Nudging the social animal in us all

It's time to think behaviourally: how harnessing behavioural economics can boost retirement savings

It's a shopping moment familiar to us all. As you arrive at the till, you either reach for your re-useable plastic bags or quietly mutter: "Sorry, I do need a bag". It only costs 5p, but that's not the point. You have violated a new, powerful social norm. As social animals, most people don't like their behaviour to stray from socially acceptable norms. That's why plastic bag consumption has fallen by over 80% over the past six months.

What this illustrates is a growing realisation that in many aspects of everyday life, the big stick doesn't work. In the UK, people don't like being explicitly told what to do and how to behave, and don't react well to attempts to scared them into submission.

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Negative messages don't resonate. Rather, thanks principally to the insights of university psychology departments, using simple behavioural interventions, or gently nudging people into more individually optimal and social desirable behaviour, is increasingly and successfully being applied by policymakers. This whether it's to get people to eat more healthily, pay their taxes on time or drastically reduce plastic bag use.

ADDRESSING THE BIG PENSIONS CHALLENGE

Gentle nudges, auto-enrolment being but one example, can also be used to address what is arguably the UK's biggest socio-economic challenge: the inadequacy of retirement provision.

This immense challenge, which entails addressing inadequate retirement saving and investing these accumulated savings more wisely, is one that is made ever-more challenging by a number of strengthening headwinds. Notable among these is the fact that people are spending on average seven years more in retirement than they were in the 1970s, the state pension being paid ever later in life and defined benefit pensions disappearing.

As a result, individuals are having to take more responsibility for their financial futures, becoming increasingly reliant on their defined contribution pots to support them in retirement, with most unaware of the increasing prospect of more modest investment returns and yields.

These headwinds mean the consequences of making a wrong decision, or none at all, will increase exponentially and are compounded by most people being woefully ill equipped to know how best to achieve a good retirement outcome, given the lack of frames of reference, guidance and largely inaccessible financial advice. Consequently, there is a deep-seated inability and, therefore, reluctance to engage with retirement.

BEHAVIOURAL IMPEDIMENTS TO GOOD RETIREMENT OUTCOMES

So, auto-enrolment aside, how can behavioural interventions help address this behemoth of a challenge? Well, this lack of engagement also stems from deeply ingrained behavioural biases that act as a barrier to informed savings and investment decision making.

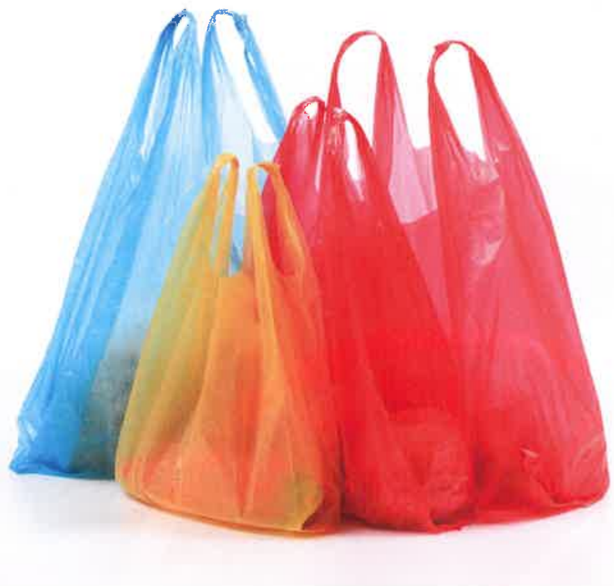
Of these, present bias and anchoring are two prominent biases that need to be overcome.

Present bias is the preference for spending today over saving for tomorrow, given an inability to both align the upfront costs of saving with benefits far into the distant future.

Present bias is compounded by anchoring. This is when people latch on to an irrelevant number that comes to hand when in uncharted territory, and use it as a reference point in their decision making. Many pension savers anchor to the minimum contribution in the mistaken belief that this has been endorsed by their trusted employer or, as auto-enrollees, by the government, as enough to provide an adequate sum in retirement. The reality is so, so different.

Of course, compulsion could be used, but this goes against the ethos of freedom and choice and, as we know, people don't like being told what to do, especially with their own money. Therefore, the focus should be on using behavioural interventions to overcome behavioural impediments.

Although it largely falls to policymakers to apply such interventions, the wider pensions community has an integral role to play. Not only can they harness their collective experience and expertise to take the behavioural agenda to policymakers, but they can also help change DC savers' behaviour by imparting simple, timely



and personalised messages via appropriate media for each demographic.

OVERCOMING PRESENT BIAS AND ANCHORING

First, overcoming present bias. Being unable to visualise one's future self means we see our future self as a stranger. So the savings decision becomes a choice between spending today and saving for a stranger to spend our money tomorrow.

That's why those who see an avatar of their older selves are willing to more than double their long-term savings.

Linked to this is getting people to visualise those activities and expenditures they enjoy today that they will still be enjoying far into the future. That way, they view the savings decision as a source of funds to finance these activities.

The challenge then is to motivate savers to think about the future without concerns about growing old getting in the way. Doing so helps to better align the current costs of saving with often distant benefits.

More closely aligning costs with benefits also underlies Save More Tomorrow, or the automatic escalation of DC contribution rates. By committing today to paying increased contribution levels only in the event of future pay rises, the individual delays the cost of saving to tomorrow.

By contrast, introducing the issuance of National Lottery tickets for, say, every £100 per month saved, brings the benefits of long-term saving closer to today. Lottery tickets are attractive as people tend to overestimate the probability of winning and visualise themselves with a big pile of cash at the end of the month. The benefits of long-term saving therefore appear more salient.

In seeking to overcome anchoring, lottery tickets can also help to move contribution levels away from the minimum contribution "anchor", as can employing simple messaging that provides a frame of reference as to how much people should be saving.

"Save three days' salary per month" is one example. Another helpful frame of reference is illustrating on an employee's monthly payslip (the one document all employees read) the monthly income stream their accumulated contributions might generate at their scheme's normal retirement date. By making a direct comparison with current earnings, this would add some perspective to the need to save more for their retirement.

The way in which messages are framed, or contextualised, is also key. As John Paul Sartre once said: "Words are loaded pistols." So, reframing pensions tax relief as a "savers bonus" and using sufficiently, but not unpalatably, large numbers to illustrate how the bonus works, e.g. a £50 bonus for every £200 saved, would move the contributions "anchor" to a more realistic level.

Likewise, positioning employer contributions as "free money" again encourages employees to move beyond the minimum contribution rate, not least because most are guided and incentivised by the size of their trusted employer's contribution.

Then there's using positive social norms – back to our plastic bag consumption – to develop a savings culture. Despite feeling strongly about being an individual, as noted earlier, as social animals most people are heavily swayed by others in their actions and opinions.

By publicising favourable statistics that show most people in a relevant cohort have started saving and disclosing the amounts involved, again if favourable, encourages others in that cohort to do similarly.

By contrast, citing statistics that show how much of a widespread problem the lack of saving is (negative messaging) compounds the problem, as people accept their sub-optimal behaviours as being the social norm.

AND THE CONCLUSION?

While behavioural economics doesn't have all the answers, applying simple interventions in a well-thought out way could not only generate more optimal individual savings but could ultimately lead to a retirement to be enjoyed rather than endured.

As traditional measures to get the nation saving haven't worked, surely it's time to think behaviourally?

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