers are the customers of the providers, this presents a significant blockage to members engaging with their pensions and to the transmission of demand for more innovative pensions. A further barrier may be the number of employers, and therefore pension providers, people will now accumulate over their working career. With a number of small pensions, it takes longer for a member to build up a sizeable sum with any one provider that may incentivise the member, and the provider, to value the relationship.

Where employers do take steps to help employees understand and engage with their pensions and, in particular, where they push for investments
that align with their corporate mission (such as HSBC and LGIM developing a low-carbon fund for HSBC’s employees), this should be championed. But a more radical option could be explored: allowing people to select their own pension provider. Just as an employee chooses which bank their salary is paid into, it may be beneficial to allow them to select their pension provider. It would, of course, still be necessary for employers to provide a default auto-enrolment option for employees who do not choose their own, but allowing a new employee to keep an existing pension provider when moving jobs may allow them to build a significant pot size faster, and to develop a ‘stickier’ relationship with the provider, rather than having a number of different providers throughout their career. It could also shift the balance in the sector from the provider building a relationship with employers, who may not act in a way consistent with a member’s best interest, to the provider being incentivised to think about what the member actually wants.
Pensions with Purpose

The rise of social impact investment

As described earlier, there is strong and mounting evidence that people care about how their money is invested. Many want their money to have a greater positive impact on the world around them. The government is also interested in this area, having commissioned a study and report into ‘Growing a Culture of Social Impact Investing in the UK’ from an advisory board led by Elizabeth Corley (DCMS and HMT 2017a). The then Economic Secretary to the Treasury, Stephen Barclay MP, welcomed this review, stating that “[t]he market has enormous potential, but we need to make it easier for people to make a social impact investment” (DCMS and HMT 2017b). There appears to be political will to enable people to invest their money in line with their values.

If pension providers adopted all the proposals outlined so far in this report, they would not yet be giving members the more ambitious social impact investing options for which there appears to be increasing demand. There is an appetite from some people to go beyond conventional responsible investment, with its focus on ESG factors. For a minority, but not a small minority, there is a desire to embrace the possibility of a social objective as well as a financial one, even if this means accepting greater risk or lower returns. This chapter looks at how the UK’s pensions industry, focusing on auto-enrolment providers, might look to meet that demand. As in chapter three, we look at the opportunity this presents for the development of a stronger culture of saving in the UK, with more people feeling a sense of pride and ownership over the investments in their pension. Our suggestions could lay the foundations for the “Pensions with Purpose” for which the UK National Advisory Board on Impact Investing advocates.

Impact Investment and the UK National Advisory Board on Impact Investing have clarified some of the realities and challenges in this area. Both bodies have considered the role, risks and potential for social impact investing across a number of sectors, including pensions.

The Advisory Group’s recommendations convey a sense that much remains to be done to develop the social impact investment market, and wider understanding of it, before it can be considered mature. The Group’s recommendations seek to grow the market, develop credible financial products, deepen understanding of impact investing amongst investment sector professionals and regulators, and to create the clarity, consistency and information-flow needed to support success. In the pensions context, the Advisory Group’s report cites surveys showing that trustees have concerns about moving towards greater integration of social impact investments (DCMS 2017a: 15-18). Trustees are concerned about:

- Meeting other legal and regulatory requirements such as auto-enrolment, which means that social impact investment is not a high priority.
- A lack of information on social impact investment risk and returns, as well as of demonstrable social outcomes.
- Pension trustees’ investment advisers lacking expertise on social impact investment.

Developing impactful pensions

As interest in impact investment grows, experts have been examining how pension schemes might support and enable it. Both the Government’s Advisory Group on Growing a Culture of Social Impact Investment and the UK National Advisory Board on Impact Investing have clarified some of the realities and challenges in this area. Both bodies have considered the role, risks and potential for social impact investing across a number of sectors, including pensions.
Social impact investments are intended to generate positive social or environmental outcomes (impact) as an explicit priority, not an incidental corollary, alongside financial return. Impact investors use the concept of a total blended return, a blend of the financial return and the non-financial impact. Whilst an impact investment does not necessarily require some degree of sacrifice of the financial return, many impact investors accept the possibility or greater risk of diminished financial return, which may arise because of the greater complexity in their supply chain or target market.

The Friends Provident Foundation is leading in social impact investment, particularly in the community energy sector. For example, it invested £100,000 in a community share offer in Awel Co-op. This is a 4.7MW two wind turbine project that is wholly owned, controlled by and benefits the local community in an area of high social deprivation. Over the project’s lifetime, it is expected that £3 million will be given to Awl Aman Tawe Charity to alleviate local fuel poverty.

- Confusion around fiduciary duties and what the law allows trustees to do.

In response to the latter, widely acknowledged, concern, the UK Law Commission has sought to clarify that fiduciary duties of trustees do not require the maximisation of short-term returns. In its 2017 report, it concluded that the key barriers to social impact investment by pension funds are not legal or regulatory, but are structural and behavioural (Law Commission 2017). The law allows trustees to make social impact investments so long as they meet a two-part test that:

- the trustees have good reason to think that scheme members share the relevant social concern (amongst themselves); and
- there is no risk of significant financial detriment to the fund.

Social impact investment could be a fund choice

When considering how to deliver social impact investment in the context of a DC pension, there are two main options: introducing social investment as part of the default fund or alternative choices of funds available to members. As of today, it is unlikely that many social impact investments are appropriate for the default funds offered to DC members. A default fund is designed to be the best option for the majority of members in a scheme. It is also subject to a charge cap (currently set at
0.75 per cent of fund assets). The charge cap was cited by our interviewees as a practical barrier to social impact investment. For example, Columbia Threadneedle UK Social Bond has an annual management charge of 1.3 per cent and a total fund charge 1.38 per cent. This is not to say that it is impossible that a social impact investment could be included in the default fund: it might be that an investment in, for example, social housing or green infrastructure, is a prudent part of the diverse portfolio making up a default fund. However, any allocation to such investments should be made on the basis of financial considerations, and not principally motivated by the desire to achieve a wider social impact.

The Advisory Group appears to share this caution. Its report is nevertheless optimistic that, as understanding amongst trustees and employers grows and the track record for social impact investment is established, these products may become part of default funds (DCMS and HMT 2017a: 6). The UK National Advisory Board recommended ‘Pensions with Purpose’ products which would combine responsible investment practices across the entire portfolio with a small proportion of investment (5 to 10 per cent) allocated to social impact investments which target competitive risk-adjusted returns. It suggests that, once the market has matured, there could be scope for inclusion of such products as part of the default fund, but also recognised that, at present, this would generally not yet be appropriate (UKNAB 2017).

Social impact investment as an alternative choice of fund

A further consideration is that, although there is demand for impact investments, this is not a majority interest. A survey for Good Money Week 2016 found around one in four people (23 per cent) would like to invest 10 per cent of their pension in impact investment (Good Money Week 2016). This is not insignificant, but it does not represent the majority of the market for whom the default fund may be most appropriate.

Although real demand exists, it is certainly not universal, and there is a well-known gap between what people say in surveys and how they then act. This points to impact investment options outside the default fund as the most appropriate way forward. This would preserve the default fund for the majority who are not especially interested in social impact investing. However, it is entirely possible that as people’s engagement with pensions increases (for example through the types of communication we propose in chapter three) and as the social impact investment sector matures, there will be greater scope to include impact investments in default funds.

Barriers to switching funds

Today, very few people in a DC pension scheme make an active fund choice beyond the default. Many of the pension providers ShareAction interviewed point to the high numbers staying in the default fund as evidence that people do not feel strongly about how and where their money is invested, despite what they say in surveys. However, we found that this action gap may reflect disengagement with pensions generally. Nearly 40 per cent of the 1015 members surveyed by ShareAction have considered switching to a fund other than the default fund. Half of those members went on to do so. Of those that did not switch:

- More than half (54 per cent) said that they could not easily find how to on their provider’s website.
- Nearly one in four people (23 per cent) said the process was too long.
- Nearly half (48 per cent) could not find an option that they liked.
- Nearly a third (30 per cent) were concerned that they would make less money.
- 10 per cent were put off because the other options cost more.
- 15 per cent were advised not to switch.

For all but two of the pension providers we interviewed, a member would only find out about alternative fund choices through the pension provider’s online platform. None of the pension providers we spoke to actively reach out to members to notify them that there is the possibility of making an alternative choice to the default fund. We know from our research that less than 10 per cent of auto-enrolled members have registered on
their pension provider’s platform. If that is the only way to make a fund choice, then more than 90 per cent may be in the default as they are simply not aware of the alternatives.

For a pension saver to select an alternative fund they must first become aware of an alternative’s existence, then decide to make an alternative choice and settle on which of the available alternatives to choose. Our research suggests that people are stumbling at the first hurdle. There are also strong behavioural biases which may prevent a member from making a switch. For example the fact that the member’s employer chooses the pension provider signals to the member that their employer has ‘got it all covered’. Research conducted by the Centre for Risk & Insurance Studies at the University of Nottingham found that the “default fund is an obvious choice for the uninformed member, as it is seemingly endorsed by the sponsoring employer or pension plan provider and helps simplify an otherwise complex decision” (Byrne, A, Blake, D, Cairns A and Dowd, K 2006: 3).

Before introducing a ‘social impact investment fund’ as an alternative option in the current system, some very basic barriers would need to be addressed. First, barriers around communication and engagement would need to be overcome. The presentation of a social impact option could most usefully happen in the context of an increased push to engage members about pensions in general, and to communicate the impact their money has. As described above, this could be part of a process of better communicating the responsible investment practices in the default fund.

Current practice in terms of presenting alternative fund options is failing to engage members. Whilst some providers offer a single default, others have a long list of alternative funds members can choose. Behavioural theory suggests that complex ‘choice architecture’, including too many choices, can lead to paralysis which prevents people from making decisions (PPI 2017b). Different providers present and label their options differently, but they often include references to different funds and managers in technical language. The choice architecture is frequently far from conducive to enabling active choices. In our research, a senior fund manager recounted how they gave up trying to navigate their pension provider’s website to switch funds.

In terms of the content of choices available, most providers offer some sort of ‘ethical’ option, which is not the same as a social impact fund. Ethical funds emerged as a response to investors seeking to align their investments with moral views, and most ethical funds are designed by screening out sectors and stocks. However, the assets frequently screened out do not fully align with contemporary concerns about investment. Frequently they screen out tobacco and alcohol but not fossil fuels, whereas many younger members are more concerned about coal than gin. Furthermore, these funds are not designed to encourage the purposefully positive impacts that investments can achieve.

In order to reach a position where a social impact fund is a credible option, the pension industry would need to embrace not only improved engagement, but increased innovation.

What would a social impact option look like?

Through the types of policies for which we have already advocated, for example surveying members, pension providers can build a picture of their members’ concerns. A social impact option should reflect what members say they want, otherwise it will not be of interest to them. During our interviews we frequently heard that savers have diverse concerns and it is therefore impractical to develop funds that address these. In practice, people’s concerns seem to coalesce...
around some distinct themes (as discussed above). Through better surveying of members, pension providers could actively seek to find common themes. As we have already suggested, the taxonomy provided by the SDGs may be a way to filter interests into themes, although there would be no expectation that a fund option address every possible interest. Pension providers could intentionally engage members in the process of designing a social impact option and then undertake product testing to determine factors like the best way to make people aware of the fund, how to support switching and how best to encourage increased contributions off the back of such switching.

When designing such a fund option, consideration needs to be given to the protections offered to the member. It must not be the case that a member choosing to leave the default fund is no longer protected by good governance and costs management. The obligation to act in the best interest of members (for trust-based schemes) and to treat customers fairly (for contract-based schemes) must be reflected in proper governance and cost control across all alternative options. This is another argument in favour of limiting the number of fund choices, whilst making sure such choices reflect the expressed views, preferences and priorities of a particular scheme’s members.

One possible model for innovation in this area is the 90/10 Funds introduced in France in 2001. Fonds solidaire

In France, companies have been obliged to offer their employees at least one social business fund (‘fonds solidaire’) in their voluntary employee retirement schemes since 2001, and employees’ savings schemes since 2008. The 90/10 funds are so-called as 90 per cent is invested in large capitalisation equities or bonds with SRI screening and the other 10 per cent is invested in non-listed organisations and activities with a ‘solidarity label’ through debt, capital or via microfinance funds. French prefectures administer the ‘solidarity’ which functions as a form of quality assurance and measurement of social impact.

(see above). Mapping this on to the UK system could mean an allocation to responsibly invested mainstream investments and a small proportion allocated to social impact investment.

Alternatively, members could be enabled to choose for a certain percentage of their assets to be invested outside of the default fund in a social impact fund. One way of achieving this could be a post-returns model whereby any outperformance in year 1, could, in year 2, be swept into an impact fund, thus preserving the financial returns of the core of a member’s pension plan.
Conclusions and Recommendations

All pensions are impactful: they have an impact on the world around us through where they are invested (or not invested) and the way these investments are stewarded. In these respects, pensions are relevant to our everyday lives, but, despite this, people often feel disengaged with their pension.

However, the story of pensions in the UK over the last decade is not entirely negative. Auto-enrolment has been a success, bringing 9 million new members into the pension system. The next challenge is how to ensure that these people save enough money to meet their needs in retirement.

This challenge has to face head-on the question of how to get people to save more, particularly when they have been passively enrolled into pensions. Although increasing the minimum contribution levels is important, there is still a long way to go from the planned increases to reach the level at which people are often advised to save. One answer to this challenge may be increasing engagement with pensions. If people ‘buy in’ to the idea and value of having a pension, they may be less inclined to opt out as contribution levels rise and to elect to voluntarily contribute more.

If we want people to engage with their pensions, we need to help them overcome some of the behavioural biases that contribute to their disengagement. One way to do this would be to help them connect emotionally with their pension by talking to them about the things they are interested in. There is growing interest in the wider social impact of investments. Communicating with people about the way in which their money impacts the real world could be a powerful engagement tool. In order to do so, pension providers could draw on the responsible investment and stewardship activities they should already be undertaking as part of prudent financial risk management. These could be framed in ways that engage people more than the usual technical and financial information shared by pension providers. Through surveying members, providers can find out at least thematic trends of interests and could tailor communications to members around their expressed themes of interest.

Providers should also think more innovatively about how they communicate this information. People increasingly want information, including financial information, to be conveyed digitally and there is some innovation in fintech that pension providers could learn from. Digital communication offers opportunities for providers to think about embedding pension communications in social media, thinking about how to use social norms and pressures to influence younger generations who may be less likely to seek advice from experts. Digital communication also removes the cost constraints of surveying a wider membership.

In developing this research and thinking about how things could be better, we found the role of the employer in the current system to be problematic. Greater connection between a pension member and their pension provider may be hindered by the perceived and actual role of the employer. Although some employers are doing well at encouraging greater saving, some are unsure of their role and may be inadvertently preventing the fostering of a deeper connection between their staff and their pension. Like pensions communication, the role of the employer appears to be due a re-think.

In the current system, there are a number of barriers to greater engagement with pensions. Left unchanged, the system is unlikely to support the next level of pension innovation: pensions.

If people ‘buy in’ to the idea and value of having a pension, they may be less inclined to opt out as contribution levels rise and to elect to voluntarily contribute more. People increasingly want information, including financial information, to be conveyed digitally and there is some innovation in fintech that pension providers could learn from.
We recommend that:

- Auto-enrolment pension providers be required to report annually on the percentage of member registrations on, and active usage of, their online platforms. Members who have not registered should be proactively encouraged to do so, and providers should report on their strategies to increase both saver engagement in general and member contributions in particular.

- Auto-enrolment providers seek to engage scheme members by communicating about investment impacts that they know to be of interest to their members. Such communications to members could draw on the responsible investment and stewardship activities that are already undertaken in providers’ default funds.

- Auto-enrolment providers embrace the opportunities posed by digital and social media. Pension providers should seek to present information in visual and emotionally engaging ways. All auto-enrolment providers should have an app and an active digital presence which seeks to make pension saving aspirational and engaging for members.

- Auto-enrolment pension providers survey members for their views on how and where their money is invested. The results of these surveys should inform communications, including tailoring them to members’ specific interests. The results of such surveys should be publicised to members.

- Auto-enrolment pension providers offer a short list of choices of alternative funds beyond the default fund, using accessible language to describe these options. Pension providers should engage with those members who are interested in achieving deeper social impact with their assets to design a fund option that encompasses social impact investment. Providers should undertake testing to determine how such an option could best encourage higher contributions.

- The DWP should prioritise action to increase pension saver engagement and financial inclusion. This could include exploring the role of employers in enabling or inhibiting member engagement and the costs and benefits of giving people the freedom to choose their own pension provider. The Minister for Pensions could sponsor an industry-led advisory group on member engagement and financial inclusion to examine mechanisms and policies that could help achieve deeper engagement with pensions, higher contributions, and stronger long-term outcomes for UK pension members.

with a true social impact dimension. Although such pensions would no doubt appeal to a subset of the current pension market, progress would need to be made in terms of people’s understanding of, and engagement with, pensions as well as there being greater maturity in the social investment market. However, as an aspiration and a natural follow-on from the increasingly engaging pensions we believe should be mainstream, there is space for leaders in the pension sector to develop social impact fund choices which would allow certain members to have truly impactful pensions.
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The Small Print

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