Summary

- Behavioural tendencies such as present bias discourage many people from saving enough for their retirement – and the effects of the cost-of-living crisis may be making it even more difficult to persuade people to save more.
- Other psychological and cultural factors also inhibit pension saving, including the hope someone else will help us deal with the problem, the reluctance of British people to talk about money, and perhaps even the inertia-based nature of auto-enrolment.
- Better, jargon-free engagement, plus access to guidance will help, but many people do not trust financial providers. Services provided by employers and the industry will still leave gaps in provision.
- Overcoming behavioural biases to ensure more people save enough for retirement should be a priority for schemes, providers, employers and policymakers.

Behavioural finance – the challenge of saving for our future self

As part of *Pensions Age*'s year-long special focus on financial literacy, David Adams considers how the way we think sometimes stops us doing the right thing when it comes to retirement saving – and what the industry, employers and policymakers can do about it

Perhaps every *Pensions Age* reader has always been sensible about money, and has been carefully saving for retirement since a very young age. But to be honest, even if a majority of you are that sort of person (and I admire you for it), most people are not like that. For most people, saving money can be difficult; and saving for retirement – which for the youngest workers may feel like an abstract concept that will not become a reality for another 50 years or more – may be very difficult indeed.

There are multiple reasons for that. First, it is difficult to save much money in the face of the cost-of-living crisis. It is possible that the worst may now be over, as inflation and interest rates start to fall again, but the economic tumult of recent years has hurt many peoples' finances badly. Mortgage payments are rising steeply for those reaching the end of fixed-rate deals, utility bills are still extraordinarily high, and many people have taken on more debt to get through the crisis.

Alongside these and other seemingly urgent demands on the money people do have, psychological factors may mean saving for retirement feels like a much less important priority. This combination of practical and psychological factors has already had a small but notable negative impact on saving for retirement: In spring 2023, 13 per cent of working adults surveyed for Wealth at Work said they had reduced or stopped pension contributions because of rising costs. A further 29 per cent said they might consider doing so in future.

In some cases, suggests Hymans Robertson partner and consultant, Julie Hammerton, this is because people don't understand how valuable a benefit a pension is.

"They may feel their money is being taken away from them and put into a black hole – which of course it really isn't, it's the opposite," she says. "But they may have really pressing financial challenges today and it's difficult to make this a priority: They're more concerned with how do I pay off my debts, pay my bills, or get on the housing ladder? Older people may be asking how they can take care of their elderly parents?"

In comparison to those issues, she says, retirement "feels too far into the future – a lot of people can't imagine themselves as older people". Indeed, psychologists have suggested that people thinking about their own future selves can only conceive of the theoretical older self as a stranger.

Present bias and cultural problems

"I think the biggest issue here is that you're asking people to imagine the future and humans are not hardwired to do that," says People's Partnership group director of policy and external affairs, Philip Brown. "That hardwiring makes us do things that aren't necessarily always in our interests. *[Being old is]* a long way into the future and it's easy to say 'Well, I'll worry about that later.'"

This is "present bias … jam today instead of jam tomorrow," says Brown. It means people would rather spend money now, "[*rather than]* work out what might be more in their interests and take more money at a later date". The pain of a cost in the present is a more powerful influence than a benefit in the future, particularly the distant future.

There are other psychological and cultural issues that make it less likely people will save for retirement. One is that many British people have a basic aversion to talking about money in general. Brown points out that in other countries, such as the US, people have conversations about the equivalent to filing in their tax return. "It's just not something in the British psyche," he says. "People don't talk about their salaries, they don't talk about pensions. And it's difficult to imagine how that would ever change."

"Retirement feels too far into the future – a lot of people can't imagine themselves as older people"

This contributes to a low level of understanding about how pensions work: A collective assumption that they are difficult to understand. To many people, they may feel like the sort of difficult thing that someone else – someone wiser than ourselves – will deal with on our behalf at some point. And of course this was largely true in the DB age. "I think some people do think it will be taken care of for them," says Hammerton.

She worries that the way auto-enrolment works might encourage this sort of thinking.

"I think many people will think 'I've got a workplace pension', because they've been auto-enrolled; and will think that the 'saving for retirement' box has been ticked," Hammerton explains. Auto-enrolment has used the power of inertia and defaults to bring millions of people into retirement saving, but it has not addressed the psychological barriers that prevent them saving enough for a good income in retirement. Nor has it provided much information that might encourage them to save more, or might help them to make decisions about how to use their pension pot at retirement.

"You've got 10 million more people saving into their workplace pensions, so the participation box has been ticked, but two boxes that remain unticked are the adequacy of saving and understanding," says Aviva head of savings and retirement Alistair McQueen. "We must not confuse participation with understanding."

Helping individuals make better choices

In fact, it seems likely that psychological biases that make people less likely to save for retirement can only be overcome through better engagement between schemes or providers and individuals, alongside access to guidance that will help people make informed financial decisions. How might that be achieved?

One key factor is the language used to address savers or scheme members. It needs to be positive: Research from State Street Global Advisors and People's Partnership has shown that negative messages, nagging people to save more, or trying to alarm them, are much less effective than messages that encourage them to do something that will improve their lives. An element of personalisation, with key messages timed to coincide with significant moments in people's lives, such as a new job, or the birth of a child, can also be very effective.

Above all, communications and engagement also need to be comprehensible. As *Pensions Age* readers know, average financial literacy in the UK is low, yet, says Stancombe, some pensions communications to savers or scheme members seem to be pitched "almost at trustee level". Jargon-filled communications simply encourage instinctive negative reactions among those who have not yet engaged with retirement saving – and even among some of those who have.

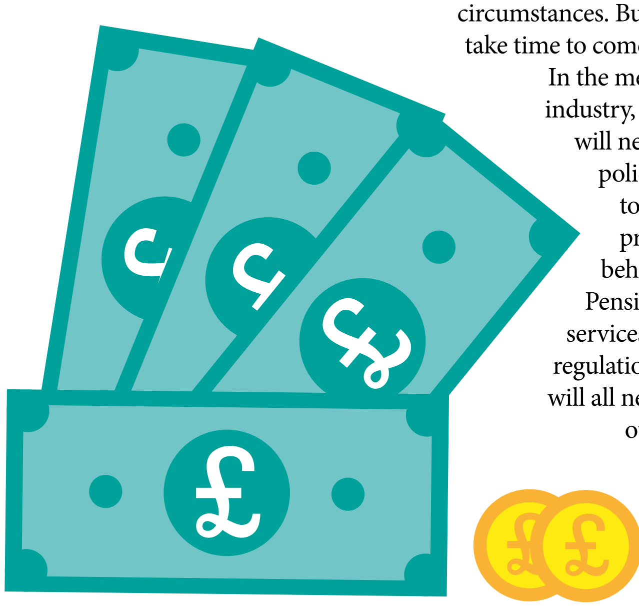
But with financial advice likely to be unaffordable for many people, more effective, accessible guidance could help them overcome the temptation not to save or not to engage with their financial future. It is possible that future regulatory change will help pension providers to provide guidance that gets a little closer to 'advice' than is permitted under current rules, but even if this happens it will only solve part of the problem.

"What people need is service provision that allows them to understand what their options are so they can make some informed choices, not just about the pension assets they have, but also the wider assets they have," says Wealth at Work director, Jonathan Watts-Lay.

But there's another psychological issue here: Trust. Many people don't trust financial services providers. "Trust is a big issue – people don't know where to go to get help," says Hammerton. "But people do trust their employers and who their employers put in front of them."

One might see this as a positive effect of the tendency to want someone else to solve this problem. Most employers may not be running DB schemes any more, but some are working with service providers to help employees in this way.

"A lot of employers, certainly larger employers, are putting more support into the workplace, under the umbrella of employee wellbeing strategies," says Watts-Lay. Other providers, such as Hymans Robertson, run workshops to help their clients' employees or scheme members improve their financial literacy.



A more holistic approach

But again, this only addresses part of the problem: Hymans Robertson's research suggests only 11 per cent of employers were running this type of programme. Hammerton would like to see the financial guidance element of the government's Midlife MOT service, currently aimed at older workers, made available on a much wider scale. "We need to look at this more holistically," she says.

"We must not confuse *[pension saving]* participation with understanding"

In the longer term, the dashboards project, open finance services and the use of technology by the industry in general will all help growing numbers of people to gain a better understanding of pensions and their overall financial circumstances. But all of these things will take time to come to fruition.

In the meantime, the pensions industry, schemes and employers will need assistance from policymakers if they are to start sidestepping the problems created by behavioural psychology. Pension schemes, products, services and the laws and regulations that govern their use will all need to work alongside our psychological shortcomings.

If the key problem with auto-enrolment is that contributions are not high enough, and trying to increase them across the board is too blunt an intervention, then increases in contributions need to happen under the radar, bit by bit, as people earn more money. We know ideas like this can work: It's now 20 years since the Save More Tomorrow scheme in the US first showed the huge increase in contributions that result over a number of years if employees agree in advance to pay a small set percentage of future salary increases into pensions.

But to help everyone overcome an aversion to save and engage the industry and government also need to reach people who receive little or no support from an employer. We need to reach the growing number of self-employed people. Ideally, we will also leave the cost-of-living crisis behind; and government will address wider policy issues that make it more difficult to persuade people to save, such as the housing crisis; and the social care crisis.

Even if we can solve those problems, we also need to remember, as Pensions Policy Institute senior policy researcher Lauren Wilkinson, says, "that some people just won't be engaged". "There needs to be policy in place to make sure those people don't fall through the gaps," she warns.

But let's not despair. With luck, in the years ahead it will be possible to persuade more people to defy present bias, or the instinct to hide away from the need to help their future selves. There are lots of different things we can do, including improving the way we teach financial literacy at school. Maybe something will change in our culture and more British people will feel they can be more open about their finances. These are difficult problems to solve, because they involve defeating our worst enemies – ourselves. But if we can start to solve them, we will all benefit.

Written by David Adams, a freelance journalist