Defined Contribution Investment Forum

The Engagement Barometer

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An annual survey of:

- The understanding, perceptions and attitudes regarding pensions contributions, investments and outcomes amongst those enrolled in Defined Contribution pension schemes
- 2016 is the ‘baseline’ year
- In subsequent years, the Barometer will measure changes in understanding, perceptions and attitudes in order to identify trends amongst scheme members

Who have we surveyed?

Over 1000 people enrolled in Defined Contribution schemes

- Men and women aged 25-64
- UK-wide
- Working full or part time (at least 20 hours/week)
- Personally earning at least £10,000pa
    - 50:50 split between those earning £10K - £39,999 and those earning £40K or more

Fieldwork: 23rd March-8th April 2016

Questions we will answer

- Why are people members of their company pension scheme?
- How aware are people of where their funds are invested?
- To what extent have people made their own choice of funds?
- To what extent do people understand the risk level of their funds?
- What are people's expectations of their pension's value?
- How much do they think they will get from their pension
- When do scheme members expect to retire?
- Do they expect to withdraw funds early?

A disparate picture

Nine million new savers will join the pension market once auto-enrolment is enforced across all businesses in the UK. Even before the many thousands of small and micro employers begin their staging process over the next two and half years, 6.1 million people had been enrolled in a workplace pension for the first time.

Heralded as a 'tremendous success' by the Work and Pensions Select Committee in its report published this May, auto-enrolment has opened retirement saving to a much broader market. Yet, enabling more people to save does not equate to wider understanding of, or faith in, pensions.

The 2016 DC Investment Forum Engagement Barometer reveals significant disparities between the well off and the lower paid when it comes to involvement with pensions, and their expectations for a comfortable retirement. The findings show how those in higher socioeconomic groups are more engaged with their pension saving, and the research reinforces the persistence of a savings gap between men and women.

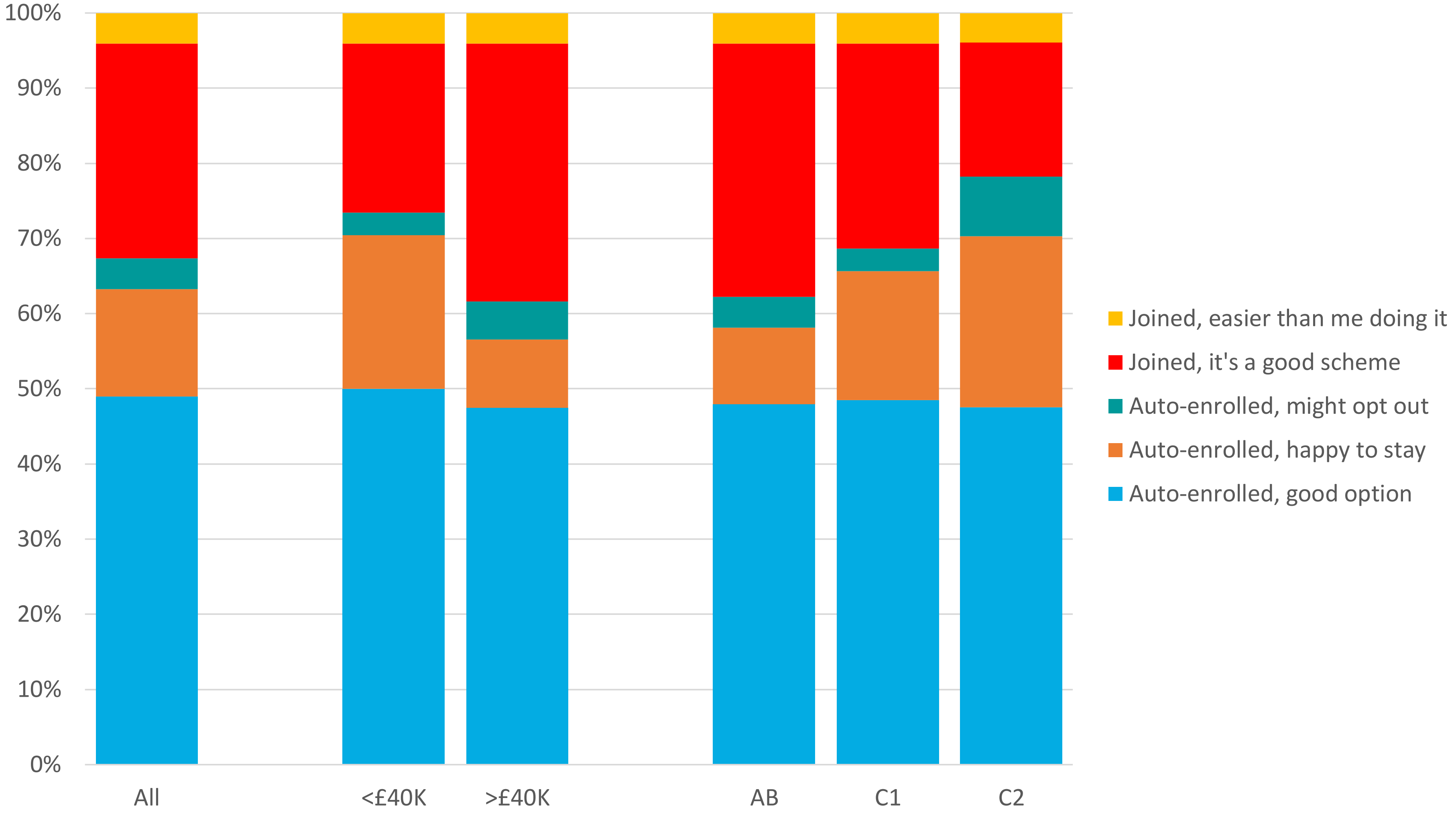
With responses from 1000 people aged 25 to 64 from across the UK, the DCIF Engagement Barometer demonstrates how the pensions industry has successfully harnessed inertia among much of the UK's workforce but makes clear that more must be done to ensure members achieve better outcomes from their retirement plans.

There in body but not in mind

Two-thirds of respondents to the survey are members of their workplace scheme as a result of auto-enrolment. While this is a positive development – assuming the majority remain in the scheme – the results also show just 28% of respondents made an active choice to join.

The story of active engagement becomes more nuanced when broken down by socioeconomic group and salary. More than a third (34%) of those earning more than £40,000 per year made an active choice to join the scheme as did 33% of those in the AB socioeconomic group. This compares to less than a quarter (22%) of those earning under £40,000 and just 27% in the C1 and 18% in the C2 socioeconomic groups.

Those on higher incomes and of higher social grades are more actively engaged in their schemes



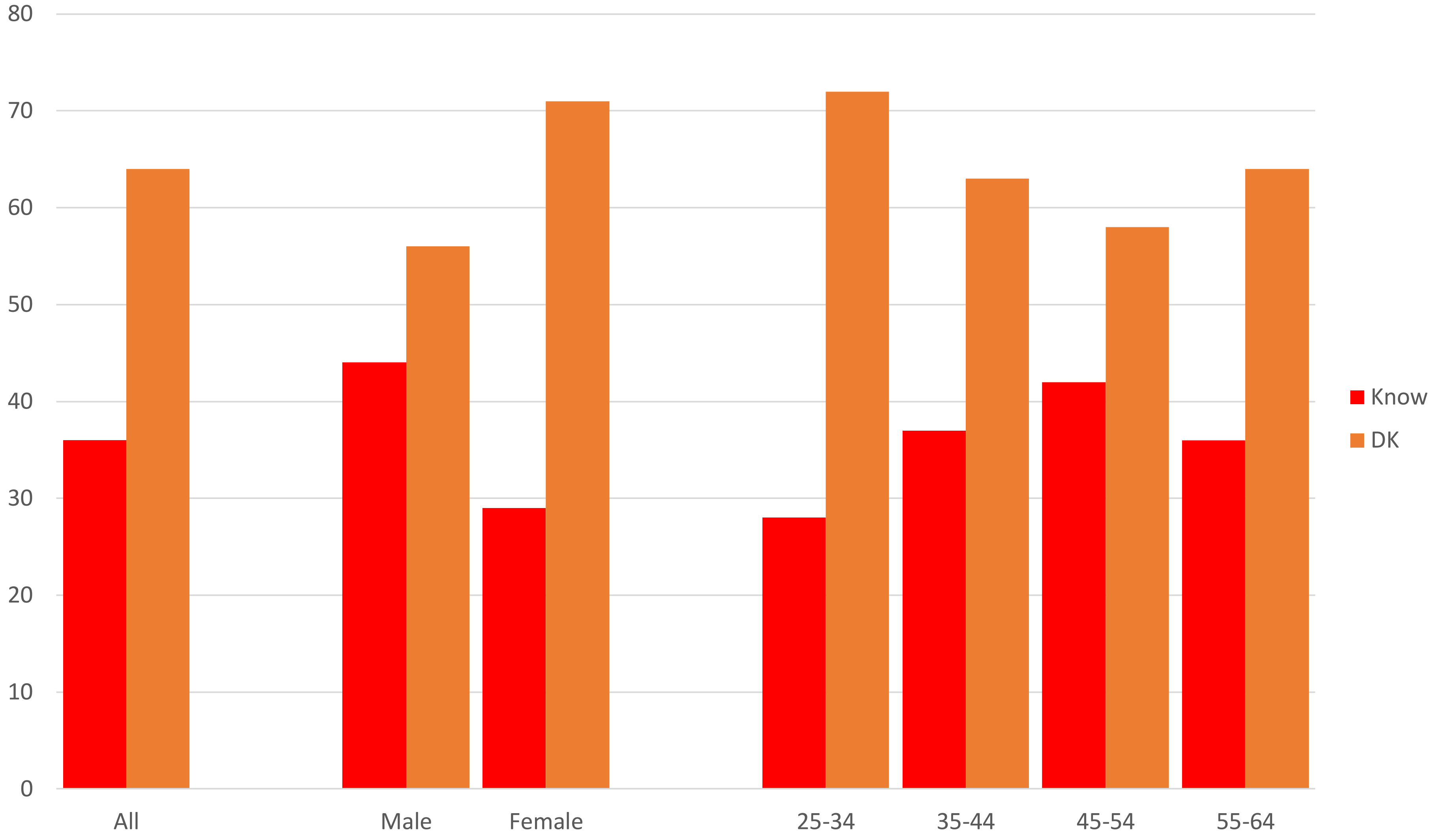
Q1: Which of these most closely describes the reason for you being currently enrolled in your workplace pension scheme? BASE: 1011 (All)

Richard Butcher, managing director of independent trustee firm PTL, says lower earners are less likely to be engaged with retirement saving since the amounts of money involved are – especially at this stage – still small. Butcher says: "Auto-enrolment is in its early days and pension pots are still trivial so they are not really engaging people. As the sums of money saved grow, naturally more people will want to get involved."

In terms of socioeconomic discrepancies, Hugh Nolan, president elect of the Society of Pension Professionals, says white collar workers tend to be more engaged with pension saving than their blue collar counterparts as a consequence of differences in employment culture. Nolan says: "If you are on the factory floor and save into a pension scheme, no one is likely to talk about who they are invested with and their fund choices. But a finance team within a big organisation might be logging on to their computers at lunchtime to see how their investments are doing."

The story of inertia continues when respondents are asked about where their funds are invested. Nearly two thirds (64%) - which equates to the amount who are auto-enrolled - say they do not know where their pension money is invested. There are also clear differences between the generations and the sexes when it comes to investment engagement. Women and the youngest respondents are least likely to know where they are invested.

But this conceals significant differences by demographics...



Q2: Do you know in what types of funds your pension contributions are invested?
BASE: 1011 (All)

The gender pay gap is well known but this has obvious repercussions for women saving into a pension. Research from the Pensions Policy Institute reveals women have an average of £7,500 in DC savings compared to £14,500 for men, and their levels of engagement are lower, too. Nearly half of men responding to the DCIF survey said they knew where their pension was invested compared to just 29% of women.

The pattern of greater engagement by those with larger salaries and in higher socioeconomic groups continued when it came to knowing where the pension is invested. Nolan suggests that some of the disparity could be attributed to a greater propensity by men to claim knowledge about a subject, while women are more modest. He adds: "[Women] have smaller pension funds than men due to career breaks lower wages generally so there is a correlation between those who have got less taking less interest and I'm afraid women have got less."

The trivial pots likely to be amassed by younger savers again explains their lack of investment proactivity, yet this argument falls away when we consider the decline in engagement among those reaching retirement. Fewer 55 to 64 year olds knew the funds they were invested in compared to 45 to 55 year olds. Engagement by 45 to 54 year olds is critical given the new freedom and choice regime which allows retirees to spend their pension pots as they wish.

Under the new regime far fewer people are choosing an annuity at retirement, yet many default investment strategies have failed to catch up with this new trend and may be pushing members towards inappropriate outcomes. Engagement by those with ten or 15 years until retirement may head off any poor outcomes when they come to draw their pensions.

Nolan says: “There have been reviews of investment strategies to make sure [members are] in the most appropriate strategy following freedom and choice. So it is frustrating that people are still driving by default into annuity protection when stats show only 5 or 6% are taking annuities at retirement.”

In the hands of the professionals

The trivial pot theory to explain low engagement is borne out by further analysis of the DCIF survey findings. Respondents earning over £40,000 are 80% more likely than their lower earning counterparts to know where their funds are invested.

Forty-three per cent (43%) of those in the AB socioeconomic group say they know where their funds are invested which compares to 32% in C1 and 24% in C2. This additional fund knowledge is then matched by additional engagement in selecting funds and investment strategies.

Forty-five percent of those in class AB and the same amount of those earning more than £40,000 made an active fund choice. This far surpasses the 37% of all survey respondents who had made an active choice. The majority of respondents had instead chosen the default. Of the 63% that had taken this route, 63% [the proportion that 40% represents of 63%] had done so willingly, 37% [the proportion that 23% represents of 63%] were invested in this fund on their behalf.

The role of the default fund is critical in understanding why so few people know where their pension is invested. The default fund takes care of the investment strategy and fund choices on behalf of members; something many feel incapable or unwilling to take on themselves. Consequently, relatively few members investigate the finer detail of where and how the scheme invests.

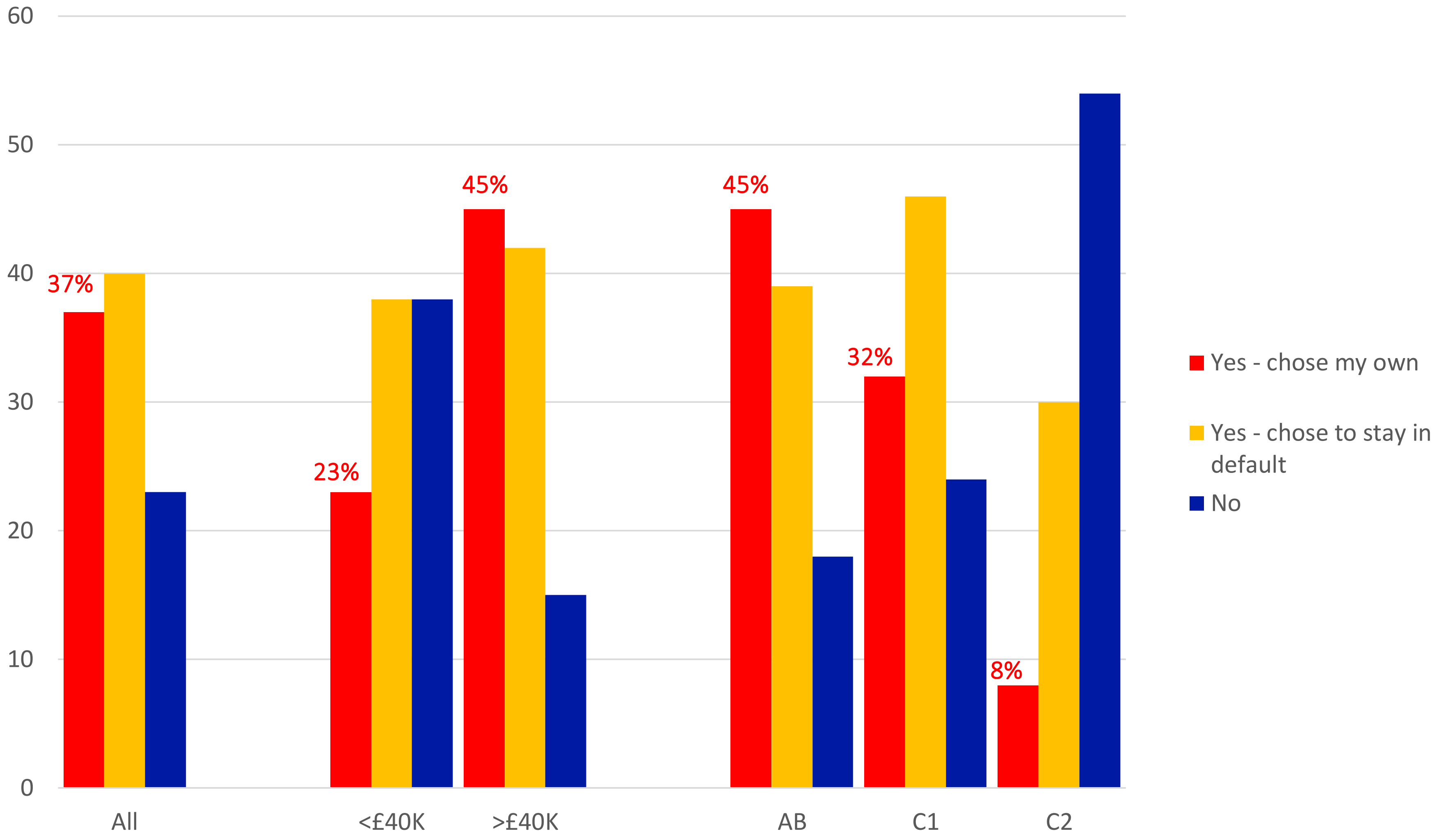
Superficially this may seem like a negative outcome but Tim Gosling, policy lead for defined contribution at the Pensions and Lifetime Savings Association, says passing responsibility for investment should be encouraged.

Gosling says: “In other areas of life we don’t ask people to take complicated decisions without professional training. I don’t do my own dentistry nor do I diagnose medical conditions on the internet. Investment should be considered in the same way. It’s not reasonable to ask people to do DIY on such complicated matters.”

However, even the finest brains in DC pension are struggling to design the ultimate default fund.

Jane Wilson, UK pensions manager at Caterpillar, says: “For the trustee, the hardest thing is trying to decide which of the lifestyle strategies should be the default. Trying to justify the choice of default to members is difficult but we don't see anything which could be done to make that easier for a trust-based scheme.”

However, once again, there are significant biases according to income and social grade



Q3: Did you choose the types of funds in which your pension contributions are invested?
BASE: 365 (All who know what type of funds pension invested in)

Taking responsibility

There are areas of pension planning that do require greater engagement by members, and one is understanding risk.

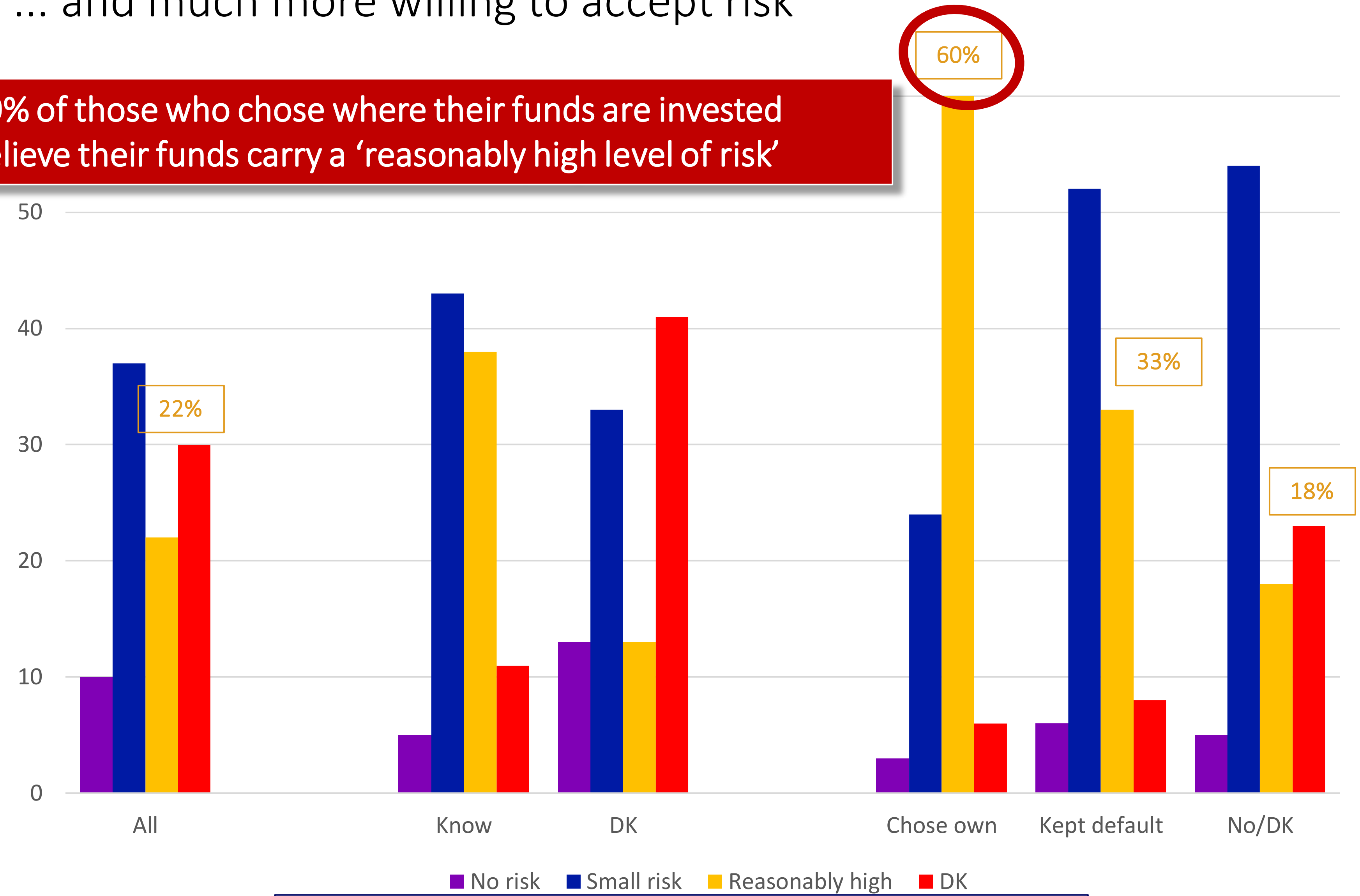
Nearly a third of respondents to the DCIF survey (30%) did not know how much risk was in their DC fund while one in ten thought there was no risk at all.

The groups that showed the highest instances of active fund choice were most aware of the level of risk in their funds, and appeared to have greater risk tolerances.

Chris Wagstaff, head of pensions and investment education at Colombia Threadneedle Investments, says: "As an industry we are not very good at explaining risk. [Failing to understand risk] is one of the big impediments to making investment decisions. There is a lot of confusion out there. If members see high volatility they confuse that with risk of losing capital but assets with high short term volatility tend to translate to longer term good investment returns."

... and much more willing to accept risk

60% of those who chose where their funds are invested believe their funds carry a 'reasonably high level of risk'



Q5: Which one of the following comes closest to expressing your understanding of the level of risk you think you are taking? BASE: 1011 (All)

The annual statement is one source from which members can track their funds' volatility and, in turn, learn about risk and performance. The DCIF Engagement Barometer found just over half (52%) of respondents had looked at their pension statement in the last six months. This figure may seem relatively high but there is no indication of how thoroughly the members explored the information.

PTL's Butcher blames the pension industry's ineptitude at communication for members' low levels of engagement with their statements. Butcher says: "When it comes to engagement, as an industry, we haven't got a clue. Some are good at it but not many of us. We need to learn new engagement skills and become better at it and talk to people who are experts in the [communication] field." Butcher says those running pension schemes, including investment governance committees, insurance companies and trustees, need to be open minded to new ideas and reach out to industries that excel in communication with their clients.

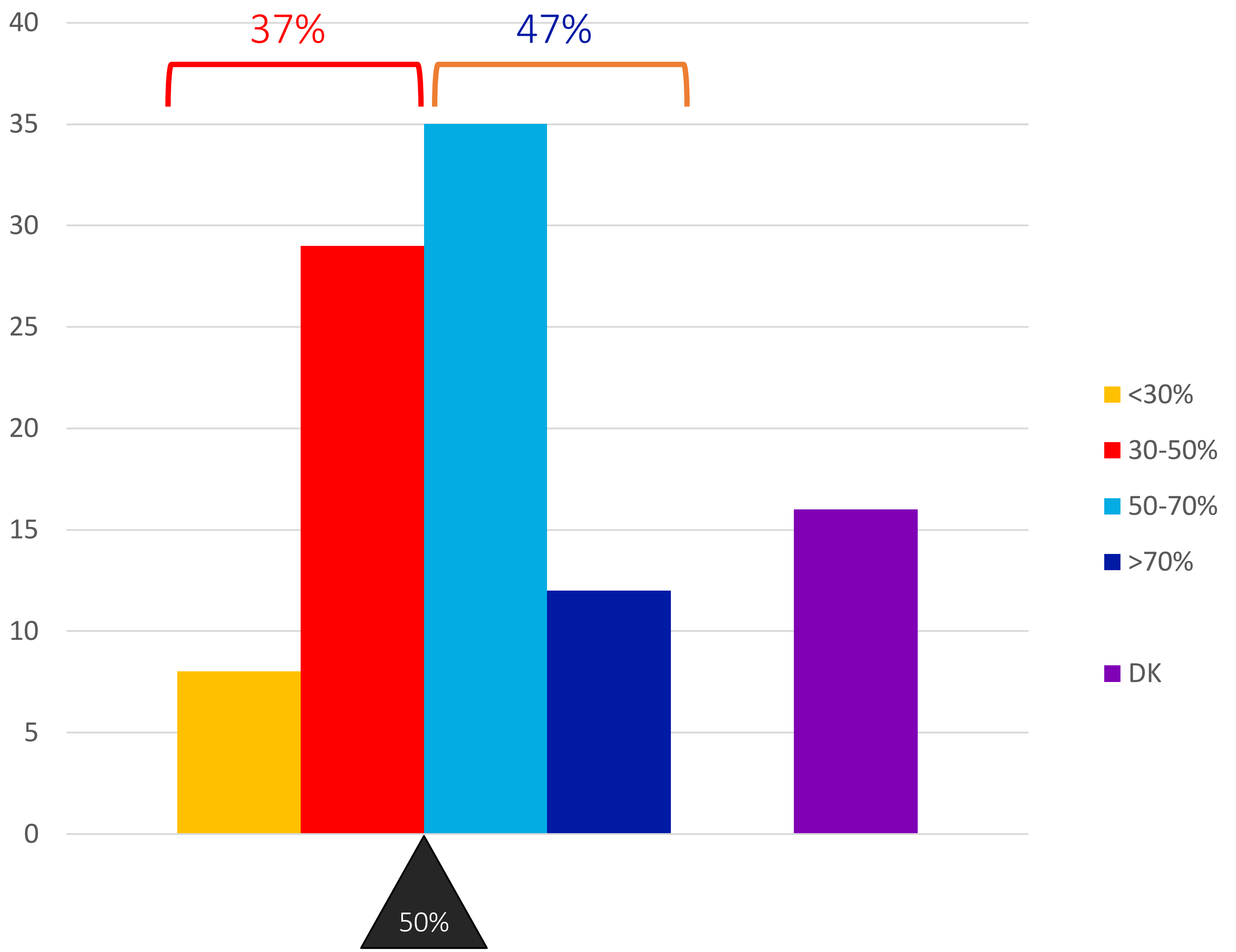
Caterpillar's Wilson says the 'most impactful' innovation her scheme implemented was a simple change to the annual pension bulletin and statement which better engaged members with the DC plan. Wilson says: "We took the plunge last year and totally reworked our annual bulletins: different layout, less words, plain English, and use of Caterpillar images. The result was astonishing. Never underestimate the pride employees feel in the products the company makes was a clear message." Wilson says Caterpillar saw a 'massive increase' in enquiries and positive feedback from people who had read, understood and been engaged by a pension communication for the first time - including those who had been members for over 20 years. The scheme has since launched a microsite for members along the same branded lines.

Below expectations

The annual statement provides an important opportunity for members to understand how much they are expected to receive in retirement, and whether this is adequate to meet their needs.

According to the barometer, nearly half of respondents think their pension will need to pay more than 50% of their current salary in order to deliver a comfortable retirement.

Nearly half think their pension will need to pay out over 50% of their present income for them to be comfortable in retirement



Q9: What proportion of your current income do you think your pension would *need* to pay out each year in order for you to live comfortably once you retire? BASE: 1011 (All)

However, 64% expect their DC plan to fall below that 50% target, with half of those expecting a pension income worth less than30% of their salary. One fifth of respondents have no idea what they will receive.

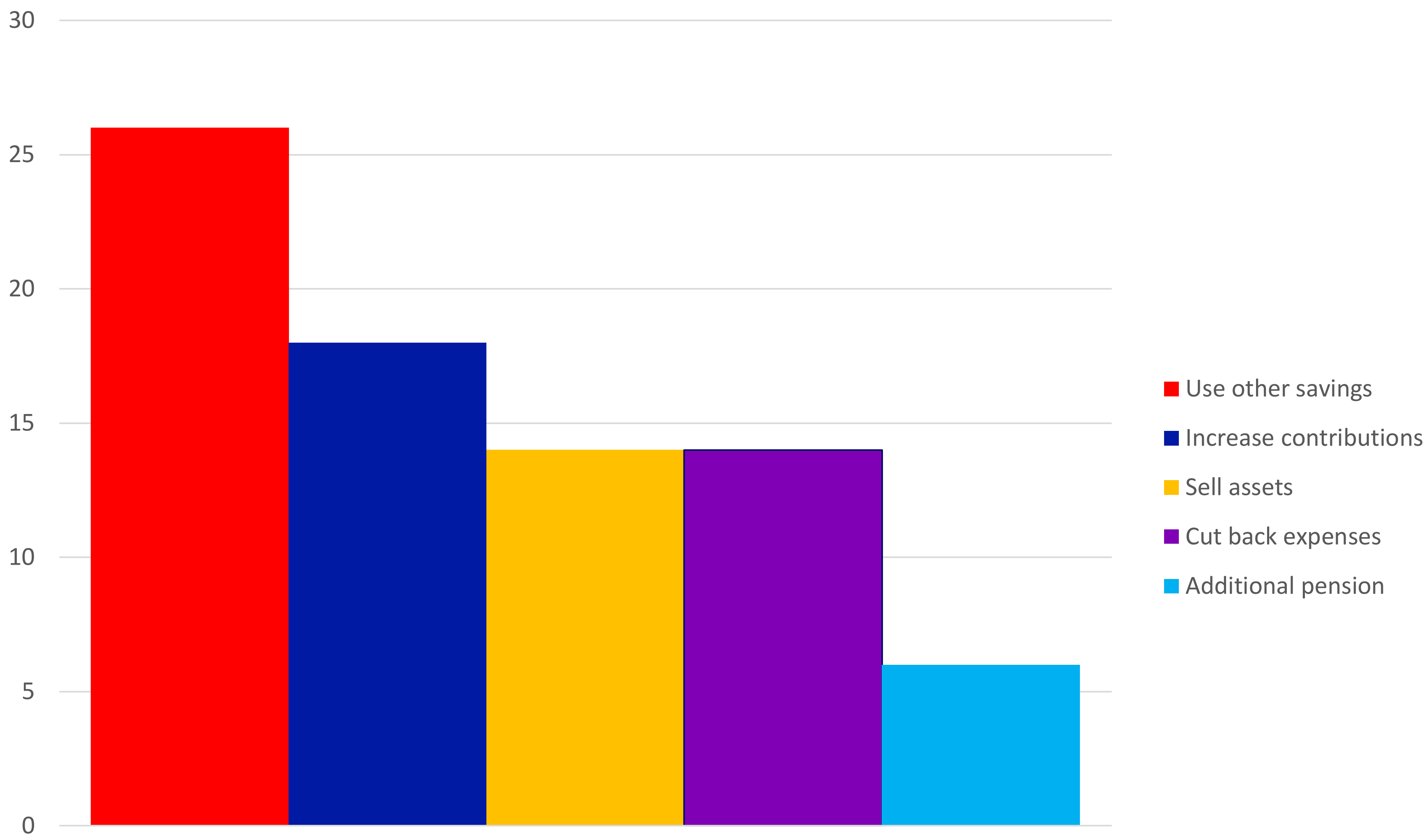
This low expectation for pension adequacy is in spite of nearly three quarters of respondents (72%) believing their investments will rise in value. This begs the question of whether default funds need to be more aggressive, or members – and employers – should contribute higher percentages of salary.

Given the low appreciation of risk among savers – 47% think there is no risk or a reasonably small risk in their investment – ratcheting up performance targets may prove intolerable.

Hugh Nolan at the SPP says: "It is not just about understanding risk, it's about choosing the defaults that minimise risks. If a member, who is new to pension saving, looks at their statement and sees it has fallen it could damage their retirement saving prospects by showing them that pensions are risky."

Under auto-enrolment, contributions will increase incrementally, reaching a total of 8%. There is a general acceptance in the DC industry that this level is not enough to achieve an adequate retirement, yet only 18% of barometer respondents plan to increase contributions.

How do those who expect their pension to pay *less* than they need think they will cope?

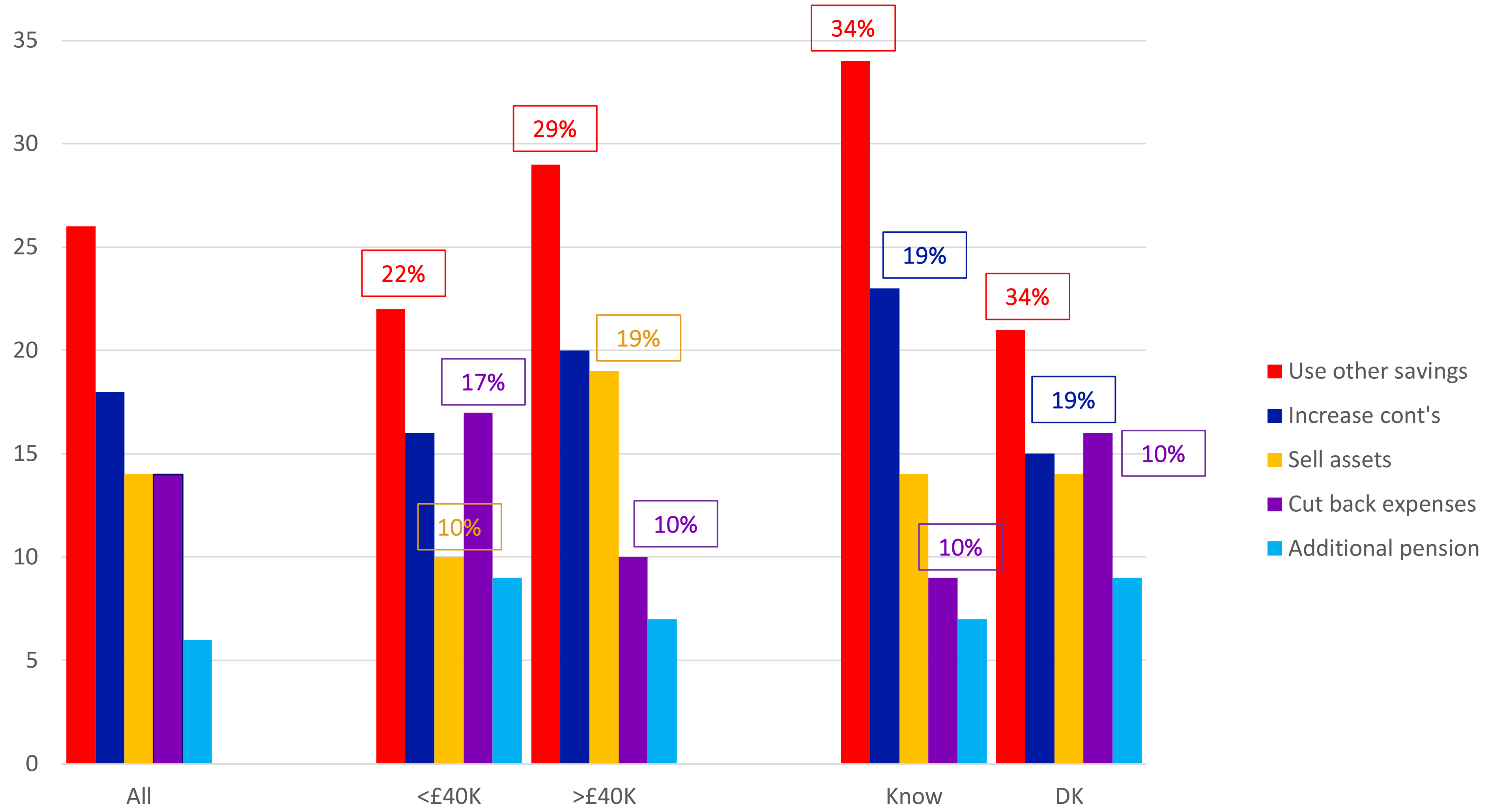


Q12: You have said you expect your pension to pay out less than you need to live comfortably once you retire. Do have plans to do any of the following? BASE: 439

The way in which respondents plan to make up any pension shortfall varies according to salary.

Those earning upwards of £40,000 were more likely to use other savings or increase contributions, while those with incomes below £40,000 showed more instances of cutting back on expenses.

The mix of solutions differs according to income and whether or not scheme members know where their funds are invested



Q12: You have said you expect your pension to pay out less than you need to live comfortably once you retire. Do have plans to do any of the following? BASE: 439

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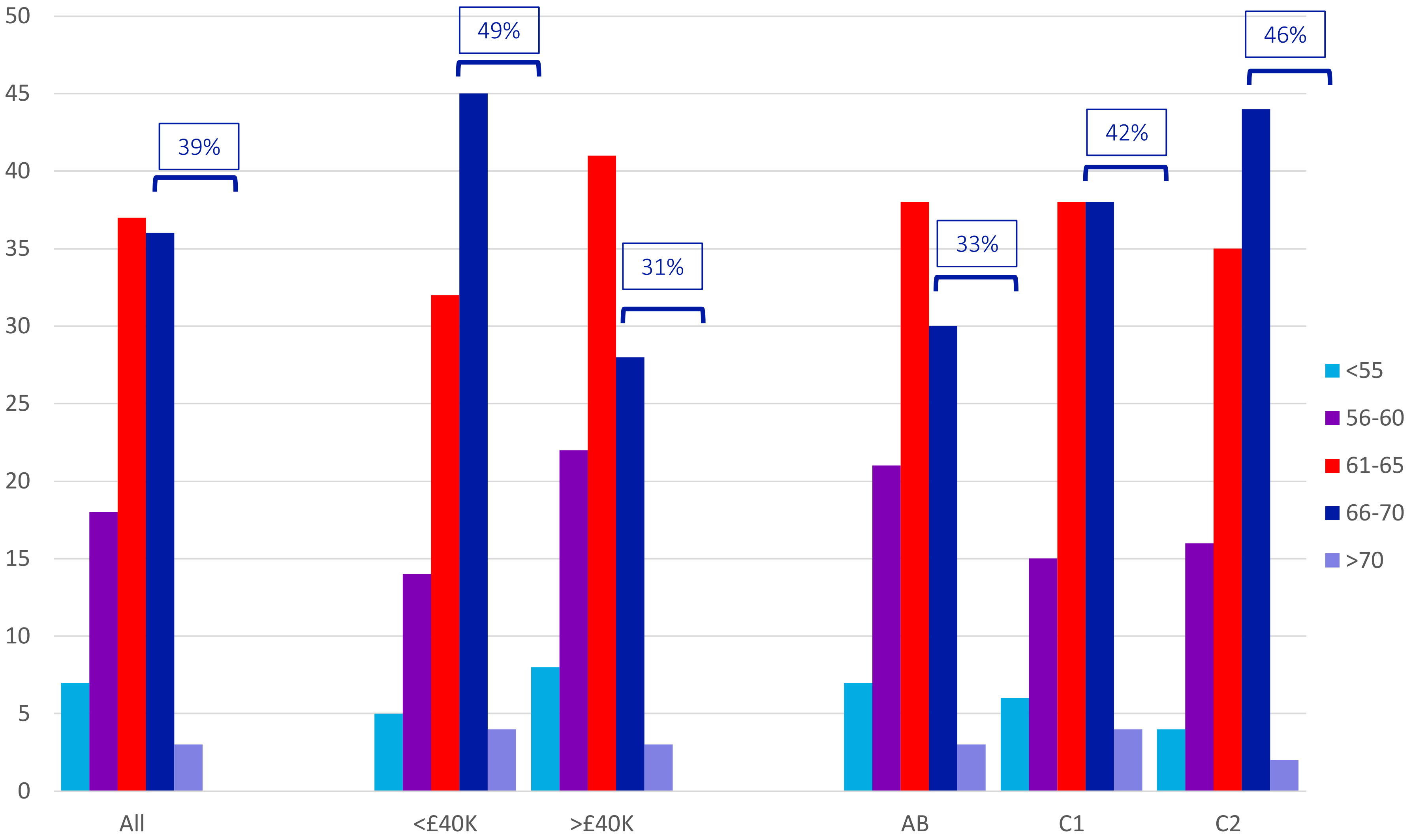
Gosling says: “Consensus out there in the industry is that 8% is just not enough but it may be enough for some people on low earnings. It depends who you are and what your targets are for retirement. If you earn £15k per annum then the flat rate basic state pension gets you quite a lot of the way there, so you don’t want to be making large contributions if you are off consuming the earnings. Conversely, higher earners are more likely to need higher contributions to hit a two-thirds replacement rate in retirement.”

Working for longer is another way to boost retirement pots and almost two-fifths (39%) of respondents to the barometer expect to stay in employment past age 65.

As expected, affluence plays a big part in deciding when individuals expect to retire. Less than a third of those earning more than £40,000 expect to retire after age 65 compared with almost half (49%) of their lower earning counterparts.

Affluence has a big impact on expected retirement age



Q7: At what age do you expect to retire? BASE: 1011 (All)

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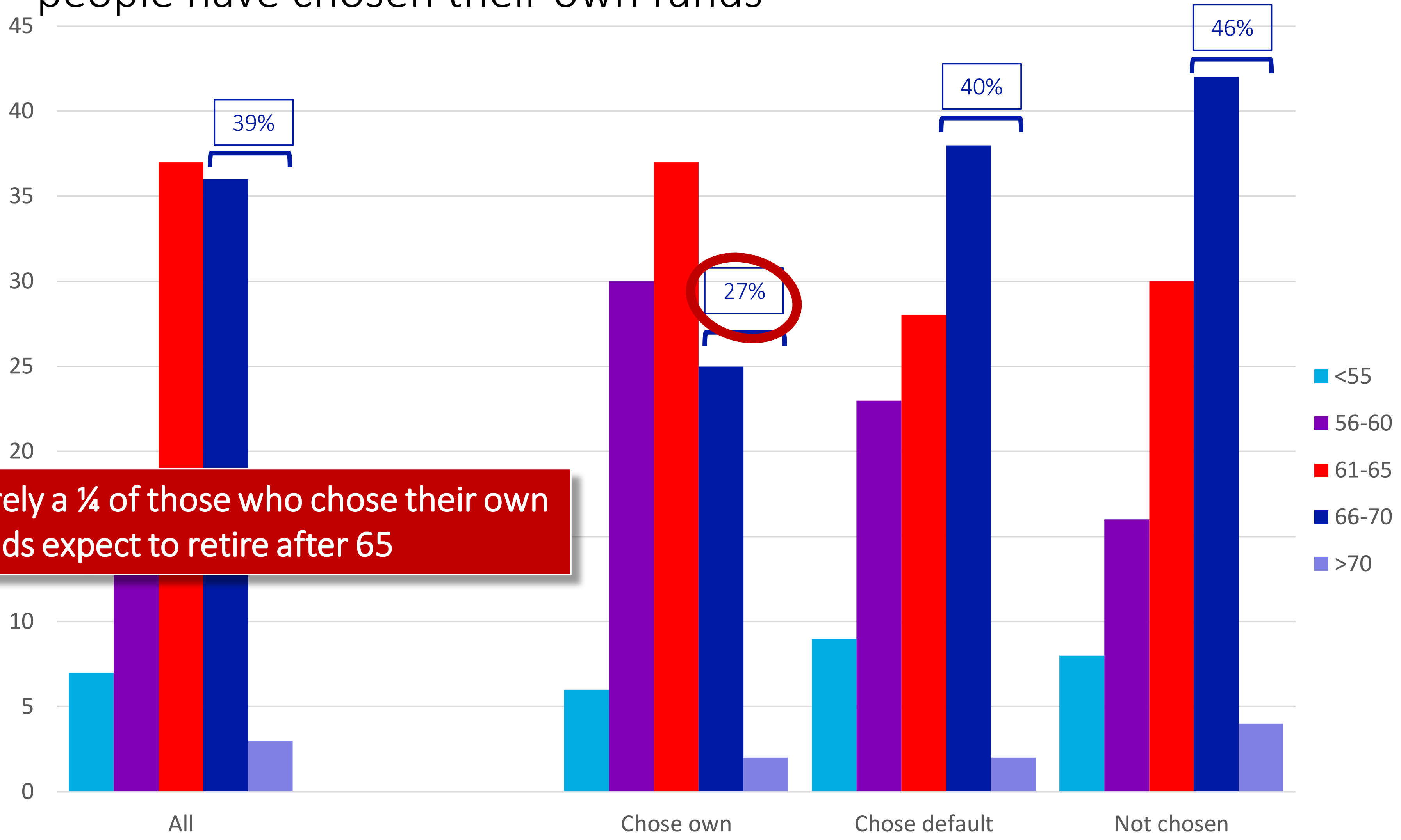
But it is engagement with pension saving that plays the biggest part in deciding expectations of retirement age.

Just over a quarter (27%) of those who chose their own funds expect to retire after age 65, compared with 40% of those who chose the default and 46% of those who made no active choice.

The pattern continues yet further when it comes to exercising freedom and choice. Those who are engaged with their investments are 50% more likely to draw income from age 55 than respondents who are unaware of where their funds are invested.

And anticipated retirement age also relates closely to whether people have chosen their own funds



Barely a ¼ of those who chose their own funds expect to retire after 65

Q7: At what age do you expect to retire? BASE: 1011 (All)

Conclusion

There is a clear paradox when it comes to DC pension engagement. The pension industry accepts its own shortcomings when it comes to providing effective communication, but recognises the importance of engaging members with their long-term savings. Workers may profit from their own inertia when it comes to workplace retirement saving but only if the strategies in which they are invested and the contributions they make are adequate.

The DCIF Engagement Barometer shows that those engaged with pensions are able to make investment decisions, appreciate any shortcomings and have plans to ensure they get the most from their retirement savings. At the other end of the spectrum there are large swathes of lower earners and less engaged members who expect their savings will be inadequate but are unequipped to make up any shortfalls.

Across the board, the barometer highlights key knowledge gaps which must be tackled before savers are too near to retirement. The industry needs to focus communication and education on the areas that matter rather than attempting to professionalise and engage every member.

The nuances of investment and the complexities of pensions are not relevant to most people – it is down to industry, regulators and government to make sure savers' hard-earned cash is being invested effectively and responsibly. Instead, people need to understand what they are saving for, whether they are likely to achieve it, and what to do if they are expecting a shortfall.

A system of defaults must be put in place which takes away the unnecessary decision making for those that do not want to do it, and nudges them to review and revise their position at points throughout their savings career. They need to be able to make changes should life events alter their plans, and appreciate that they are responsible for doing so, but not make decisions about specific asset classes of fund managers.

Information overload is counterproductive but simple, effective communication – which is already employed in other industries – is the way in which DC pensions can engage their members and overall achieve better outcomes.

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