Resuscitating Retirement Saving

How to help today's young people plan for later life

Dr Craig Berry

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Executive summary

Young people are increasingly being expected to save greater amounts for their own retirement. But today's young people value 'living for now', and appear to spend a higher proportion of their income than other age groups. There has been an increase in the number of young people with savings, although they are not necessarily saving *more*, and debt and poor financial management remain problems associated with today's young people. Today's young people tend to favour investing in housing rather than planning for retirement, although housing pathways are often chaotic, especially for those not able to rely on financial support from older relatives.

Youth unemployment is higher now that at any point since comparable records began. Young people have been disproportionately affected by the economic downturn, and are more likely than previous generations to be employed in temporary positions. Qualitative research demonstrates that today's young people value freedom and control in their work more than previous generations. The implications for pensions saving of both experiences of and approaches to the labour market among today's young people are unclear.

We know, however, that today's young people tend not to plan for retirement, and have only limited knowledge of the pensions system or indeed the nature of pensions saving. They are less likely to be enrolled in an occupational pension scheme. Where they are enrolled, they are more likely to be a member of a defined contribution rather than defined benefit pension scheme, with lower overall contribution rates. Young people seem to exhibit a loss of faith in the pensions industry, and are less supportive of auto-enrolment than other cohorts.

It is not clear, however, that today's young people are substantially different to previous generations of young people in terms of financial behaviour. It is normal to expect young people to be less concerned about retirement planning and accumulating assets for later life, but it seems that various developments have postponed the age at which retirement planning and asset accumulation begins. The habit of pensions saving does not become ingrained during the more prolonged transition between adolescence and full adulthood.

Pensions policy and practice must take into account the likely futures that will be confronted by today's young people. The trends likely to impact on young people over coming decades include: increasing longevity, population ageing and associated fiscal problems, further postponement of transitions to adulthood, a volatile housing market, the rise of flexible working, increasing care needs, the growing economic importance of the internet, and the rise of defined contribution pensions saving. The retirement paths of today's young people will be very different to the parents' generation.

Auto-enrolment will introduce a significant 'nudge' into the pensions system. Given, however, the possibility that many young people will opt out of occupational pensions saving, it may be necessary to consider other ways behavioural economics and

psychology can encourage pensions saving among young people. Behavioural traits that may impact on pensions saving include a status quo bias, anchoring and the availability heuristic, a herd mentality (or social norms more generally), and hyperbolic discounting. Decisions are also affected by how choices are presented. NEST and auto-enrolment present an opportunity to counter some of these traits, but it is necessary also to consider how we can nurture a sense of control over their finances among young people while encouraging higher savings rates.

On the basis of evidence on the financial circumstances of today's young people, and an analysis of how current trends might impact upon young people in the future and the role of behavioural economic, the report makes several recommendations related to both pensions policy and wider challenges. It is vital that the incentive structure inherent in NEST is communicated extensively to young people. The introduction of NEST and auto-enrolment is, more generally, an opportunity to educate young people about pensions and the value of pensions saving. Communication strategies should emphasise some of the key attractions of NEST to young people, such as the mobility of accounts, and the availability of account information online. The government should also be planning for the next phase of pensions reform, considering both 'save more tomorrow' plans to increase savings rates over time, and offering a compulsory choice between different savings plans.

There is also a strong need for a 'Plan B' in case young people opt out of occupational pensions saving in large numbers. One alternative is for the government to offer young people vehicles for saving in a more liquid format; funds could be converted into pensions saving at a certain point. This would offer greater flexibility while reinforcing the message that retirement planning cannot be delayed indefinitely.

In terms of financial education, greater emphasis should also be placed on whole-of-life planning and the development of broader thinking skills, not least to help to young people make more informed decisions around different forms of investment – an appetite for home-ownership seems to be inhibiting pensions saving, with potentially damaging consequences. Existing relationships of trust should also be utilised in delivering advice; educational schemes should seek ways to assist parents in helping their children make financial decisions.

It is also vital that a wider savings culture is nurtured. The government should consider the adoption of a rule-of-thumb message on pensions saving along the lines of the 5-a-day healthy eating message. The fact that pensions enable consumption-smoothing should also be central to communications, utilising existing norms around consumption. Similarly, young people are attracted by the control afforded by online access to financial services, given that it resonates with their lifestyles more generally. NEST will make information available online to individual account holders; other pensions providers should build upon this initiative.

Introduction

Population ageing, leading to a declining old age support ratio, is likely to undermine the ability of the state to fund a decent standard of living for all individuals in later life. In the Global Ageing Preparedness Index developed by the Centre for Strategic and International Studies, the UK ranks fifteenth among twenty comparable countries in terms of the impact of ageing on fiscal sustainability (Jackson et al, 2010).

As such, the previous and current UK governments have sought to encourage individuals to save more for their own retirement. This report assesses the ability of today's young people to shoulder this responsibility. Given the end of 'jobs for life', the persistence of youth unemployment, the difficulties associated with entering the housing market for young people, and the withdrawal or closure of defined benefit pensions schemes, there are valid concerns about the ability of today's young people to meet this challenge.

The previous government introduced the Child Trust Fund and the Savings Gateway to provide greater incentives, and generate a savings culture, to encourage young people to save for retirement. These initiatives have, however, been abandoned by the current government, as part of its deficit reduction plan. The government has, however, retained the main instruments developed by the previous government designed to increase private pensions saving, that is, the National Employment Savings Trust (NEST) and 'auto-enrolment'. Eligible individuals (generally low-to-median earners) will be automatically enrolled from 2012 into an occupational pension scheme, with a guaranteed minimum employer contribution. There remain concerns, however, over whether these instruments alone will produce an adequate income in retirement for all individuals, and crucially, whether young people will 'opt out' of occupational pension saving in large numbers.

Today's young people, the first generation to have grown up with the internet, are renowned as a highly educated and demanding cohort. They are also often depicted in popular culture as relatively irresponsible regarding financial issues. Generally speaking, this report refers to young adults aged between late-teens and early-thirties – the variety of cohort categories evident in the existing literature prevents definitional precision. Of course, it is not immediately clear whether the features attributed to today's young people are cohort or lifestage effects: does today's generation of young people embody characteristics not present among previous generations of young people, or does it instead uphold attitudes and behaviours common to all generations? This question will be considered where relevant throughout the report, but ultimately, the argument here is that what we are witnessing is a postponement of adulthood, or an expansion of the transition period between adolescence and adulthood. Embarking on a career, buying a home and starting a family now occur later in the lifecourse for today's young people, and therefore the key triggers for retirement planning or delayed. To some extent, extending working lives and delaying retirement will mitigate this development; but it seems unlikely that increasing effective retirement ages will keep pace with the postponement of adulthood. Moreover, the period between adolescence and adulthood seems now to intermingle with

the formation of key economic and financial habits; under-saving may be a difficult habit to break for young people in the future. As such it does not matter whether we are witnessing lifestage or cohort effects, because for today's cohort of young people, the lifestage in question is more prolonged, and may ultimately have a greater determining impact on retirement planning than experienced by previous generations.

The report's main aim is to generate a greater understanding of how the public and private sectors can best enable today's young people to plan for their retirement. This requires a greater understanding of the behaviour and economic circumstances of today's young people and their tendency to under-save, and of how certain current social and economic trends will impact on young people in coming decades. The report also considers what can be learned from behavioural economics – both in terms of behavioural barriers to pensions saving and retirement planning, and the 'nudges' that may be helpful in addressing under-saving.

The methodology through which the report was compiled consists of four main aspects:

- Quantitative evidence that the report draws upon includes (other sources have also been used where appropriate):
    - Published output from the Wealth and Assets Survey 2006/2008, as reported in *Wealth in Great Britain* (ONS, 2009).
    - Published output from the Family Resources Survey 2008/2009, as reported in *Family Resources Survey* (DWP, 2010).
    - Published output from the Labour Force Survey and Annual Survey of Hours and Earnings, as reported in *Economic and Labour Market Review* (Barham et al, 2009).
    - Published output from the Financial Services Authority's (FSA's) Baseline Survey, as reported in *Levels of Financial Capability in the UK: Results of a Baseline Survey* (Atkinson et al, 2008).
- Secondary analysis of existing literature, particularly qualitative studies. Relevant publications were identified by searching databases and the internet using search terms such as 'young people', 'pensions', 'savings', 'financial', 'behavioural economics' and 'nudge', and appropriate variations. Searches for popular designations of today's young people such as 'Generation Y' were also conducted. The report also draws upon qualitative studies commissioned by the Department of Work and Pensions (DWP), such as *Live Now, Save Later? Young People, Saving and Pensions* (Pettigrew et al, 2007).
- A private stakeholder meeting hosted by ILC-UK and Prudential on 17 March 2011. Participants included representatives from DWP, the NEST Corporation, the National Association of Pension Funds, the Pensions Advisory Service, the Institute of Actuaries, and the Association of British Insurers.

- The author's original analysis of relevant policy developments, and surrounding debates.

The report's focus is the UK, particularly in terms of recommendations, and all of the quantitative evidence refers to the UK or its constituent countries. However, it utilises qualitative evidence on young people from other English-speaking countries where appropriate.

The report begins by summarising existing knowledge on young people, in terms of assets and housing, skills and jobs, and pensions. It then speculates on how young people may be affected by various social and economic trends in the future. Finally the report details several areas where change in policy and practice may encourage young people to save more for their own retirement, by considering what we can learn from behavioural economics, current debates around pensions policy, and various other challenges.

Chapter 1: Young people today

This chapter reviews the evidence on the financial and economic circumstances of today's young people. It is split into three main sections: assets and housing, employment and skills, and pensions.

Assets and housing

- Today's young people value 'living for now' and as such seem to spend a higher proportion of their disposable income than other age groups.
- The past decade has seen an increase in the proportion of young people with savings, although it is not clear that they are saving *more*.
- Debt and poor budget management are significant problems for today's young people.
- Today's young people are eager to invest in housing but face manifold difficulties in getting onto the housing ladder.
- A significant disparity has emerged between those able, and those not able, to draw upon financial support from parents in investing in housing. Those without support are increasingly experiencing vulnerable and chaotic housing pathways.

A study for DWP consisting of focus groups with people aged 16-29 identified the importance of 'living for now' over planning for the future. To some extent, this is because young people focus on the more immediate goal of buying property before they consider how to finance their retirement (Pettigrew et al, 2007). But young people also seem to spend a greater proportion of their income than other age groups, as table 1.1 (below) demonstrates. According to the Living Costs and Expenditure Survey, households where the household referent person (HRP) is aged under 30 spend 91.6 per cent of their disposable income.[1]

There is a large amount of data available on the liquid assets of different age groups. The Family Resources Survey details the different sources of income according to age of head of householed (see table 1.2).[2] The survey also shows the type of savings and investments held by different age groups (see table 1.3). Overall, there seems to have been an increase in the proportion of young people with savings since 1998/99. In 1998/99, 86 per cent of 16-24 year-olds and 91 per cent of 25-34 year-olds had some kind of savings (14 per cent and 9 per cent, respectively, had no savings accounts of any type). In 2008/09, as shown below, 97 per cent of 16-24 year olds and 98 per cent of 25-34 year-olds had some kind of savings (3 per cent and 2 per cent, respectively, had no savings accounts of any type). There have been increases in the number of people with a current account; perhaps the main change, however, is the popularity of new savings products such as ISAs in comparison to predecessors such as TESSAs.

[1] It should be noted of course that a large number of people under 30 will not be recognised as the household referent or as 'head of household'; their financial circumstances and/or behaviour are therefore not recorded here.
[2] See note 1.

Table 1.1 Weekly expenditure and income by age, 2009

Age of household referent person	Weekly expenditure		Weekly household disposable income		Weekly household gross income	
	£ per household	£ per person	£ per household	% spent per week	£ per household	% spent per week
under 30	430.4	177.6	470	91.6	575	74.9
30-49	558.8	191.4	690	81.0	873	64.0
50-64	485.4	219.2	602	80.6	744	65.2
65-74	341.7	191.3	423	80.8	464	73.6
75 or above	236.4	164.2	307	77.0	331	71.4
All	455.0	194.4	558	81.5	683	66.6

Source: ONS Living Costs and Expenditure Survey
1. Expenditure figures do not include mortgage interest payments
2. Average number of people per household = 2.4 (under 30), 2.9 (30-44), 2.2 (50-64), 1.8 (65-74), 1.4 (75 or above), 2.3 (All).

Table 1.2 Proportion of gross weekly household income from different sources by age, 1998/99 and 2008/09

	Source of income																	
	Wages and salaries		Self-employed income		Investments		Tax credits		State pension plus any IS/PC		Other pensions		Social security disability benefits		Other social security benefits		Other sources	
Age, head of household	98/99	08/09	98/99	08/09	98/99	08/09	98/99	08/09	98/99	08/09	98/99	08/09	98/99	08/09	98/99	08/09	98/99	08/09
16-24	64	66	3	4	-	-	n/a	5	-	-	-	-	1	-	14	10	18	14
25-34	81	87	7	6	1	1	n/a	3	-	-	-	-	1	-	8	5	2	2
35-44	76	77	12	11	1	1	n/a	3	-	-	-	-	2	1	7	5	2	2
45-54	75	78	12	10	3	2	n/a	1	-	-	2	2	2	1	4	4	2	2
55-59	64	55	12	27	4	3	n/a	-	1	1	9	6	4	1	4	4	2	2
60-64	46	44	9	10	6	5	n/a	-	5	9	20	20	7	2	5	7	2	2
65-74	13	12	4	5	9	6	n/a	-	35	35	29	30	4	4	4	6	2	2
75-84	6	5	2	2	8	6	n/a	-	42	41	27	31	6	5	8	7	1	2
85+	5	2	1	-	9	7	n/a	0	47	44	18	26	9	7	11	11	1	3
All households	64	63	9	10	3	2	n/a	2	6	6	7	7	3	1	6	5	2	2

Source: Family Resources Survey
1. All figures are percentages
2. Tax credits were not available in 1998/99
IS = Income Support
PC = Pension Credit (not available in 1998/99)

Table 1.3 Households by type of savings and investment and age, 2008/09

Age, head of household	Type of savings and investments									
	Current account	NSI Savings Account	Basic Bank account	Post Office card account	ISA/PEPs	Other Bank / Building Society Account	Stocks and shares / member of a Share Club	Unit trusts	Premium bonds	Company share scheme / profit sharing
16-24	88	3	11	5	26	35	6	1	9	2
25-34	92	3	8	4	35	45	10	2	11	5
35-44	93	3	8	5	33	48	16	2	17	6
45-54	93	4	8	5	41	49	21	4	25	5
55-59	92	5	7	5	48	54	25	6	29	3
60-64	93	5	6	6	52	53	25	6	30	2
65-74	89	5	4	11	49	49	20	6	31	1
75-84	88	4	4	14	42	49	19	5	29	-
85+	86	6	2	16	32	50	15	3	23	-
All households	91	4	7	7	40	48	18	4	22	3

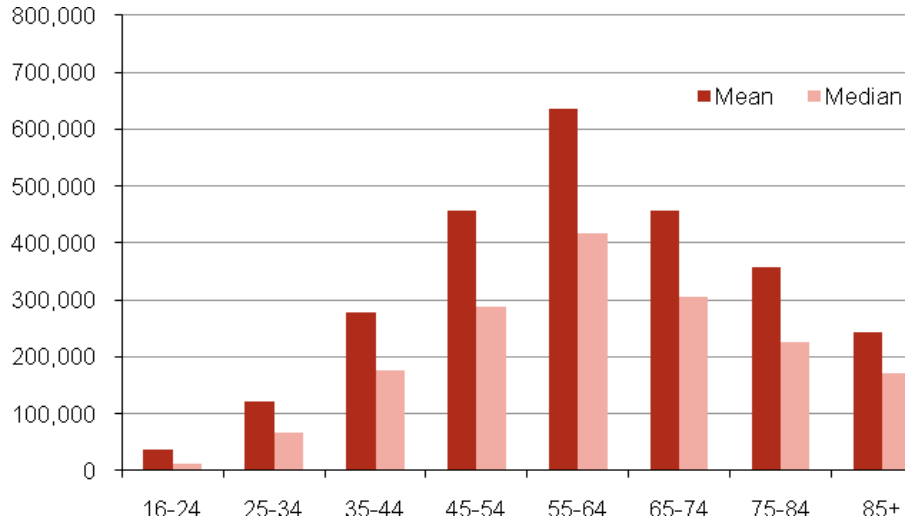
Source: Family Resources Survey
1. All figures are percentages
2. Endowment Policy (not linked), National Savings Bonds, Credit Unions and other types of assets have been excluded from these results due to small proportions across all age groups.

Results from the Wealth and Assets Survey are presented below. Figures 1.4 and 1.5 show the distribution of household net total wealth by age of head of household.[3] Net total wealth is made up of four components: net property wealth, net financial wealth (explored further below), physical wealth and private pension wealth. Clearly, the differences between generations are significant, but particularly large when pension wealth is included. Figure 1.6 shows the distribution of household net financial wealth by age of head of household.[4] Net financial wealth is the sum of formal financial assets (not including overdrawn current accounts, informal assets held by assets, children's assets, and endowments for the purpose of mortgage repayments, minus financial liabilities comprising arrears on consumer credit and household bills, personal loans and other non-mortgage borrowing, informal borrowing, and overdrafts.

Clearly, today's young people have fewer assets than older age groups. This should be expected, as young people have had less time to build up or inherit assets. There is evidence from the Family Resources Survey, however, that suggests that today's young people are more likely than the previous generation to have savings in some form. Yet this trend cannot be taken at face value; they do not, for instance, tell us whether young people are saving more. The Wealth and Assets Survey, which records such information at the national level, commenced in only 2006.

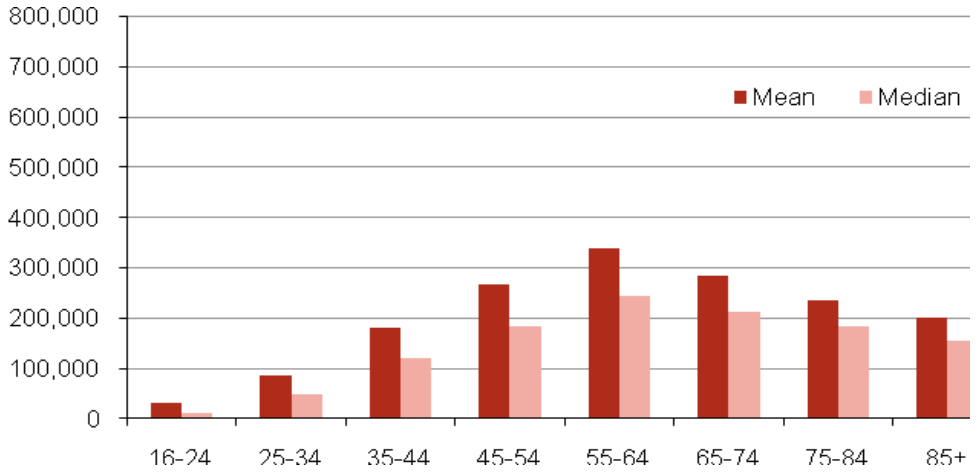
[3] See note 1.
[4] See note 1.

Fig 1.4 Distribution of household net total wealth by age (£), 2006/08



Source: ONS Wealth and Assets Survey
1. Age refers to head of household

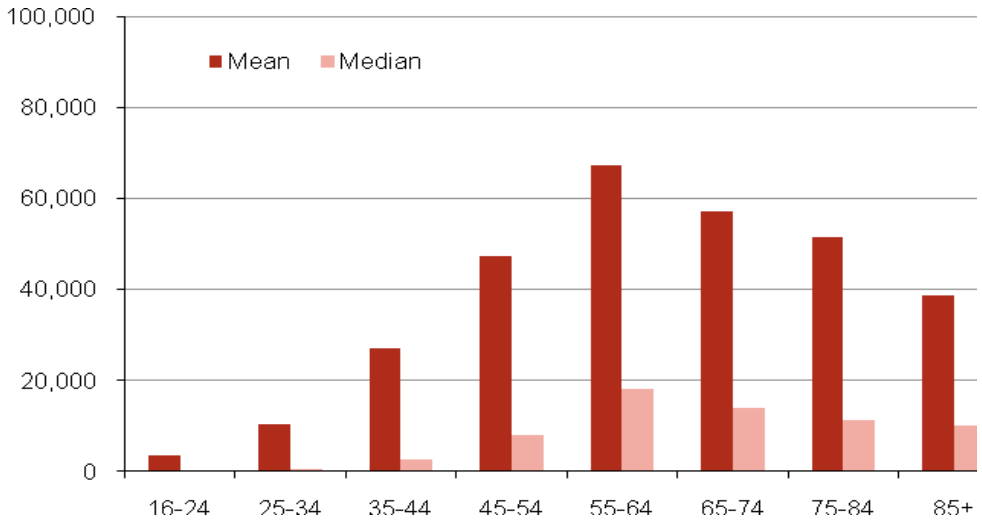
Fig 1.5 Distribution of household net total wealth by age (£), excluding pension wealth 2006/08



Source: ONS Wealth and Assets Survey
1. Age refers to head of household

The assets profile of today's young people cannot be assessed in full without considering the problem of indebtedness. There are significant reasons to be concerned about the financial future of young people. ILC-UK research based on the British Household Panel

Fig 1.6 Distribution of household net financial wealth by age (£), 2006/08



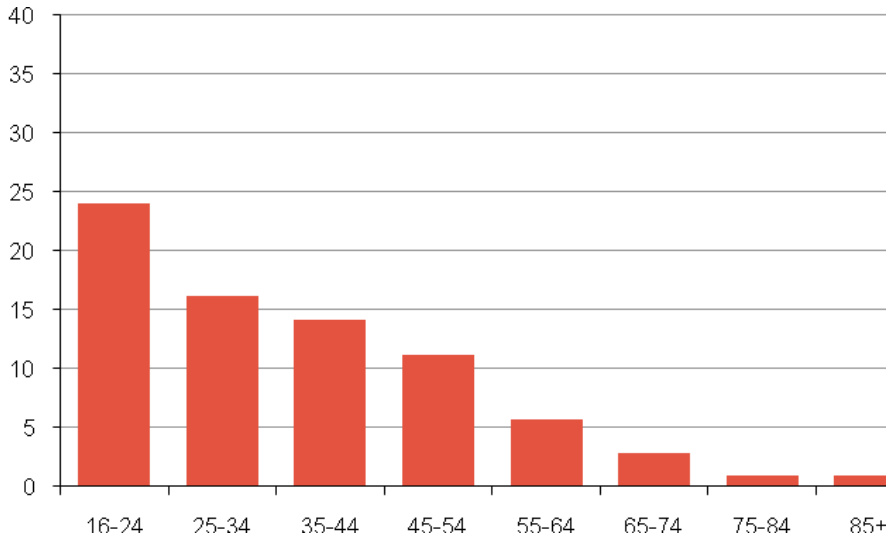
Source: ONS Wealth and Assets Survey
1. Age refers to head of household

Survey by Richard Boreham and James Lloyd (2007) has suggested that an increase in indebtedness among young people between 1995 and 2005 largely cancelled out an otherwise steady increase in liquid assets. The cohort aged 25-34 in 1995 had mean household liquid debt of £2400. The equivalent cohort in 2005 had mean household liquid debt of £4600. Moreover, when the 1995 cohort had reached the age category 35-44 by 2005, liquid debt had increased from £2400 to £4500.

While we might expect older age groups to have accumulated greater levels of assets, there are few strong reasons to expect younger people to have built up higher levels of liquid debt. Yet the Wealth and Assets Survey shows that the 25-34 age group is the UK's most indebted: a quarter of households have net financial wealth of below *minus* £2800. Young people are also far more likely to be in arrears, that is, unable to meet household commitments such as repayments on (mortgage and non-mortgage) borrowing, rent, and other household bills (see figure 1.7).[5] They are also more likely to run out of money: 50 per cent of people aged 16-24 and 41 per cent aged 25-34 report that they run out of money by the end of the week or month at least 'sometimes' (compared to 40 per cent for those aged 35-44, 33 per cent for 45-54, 23 per cent for 55-64, and 17 per cent for 65-74). The FSA's baseline survey shows that 24 per cent of those aged 20-29 are overdrawn on one or more accounts in their own name (compared to 19 per cent for those aged 30-39, 15 per cent for 40-49, and 11 per cent for 50-59). Furthermore, 24 per cent of those aged 20-29 have outstanding borrowing which is greater than 300 per cent of their monthly income (compared to 18 per cent for those aged 30-39, 14 per cent for 40-49, and 10 per cent for 50-59).

[5] See note 1.

Fig 1.7 Proportion of households in arrears, 2006/08



Source: ONS Wealth and Assets Survey
1. All figures are percentages
2. Age refers to head of household

The expansion of higher education is also relevant to the increased indebtedness of today's young people. While university funding increased under the previous government, increasing demand for places means that funding per head in the UK halved between 1986 and 2006 (Leitch Review, 2006). The shortfall may have contributed to the declining economic value of degrees, but it has also been made up to some extent by increased contributions from students themselves (in England and Northern Ireland; the Scottish and Welsh systems remain more generous). The system of grants and subsidised loans has been gradually eroded, and course fees increased (Wyness, 2010). The full financial impact of the high level of debt burden for young graduates is not completely known. Furthermore, new funding arrangements may discourage potential university applicants from poorer backgrounds, although repayments of maintenance loans and deferred fees are income-contingent. Some graduates may wish to focus on repaying student debts before saving for a pension – and those now unable or unwilling to attend university may face more barriers in the labour market. In addition to the direct financial impact, it is arguable that the use of debt to fund university education has sanitised today's young people, to some extent, to personal debt.

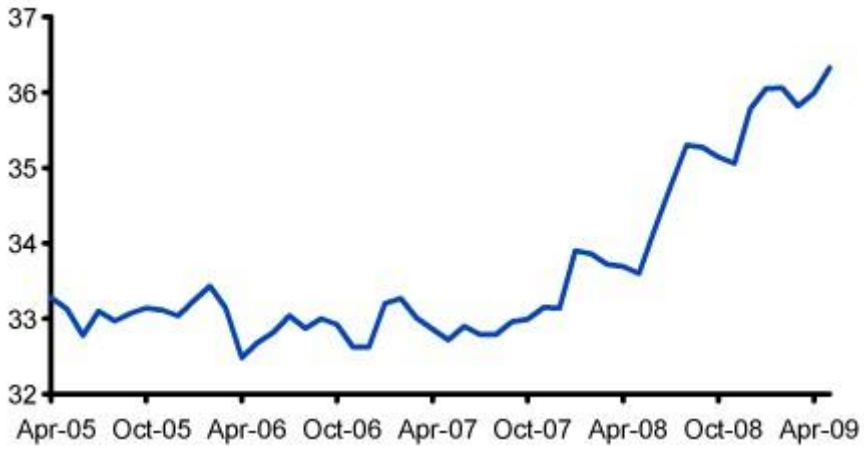
A recent YouGov poll also showed young people still exhibit financial 'bad habits' despite the economic downturn. For example, 29 per cent of people aged 18-24 have more than one personal current account with overdraft facilities – nearly 1 in 10 in fact have three or more. In total, two-thirds of people aged 18-24 in 2010 have applied for a credit card; less than 1 in 5 of these claim to pay their monthly bill in full, compared to almost half of those aged over 55 with a credit card (Sarbah, 2010).

We know that today's young people aspire to get onto the housing ladder (Bosanquet & Gibbs, 2005). In fact, there is evidence that young people place more trust in investing in property than in saving for a pension (Pettigrew et al, 2007). It was noted above that the number of young people saving seems to have increased in recent years. However, it also seems that the need to save for a mortgage deposit is the key factor behind this trend (Hyde, 2010). It is clear that young people face manifold difficulties in buying their first home. Most obviously, the rate of increase in house prices has far outstripped inflation and earnings in recent decades – with the pace increasing even more significantly in the last ten years. More specifically, the gap between the average house price for first-time buyers, and the average income of first-time buyers has increased enormously since the 1970s. The slowdown in house-building, particularly in the public sector, has contributed to this trend – the average number of homes completed per year between 1951 and 1984 was over 300,000; it dropped to below 200,000 for the period 1998 to 2009. The sale of social housing on a massive scale has also been an important contributory factor (Howker & Malik, 2010; see also DCLG, 2011).

While home-ownership has increased significantly since the 1970s, the pace of increase has slowed considerably in recent years. Despite this, Boreham and Lloyd's research (2007) research, noted above, found a significant increase in the proportion of assets held in illiquid rather than liquid form. While home-ownership barely increased amongst comparable cohorts of young people between 1995 and 2005, the continuing increases in house prices meant that those who had managed to get onto the housing ladder in this period had seen huge rises in the net value of their assets, given that house prices outstripped mortgage debt. This creates somewhat misleading aggregate figures, given that those not able to buy property in the period have not benefited in this way. However, Boreham and Lloyd also deliver significant bad news for those young people that did manage to get onto the housing letter. While house prices increased faster than the value of mortgage debt, mortgage debt itself increased faster than income, potentially locking young home-owners into long periods of indebtedness and financial difficulty. Data published by the Council of Mortgage Lenders (CML) in recent years shows that – despite the proliferation of mortgages full property value – the average deposit required for first-time buyers, and as such the average age of first-time buyers, has also increased significantly between 1984 and 2004 (Smith et al, 2005).

Research for the Joseph Rowntree Foundation has detailed the difficulties that many young people have in trying to get onto the housing ladder. It is clear that the availability of financial support from parents and grandparents, the so-called 'bank of mum and dad', is vital – more of a leg-up than a ladder (Kelly, 2010). Indeed, more recent data published by the CML shows that while the average age of first-time buyers has remained fairly stable between 2005 and 2009 at around 31 or 32, the average age of first-time buyers not in receipt of support from their family has increased hugely over the same period, particularly since 2007 (see figure 1.8).

Figure 1.8 Average age of first-time buyers in the UK not receiving financial support from their family



Source: CML

Increasingly, today's young people (particularly those without strong family support) are vulnerable to becoming trapped in 'chaotic' housing pathways (Rugg, 2010). Many young people are unable to afford to leave their parental home, and many also experience the 'boomerang effect' of moving between home and the private rented sector (Kneale et al, 2010). Ed Howker & Shiv Malik (2010) have documented the myriad wider impacts of living in the family home until later in the lifecourse, including the alarming implications for relationships, employment prospects, and propensity for violence. In terms of renting, the Survey of English Housing shows that the average age of head of household in the private rented sector has risen significantly in the last ten years, despite the costs and vulnerabilities associated with the sector for many young people (Rugg, 2010; see also Howker & Malik, 2010).

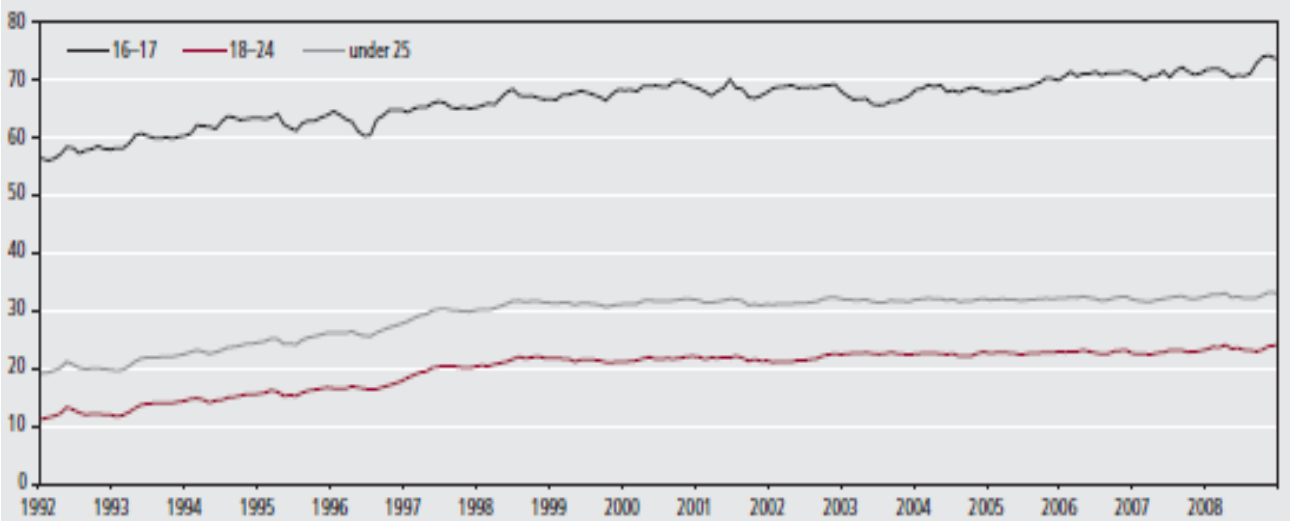
James Lloyd (2007) has warned that asset-building for retirement is now skewed too heavily in favour of property. As such, he calls for more financial advice to educate individuals on the potential problems associated with the housing market. It is arguable, of course, whether today's young people should be advised to save towards a mortgage deposit. Buying a house is, at least, an investment, and on that basis may be preferable to renting. But it may be that a failure to save for a pension will have a far greater impact on the future of retirement for young people, than a failure to become home-owners – especially when we consider the volatility of the housing market. Either way, it seems clear that problems associated with housing for today's young people have a significant impact on individuals' ability to build up assets in other forms. Overcoming this would require a cultural shift away from home-ownership (perhaps dependent itself on an increase on value for money within the private rented sector), or alternatively, a once-in-a-generation solution to housing scarcity.

Employment and skills

- Higher education has become increasingly important to the employability of young people, but the value of degrees has declined.
- Youth unemployment is higher now then at any point since comparable records began, and young people have been disproportionately affected by the economic downturn.
- Young people are increasingly likely to be employed in temporary positions, which may undermine broad stability in the full-time earnings of older and younger workers.
- Qualitative research suggests today's young people value freedom and control in work more than previous generations, and are happier to change jobs and careers frequently. The implications for pensions saving are unclear.

Recent decades have witnessed a dramatic increase in the number of young people attending university. The Further Education and Higher Education Act 1992 granted university status to around 50 'polytechnic' educational institutions, but more generally, this trend can be seen as part of a wider transition of the UK labour market: fewer skilled positions in the manufacturing industry, which had not relied traditionally on recruiting graduates, and a growing number of 'white collar' jobs with skills profiles more amenable to a university education (Barham et al, 2009). Higher education has therefore become a key component of the employability of young people entering the labour market for the first time. According the Department for Business, Innovation and Skills (2010), the higher education participation rate for people aged 17-30, in the UK, in the academic year 2008-09 was 45 per cent (41 per cent for men, and 50 per cent for women), up from 43 per cent in the previous year.

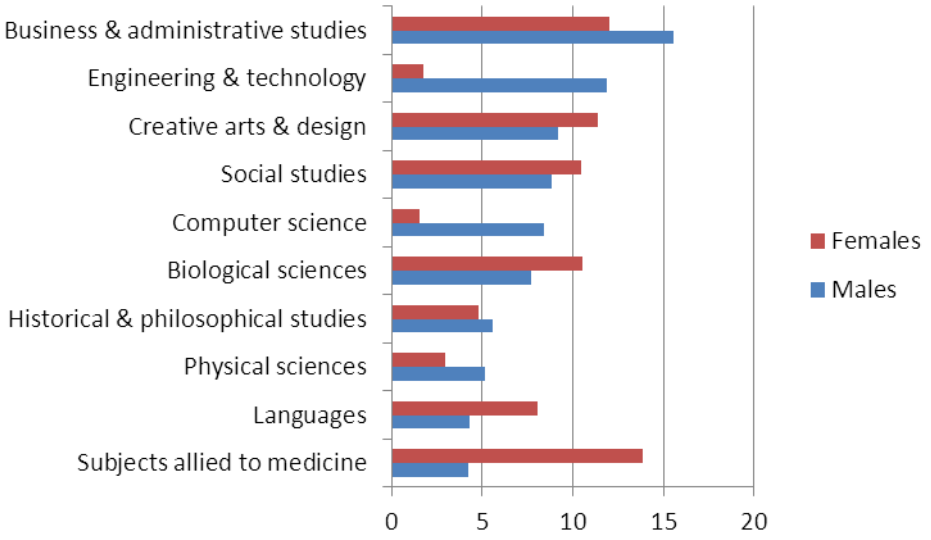
Fig 1.9 Proportion of young people in full-time education in the UK by age, 1992-2008



Source: ONS Labour Force Survey
1. All figures are percentages
2. Series data from March-May 1992 to October-December 2008; data seasonally adjusted

Figure 1.10 also shows the most popular degree subjects, for first degrees. The most interesting results are the domination of degrees related to business and administration, and the large gender gaps in engineering and technology, and computer science (in favour of men), and subjects allied to medicine (in favour of women). Interestingly, however, the latest data from the Higher Education Statistics Authority (2011), suggests that while the domination of business and administration increased between 2005 and 2010, the gender gaps in education and technology and subjects allied to medicine narrowed over this period.

Fig 1.10 First degree qualifications obtained (selected results) by gender, 2007-08



Source: DCSF; Welsh Assembly Government; Scottish Government; Northern Ireland Department of Education; Higher Education Statistics Agency
1. All figures are percentages

Inevitably, the escalating numbers of graduates has, to some extent, saturated the graduate jobs market. As such, the value of degree qualifications for individuals has been questioned. Various studies have found that that the gap in earnings of graduates compared to those without degrees has narrowed in recent years; graduate 'over-education' has therefore become a concern for today's young people, and indeed a cause of job dissatisfaction (see Walker & Zhu, 2005; Green & Zhu, 2010). Furthermore, the difference in value between subjects studied is stark. Whereas a male mathematics or computing graduate can expect a gain of around £220,000 over his working life, compared to someone leaving school with only A-Levels, the for an arts graduate is less than £25,000. Of course, measuring the value of particular degrees is not an exact science – indeed some studies claim that certain subjects have a negative impact on lifetime earnings (see Bosanquet & Gibbs, 2005; O'Leary & Sloane, 2005). There is also evidence that degrees from prestigious or 'good' universities confer much higher lifetime earnings on

their recipients than lesser institutions (Chevalier & Conlon, 2003).

Clearly, many graduates do not fare well in the workplace after leaving higher education. A 2008 survey by the Confederation of British Industry found that many companies believe some graduates lack basic literacy, numeracy, problem-solving and self-management skills necessarily to succeed in the workplace. As a result of the apparent lack of value of undergraduate degrees, many graduates are concluding that 'the degree is not enough', and are focusing instead on building up experience and achievements outside of formal education (Tomlinson, 2008). It seems the pressure to demonstrate their employability is much greater for today's young people than previous generations – compounded by the fact that the value of higher education is far from guaranteed.

Youth unemployment has been a feature of the UK labour market for several decades. However, it is higher now than at any point since comparable records began in 1992; 1 in 5 people aged 16-24 is out of work. Of course, rising participation in further and higher education partly explains this trend, but young people not in education, particularly those aged 16-17, have been experiencing significantly increased unemployment rates since the late-1990s. The same period has also witnessed the problem of 'NEETs', that is, young people not in employment, education or training – particularly among young women (Barham et al, 2009). Table 1.11 shows the distribution of young people by educational and labour market status. It should also be noted that on-the-job training is far more likely to be offered to young people that have qualifications before they enter the labour market; the higher their pre-existing qualifications, the more likely they are to be offered training in the workplace (Barham et al, 2009).

Table 1.11 Education and labour market status of young people in the UK by age, 2008

		Percentages		
		16-17	18-24	16-24
In employment...	and in education	28	21	23
	not in education	5	42	34
	Total in employment	33	64	57
Unemployed...	and in education	8	2	4
	not in education	4	7	7
	Total unemployed	12	10	10
Inactive...	and in education	53	18	26
	not in education	2	8	7
	Total inactive	55	27	33
Total not in employment, education or training (NEET)		6	15	13

Source: ONS Labour Force Survey

1. Base for percentages excludes people with unknown educational status

While young people have not experienced significantly lower employment rates than other age groups, it seems that the recent recession has disproportionately affected young people. The unemployment rate for people aged 16-24 has risen more sharply than other age groups since 2008. Inevitably, it is often cheaper and easier for employers to make younger, less experienced employees redundant. Furthermore, many employers freeze or reduce recruitment during recessions, meaning opportunities for new entrants in the labour market may be disproportionately reduced. The recent recession, however, has witnessed an additional effect: firms have retained greater numbers of employees than economists normally expect during recessions (due in part to an increase in part-time working). As such, there may be fewer opportunities for young people even as the economy starts to recover (Potton, 2010; see also Howker & Malik, 2010).

Young people are more likely to be employed in temporary employment than other age groups. In 2008, 17 per cent of 16-17 year olds and 12 per cent of 18-24 year olds were in temporary positions, compared to around 6 per cent of working age people in general (Barham et al, 2009; ONS, 2011). Of course, the expansion of further and higher education may explain this situation. However, it may also be related to the changing nature of labour market conditions for today's younger people. Table 1.12 outlines the reasons given for employment in temporary work, according to educational status. For those not in education, an inability to find permanent employment is by far the most important reason for employment in temporary positions. It is worth noting here that the current government intends to introduce a three-month waiting period before employers are required to automatically enrol temporary workers into NEST or an equivalent scheme. While individuals can 'opt in' during this period, the change is likely to restrict the number of temporary workers benefiting from minimum employer contributions into an occupational pension.

Table 1.12 Temporary young workers by reason for taking a temporary job by education status, 2008

	Percentages					
	In education			Not in education		
	16-17	18-24	16-24	16-17	18-24	16-24
Contract includes a period of training	6	9	8	*	6	6
Contract for probationary period	3	2	2	*	7	8
Could not find a permanent job	8	7	7	48	40	40
Did not want a permanent job	53	50	51	14	17	17
Some other reason	30	32	32	20	30	29

Source: ONS Labour Force Survey

** Sample too small to provide an estimate*

Table 1.13 Proportions of people aged 18-24 employed in different industries, 1995 to 2008

	Agriculture and fishing	Mining, energy and water	Manufacturing	Construction	Distribution, hotels and restaurants	Transport, storage and communications	Finance and business services	Public administration, education and health	Other services
1995	2	1	19	7	30	5	15	15	7
1996	2	1	19	6	31	5	14	15	7
1997	1	1	18	6	33	5	14	14	7
1998	1	1	18	6	33	5	15	13	8
1999	1	1	16	6	33	6	16	14	8
2000	1	1	15	6	33	6	16	14	7
2001	1	1	14	7	33	6	17	15	7
2002	1	1	13	7	33	6	16	16	7
2003	1	1	12	8	35	5	15	16	8
2004	1	1	10	8	36	5	14	17	8
2005	1	1	10	9	35	5	14	16	8
2006	1	1	9	9	35	5	15	16	8
2007	1	1	10	9	34	5	15	16	8
2008	1	1	9	9	36	4	14	16	9

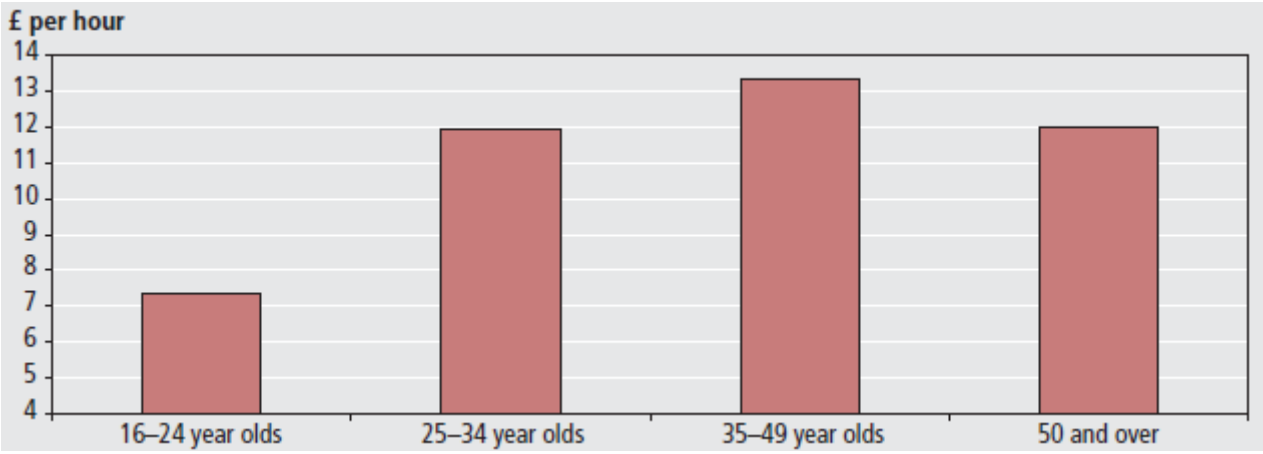
Source: ONS Labour Force Survey
1. All figures are percentages

Recent years have seen notable shifts in the industries within which young people are employed, as detailed in table 1.13. These changes have, of course, taken place in the context of wider economic trends. The declining number of jobs for young people in manufacturing reflects the decline of manufacturing more generally – in 1978 the sector provided 26 per cent of all UK employment, but this had fallen to 10 per cent by 2008. This has a particular impact, however, on young people: craft apprenticeships in the manufacturing sector had been an important route into the labour market, especially for men. This trend has been partly offset by a slight increase in the proportion of young people employed in construction, whereas in 2008 over 40 per cent of employees aged 16-24 were undertaking or had undertaken an apprenticeship (Barham et al, 2009).

There has been a significant rise in the proportion of young people employed in services, particularly the distribution, hotels and restaurants sector. Jobs in this sector are more likely to be part-time or non-standard. Yet this trend is also closely related to the expansion of further and higher education, given that employment of this type is easier to fit around studying. In general, industrial change has made the labour market more difficult for those with low educational attainment among the current generation of young people. However, young people are now far less likely to have no or few qualifications.

Inevitably, young people earn less than older age groups (see figure 1.14). Yet earnings growth for young people has been largely commensurate with older workers since 1997. Today's young people are no more likely to be earning less than older workers than

Fig 1.14 Median hourly earnings of full-time employees, 2008



Source: ONS Annual Survey of Hours and Earnings
1. Data excludes earnings from overtime for employees whose pay for the study period was not affected by absence
2. Data includes employees not on adult rates of pay

previous generations (although there has been a slight increase in the pay gap between workers aged 16-24 and those aged 50 or over since 2003. Furthermore, the impact of the national minimum wage means that the earnings distribution among young people is now less unequal than in 1997 (Barham et al, 2009). However, these figures must be presented with an important caveat: they are based on earnings of full-time employees, but today's young people are more likely to work part-time than older age groups, and previous generations of young people.

There has been some research on today's young people's understanding of and approach to work. Most of the available evidence is based on young people in the United States. Hae Jung Kim et al (2009) studied today's young people employed in the American retail sector. They found that

> Gen Yers [sic.] are active job crafters rather than passive recipients in the conventional job design model. Gen Y employees who are confident and prefer some control and less-structured environments may be more likely than previous generations to adapt job characteristics to make work more meaningful.

Kim et al's conclusion was that today's young people are not suited to careers in the retail sector. In addition to working arrangements, young people were also unconvinced about the meaningfulness of jobs in this sector. The same conclusion was reached by Jessica Hurst and Linda Good (2009); they added that the often unsociable hours in this sector contradicted young people's desire for work/life balance. This point was also emphasised by a cross-sectoral study by Lucy Cennamo and Dianne Gardner (2008). They compared young employees with those belonging to 'Generation X' and the baby boom generation, finding that today's young people place more value on freedom in both the workplace and their lives more generally.

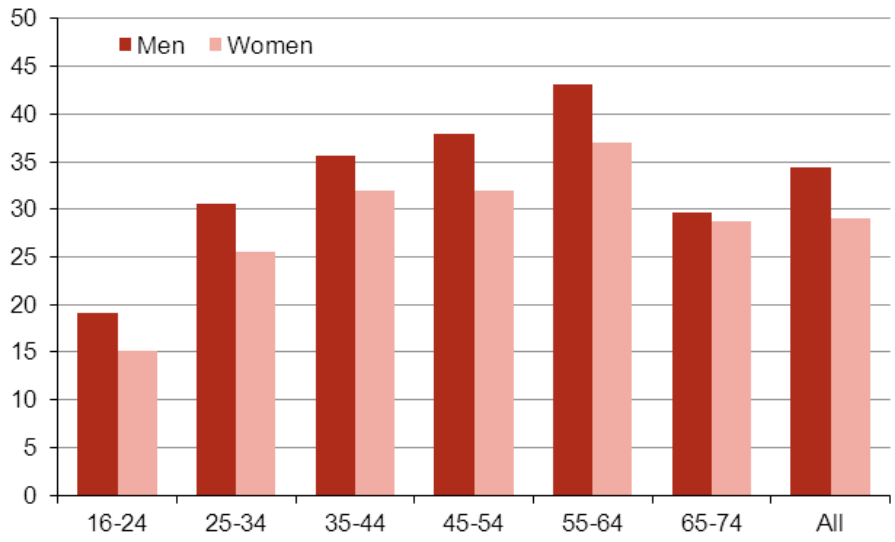
We should be careful of inferring too much from these arguments. Whereas young people's approach to work is often seen as negative, it is potentially extremely positive for tomorrow's economy that today's young people are demanding and keen to innovate. One way in which it may be negative, however, is in enabling retirement savings. If young people are prepared to sacrifice employment and remuneration opportunities in pursuit of a better lifestyle or a higher job satisfaction, it may constrain their ability to build up a pensions savings pot. The various exogenous pressures faced by young people in the labour market, explored throughout this section, may also have this implication. This is a possibility enhanced by the likelihood that young people will change employers and even careers frequently in their working life, as the next chapter explores. This could be a source of insecurity, but young people may be well-suited, and even positively inclined, to this reality. The impact of such developments on pensions saving are unknown, but auto-enrolment should in principle mitigate any negative implications.

Pensions

- Today's young people tend not to plan for retirement, and think about later life in quite negative terms, or not at all.
- Young people have very little knowledge of pensions, due in part to the long-term nature of pensions saving.
- Young people are less likely to be enrolled in an occupational pension scheme, and more likely to be enrolled in defined contribution (DC) rather than defined benefit schemes. Moreover, DC contributions rates are lower for young people.
- There appears to be a loss of faith in the pensions industry among young people, due partly to a rise in individualist values and ICT, and exacerbated by the fact that young people are far less likely to have engaged extensively with financial services.
- Younger cohorts are less supportive of auto-enrolment and more likely to opt out, perhaps due in part to a desire for greater control over their finances.

There is clearly a tension between saving for the near future – to create a 'rainy day' fund, to build up a mortgage deposit, or simply to fund large instances of consumption like buying a car or going on holiday – and saving for the future. Of course, we know the two are closely correlated: those who (do not) save for now are, generally speaking, more likely to (not) save for the future. Yet today's young people may be particularly poor at saving for the long-term, despite the fact they seem more inclined to save for the short-term. The FSA's baseline survey found that young people are much less successful in 'planning ahead' – one of the four key domains of financial capability – than older cohorts. Moreover, the authors point out that this does not necessarily mean that young people's capability will improve in this regard as they get older: '[i]t may well be that the young people of today will be very different in their old age from the current older generations' (Atkinson et al, 2006). Similarly, in *Wealth in Great Britain*, the ONS (2009) showed that young people are far less likely to have considered for how many years they will need to fund their retirement, as shown by figure 1.15.

Fig 1.15 Proportion who considered how many years they will need to fund retirement



Source: ONS Wealth and Assets Survey (2006/08)
1. Data excludes retired individuals. 'All' category includes people aged 75+ not yet retired
2. Data excludes individuals answering 'Don't know'

This data largely concurs with a qualitative study undertaken by Nick Pettigrew et al (2007) on behalf of the Department of Work and Pensions (DWP). Pettigrew et al undertook sixteen focus group discussions with young people aged 16-29, supplemented with a series of one-on-one interviews with some participants. While they found some evidence that financial responsibility increases with age, overwhelming those surveyed emphasised the importance of using their income to live for today, rather than save for the future – with the partial exception of the more immediate goal of buying property (see also Lloyd, 2007). Generally speaking, the young people studied by Pettigrew et al did not think about retirement. They assumed they will become more affluent over their lifetime, and irrespective of how wealthy they were at the time of the research, they believed that they did not yet earn enough to start saving for retirement. There were some individuals who did report that they were already saving for retirement – they tended to be the people with the firmest plans and ambitions for their future more generally.

Across all participants, there was a general consensus that saving for retirement is a good thing, but actual 'savers' were viewed in quite negative terms as individuals by those not yet saving significant amounts. Later life was also viewed quite negatively by participants, as a time of stagnation and decline; related to this, they assumed that the cost of living falls in later life, therefore undermining the need to save for a pension. Pettigrew et al report that participants had very low knowledge of pensions, partly due to deliberate avoidance of the subject due to the long-term nature of pensions. One opinion expressed frequently by participants was that pension saving is not worthwhile if you change your job

frequently, and many of the participants had this expectation. Pettigrew et al's findings suggest that there is, on the one hand, complacency and unwillingness to think about the future among today's young people. They may be maturing in an age of austerity, but their relatively prosperous upbringing means they appear to lack the fear required to compel people to conserve their income for future needs. On the other hand, young people's inability to comprehend the long-term and understand the reality of later life prevents them for adequately planning for retirement.

According to the British Household Panel Survey, 26 per cent of people aged 25-34 in 1995 contributed to a private pension – this had halved to 13 per cent by 2005. Perhaps even more worryingly, by the time the 1995 cohort had reached the age of 35-44 in 2005, the proportion contributing to a pension had dropped from 26 per cent to 20 per cent (Boreham and Lloyd, 2007). Table 1.16 presents the latest data, from the Annual Survey of Hours and Earnings, on occupational scheme membership.

Clearly, occupational pension scheme membership continues to fall across most age groups, but particularly the young – at a time when individuals are being urged to save more for their own retirement. Personal pension scheme membership rates have also fallen, 'showing that where young people are exercising an active choice they are no longer investing in a pension' (Bosanquet & Gibbs, 2005). We know that young people are far more likely to be enrolled in a defined contribution rather than defined benefit occupational pension scheme, at least in part because private sector employers are increasingly closing defined benefit schemes to new entrants. Table 1.17 demonstrates, however, that the proportion of earnings paid into such defined contribution schemes is far lower for young people.

Table 1.16 Employee membership of an employee-sponsored pension scheme by age

	2005		2006		2007		2008		2009	
	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women
16-21	15	11	14	12	14	12	11	10	11	10
22-29	38	44	37	44	36	42	34	39	34	38
30-39	58	60	57	61	56	59	54	58	52	57
40-49	68	63	67	64	65	63	63	62	62	61
50-54	68	64	68	64	67	64	67	64	65	62
55-59	64	58	63	60	63	60	63	60	63	59
60-64	50	43	52	45	51	45	51	45	52	43
65+	17	16	15	17	16	17	19	18	14	15

Source: ONS Annual Survey of Hours and Earnings

1. Pension is arranged through an employer, main pension only

2. All figures are percentages

Table 1.17 Distribution of members of private sector defined contribution occupational pension schemes by age and contribution rates

	20-29		30-39		40-49		50-59		60+	
Total contribution rate	2006	2009	2006	2009	2006	2009	2006	2009	2006	2009
Greater than zero and under 4%	12	7	7	5	7	5	7	5	na	8
4% to under 8%	42	38	33	25	28	23	27	22	24	18
8% to under 12%	24	29	34	37	30	32	27	27	29	24
12% to under 16%	12	12	15	19	18	22	18	22	17	22
16% to under 20%	4	6	6	7	7	8	8	11	12	17
20% to under 24%	3	5	2	4	4	5	5	5	na	6
24% and over	2	3	3	3	6	5	8	8	10	6

Source: ONS Annual Survey of Hours and Earnings
1. All figures are percentages
2. Schemes not contracted out of the additional state pension
3. Pension is arranged through an employer, main pension only
4. Employee plus employer contributions; at least one is greater than zero
5. Contributions include one-off fixed amount payments, but exclude employer contributions covering more than one employee and Additional Voluntary Contributions by employees.
na = figure not available

In 2009, for instance – in addition to the fact they are less likely to be enrolled in an occupational pension in the first place – only 55 per cent of defined contribution scheme members contributed 8 per cent or more of their earnings to their pension (this figure *includes* the employer contribution). This compares to 70 per cent of those aged 30-39, 72 per cent of those aged 40-49 and 50-59, and 74 per cent of those aged 60 or over. Furthermore, table 1.13, above, demonstrated that today's young people are far more likely to be employed in the distribution, hotels and restaurants sector than other age groups, or previous generations. The Annual Survey of Hours and Earnings shows that employees in accommodation and food services have extremely limited occupational pensions coverage (ONS, 2010b).

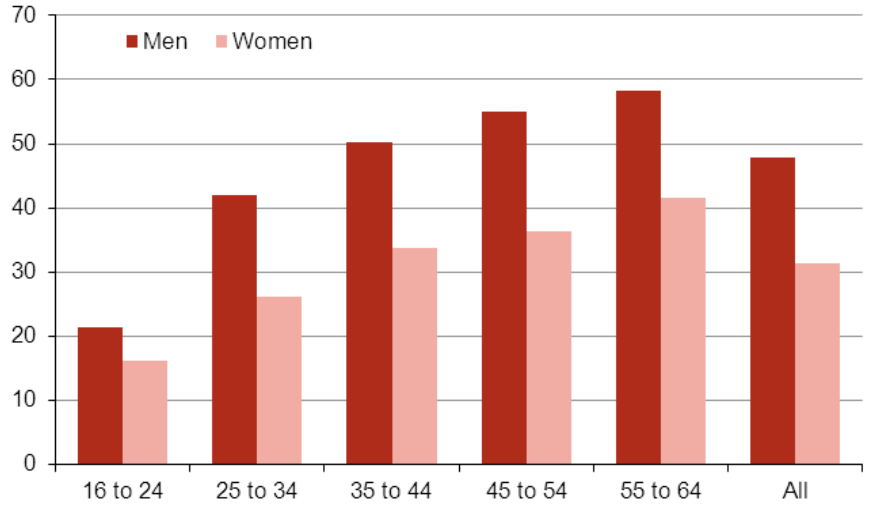
Many of the generational features of young people today may help to explain their lower membership and contribution rates in pension schemes. Clearly, lower earnings are a barrier: lower-income groups across the age distribution are less likely to save, and likely to save less. Property prices during the housing market boom also meant that young people required more of their income for housing costs, preventing retirement saving. However, we may be able also to point to a 'loss of faith' in the pensions industry among young people (Bosanquet & Gibbs, 2005). As discussed above, today's young people are less trusting of authority figures than previous generations and older groups, preferring to place trust in their peers. While this may not be entirely negative, clearly it has a detrimental impact on propensity to save for a pension. A Chartered Insurance Institute (CII) (2010) report on trust in financial services argues that the 'golden age' of trust is over,

at least partly due to the rise of individualist values and the availability of instant information through new ICTs – factors which are most applicable to young people – and exacerbated of course by the recent financial crisis. Interestingly, the CII reports that lack of trust in financial services may not actually lead to behavioural change, in terms of switching providers. Instead, they find a phenomenon known as 'jimbyism' (i.e. just in my back yard); people trust their own bank, for instance, while upholding negative views of the industry in general. However, as Jackie Wells and Mary Gostelow (2009) have pointed out, this applies far less to young people not yet engaged by financial services – they have no personal experience to rely upon; as such, restoring trust in the industry in general should be a priority.

The complexity of pensions may also help to explain young people's pensions behaviour (Altmann, 2010). Figure 1.18 presents data from the Wealth and Assets Survey, showing that young people – particularly under the age of 25 – understand pensions less than other age groups. There is also a stark gender difference, across the age distribution.

The financial literacy of today's young people is poor (Autio et al, 2009; Lusardi et al, 2010; Bosanquet et al, 2008). This may be a cause of the pensions behaviour of today's young people, but may itself be a result of the circumstances into which young people have matured. Indeed, Adrian Furnham and Martin-Pierre Goletto-Tankel (2002) argue that it is attitudes towards financial services which generates levels of understanding about them. Programmes of financial education are generally based on the opposition proposition, that is, that a greater understanding of financial services will lead to more positive engagement,

Fig 1.18 Proportion who understand enough about pensions to make a decision about saving for retirement



Source: ONS Wealth and Assets Survey (2006/08)
1. Data excludes those above SPA and retired

but it seems that it may be necessary to address attitudinal features of young people in order for behaviour change – through education or otherwise – to be effective. Nick Bosanquet et al (2008) argue that today's young people are 'tech-savvy, financially inept'. Their technological know-how means they have a greater capacity for control over their finances. Moreover, they have a strong desire for control: when asked by polling company Populus in 2008 whose responsibility it is to check the suitability of a financial product at the point of purpose, either you or the financial institution, 70 per cent of 18-34 year olds agreed with the answers 'you' or 'both, but mainly you', compared with 19 per cent for 'the financial institution' or 'both, but mainly the financial institution'. Yet paradoxically today's young people 'are a generation which, on the one hand is using financial services with greater intensity; but on the other hand, is using them with less knowledge and confidence.' Many young people are confused by financial 'jargon', and lack a basic understanding of how aspects of financial products such as interest rates and tax relief work (Bosanquet et al, 2008).

It seems apparent that both financial illiteracy and pensions complexity must be addressed. Alternatively, it may be that we can simply 'nudge' young people into the right decisions, even if they don't fully understand them – an objective at the heart of the government's plan to auto-enrol eligible employees into a low-cost occupational pension scheme. However, auto-enrolment allows people the opportunity to 'opt-out'. Indeed, in a 2006 survey carried out for the government by the National Centre for Social Research with the University of Birmingham, more 18-24 year old employees opposed auto-enrolment than supported it, as table 1.19 demonstrates (Clery et al, 2007). It is estimated that around 20 per cent of eligible employees intend to opt out of occupational pension schemes after they become compulsory for most employers (Friends Provident, 2007). Moreover, can we ever be certain that the decisions we may nudge young people towards are the correct ones?

As such, auto-enrolment alone may not resuscitate retirement saving among young people. It is necessary to take into account the economic and financial circumstances, and likely behaviour, of today's young people in designing policies and products which aim to

Table 1.19 Views of employees on automatic enrolment by age, 2006

Whether employers should automatically enrol employees in their pension scheme	18-24	25-34	35-44	45-54	55-64	65-69
Should	42	56	59	56	64	61
Should not	56	43	39	41	34	36
Don't know	2	1	2	3	2	3

Source: Clery et al, 2007

1. All figures are percentages

2. Level of employer contribution not specified

encourage greater pensions saving. The third chapter considers various policy solutions in light of the analysis presented here. Firstly, however, the next chapter considers what kind of retirement futures today's young people can look forward, if current social and economic trends persist as expected.

*

It would be unwise to claim that today's young people are substantially different to previous generations of young people. In some ways they have more opportunities, in terms of higher education and career mobility than previous generations. However they also face a number of challenges, such as high unemployment rates and difficult housing pathways. It is normal to expect young people to be less concerned about retirement planning and accumulating assets for later life, but it seems that these challenges are postponing the age at which retirement planning and asset accumulation begins. The habit of pensions saving needs to be established during this transition phase; NEST and auto-enrolment will help in this regard, but may not be sufficient alone to counter negative attitudes towards saving.

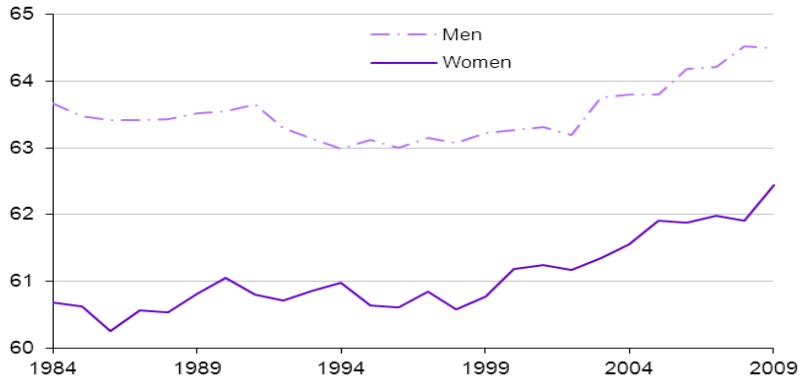
Chapter 2: Young people tomorrow

- Pensions policy and practice must take into account the likely futures that will be confronted by today's young people.
- Effective retirement ages have risen over the previous decade but we cannot assume that retirement ages will keep pace with increases in state pension age; the retirement paths of today's young people will be very different to their parents' generations.
- The trends likely to impact on young people over coming decades include: increasing longevity, population ageing and associated fiscal problems, postponed transitions to adulthood, a volatile housing market, the rise of flexible working, increasing care needs, the growing economic importance of the internet, and the rise of defined contribution pensions saving.

It is important that any policy or product designed to encourage or enable pensions saving by today's young people is grounded in an understanding of their generational characteristics. It is equally important, however, that policies and products take into account the likely futures that will be faced by young people – even where they are themselves complacent about the future. This will ensure that solutions are attractive to the intended market, and also appropriate to the context in which they will be utilised.

The nature and process of retirement has a long history (see Berry, 2010). The period of life spent in retirement has gradually increased as the state pension age has been lowered, while life expectancy has increased. The post-war era also witnessed significant falls in the average retirement age, as industrial change led to 'de facto' retirement for some older workers, and 'final salary' occupational pensions provided both the means and motive for many people to retire early. Of course, the post-war era was also characterised by periods of substantial economic growth, and in particular labour market growth. As table 2.1 shows, however, the average age at which both men and women withdraw from the labour market has been rising fairly steady, from around the turn of the century.

Fig 2.1 Average age of withdrawal from the labour market, 1984-2009



Source: ONS Labour Force Survey
1. Data not seasonally adjusted

Box 2.2 Likely retirement paths for 'baby boomer' generation

Eric Eric is a university-educated, public sector middle-manager. His final-salary pension enables him to retire in his late-50s, when his work becomes repetitive and less stimulating. He becomes a self-employed consultant for a short period but fully retires aged 60 to care for his wife. After her death he emigrates to South Africa to live with his daughter.	**Patricia** Patricia is a clerical worker in the financial services industry. She leaves full-time work aged 52, less able to cope with its demanding nature. She works part-time in menial jobs until receiving her state pension aged 60, topped up by a small occupational pension. She begins to receive home care, funded by the local authority, in her late-70s.
Laura Laura is a higher education lecturer. She gives up work in her mid-30s to start a family. She returns to work aged 40, albeit on a part-time basis in order to meet her elderly parents' care needs. She retires in her mid-50s as her own health begins to deteriorate, surviving on a small occupational pension topped up by means-tested benefits.	**Stephen** Stephen works as a surgeon in the NHS. At the age of 50 he moves to the US to establish a private practice. Despite his affluence, he continues working until his late-60s. In retirement he lives off a final-salary pension and the proceeds from selling his share in the practice. He continues to work as a volunteer in community health projects.
Dennis Dennis is a low-skilled worker in the manufacturing industry. He retires in his mid-50s due to ill-health and poor job quality. After his wife's death he lives with his son's family in his late-60s, but moves into residential care in his early-70s and dies soon afterwards.	**Ellen** Ellen is a university-educated public sector manager. She continues to work until her mid-60s, deferring her state and occupational pensions to retire alongside her husband. She is widowed aged 70, moves into residential care in her late-70s and dies in her mid-80s.
Victoria Victoria is successful entrepreneur in the hospitality industry. She ceases full-time work in her early-50s but continues in several board and trustee roles in the public and private sectors. She spends an increasing amount of time at her property in Spain, but moves into a high-quality retirement village in the UK in her late-60s.	**Bob** Bob is a semi-skilled construction industry worker. He moves between employment and self-employment throughout his career. He works in self-employment until aged 70, at which point his business is dissolved. His growing care needs are met informally by his wife; the bulk of his income is through means-tested benefits.

Source: adapted from Berry (2010)

Box 2.3 Possible retirement paths for 'Generation Y'

Amanda Amanda studied English at university, but struggles to find related work. She is enrolled into NEST in her mid-twenties, but periods of worklessness means that she does not build a significant pension pot. During a boom in online publishing, Amanda finds a steady job, buys a house, and has a child aged 40. After several years working part-time, she is made redundant at 49 during a downturn. She relies on means-tested benefits in retirement.	**Michael** Michael leaves education at 18. He works in his father's business before becoming an entrepreneur, electing to concentrate on property development in his late-thirties after marriage and the birth of his two children. He has a high income for a sustained period, but does not save specifically for retirement. After a housing market downturn his business becomes insolvent. He joins an equity release scheme aged 70 but dies only 4 years later.
Chris Chris is from a poor background, but attends university to study law. He qualifies with significant debt, but manages to pay it off within ten years. He changes jobs frequently, focusing on internet privacy law. He has a high income and generous occupational pension. He becomes a part-time consultant for freedom of speech groups in his fifties. But his own retirement is dominated by providing and funding care for his parents. He never marries or has children.	**Ashley** After leaving education at 18, Ashley is unable to find a permanent job. She builds her experience through volunteering, leading eventually to a position in charity admin aged 26. She decides to save for a mortgage deposit rather than a pension, but is never able to buy a house. She has children in her late-thirties. She is required to support them for longer than anticipated, while caring for her parents. A small pension is hardly enough to cover her living costs in retirement.
Jennifer Jennifer reads media studies at university, intending to become a journalist. Unable to find paid employment, she works in administration in local government. After her mother is diagnosed with MS, Jennifer moves home to care for her. Eventually she reduces her hours and stops making NICs, but elects not to claim Carer's Allowance. Jennifer enrols in an equity release after inheriting her parents' home to support herself through retirement on her limited state pension.	**Matt** Matt trains in the manufacturing industry but is made redundant aged 26. Re-training enables him to find fairly stable employment with an online retailer. He sets up a sports-based blog forum in his spare time, which eventually launches as a business with significant revenue. Matt sells the business in his forties, and lives on the profits, but does not save for retirement. His own health deteriorates in his sixties; he lives until 95 but spends most of his retirement in poverty.
James James' parents support him through his mathematics degree, although his student debts remain high. He gets a good job at an accountancy firm but lives initially at home in order to minimise costs. He marries Kara, but despite a relatively high joint income, the couple are dependent on James' parents in assembling a mortgage deposit. As his career progresses, however, James is able to supplement his occupational pension with investment into a personal pension. James retires early at 66.	**Lauren** Lauren leaves school after her A-Levels and accepts an internship in the fashion industry. Her earnings are low, but she is promoted after obtaining a business degree through online study. She re-trains as an auditor after having children. However, early-onset dementia in her fifties leaves her unable to work. She is supported by her partner and children, but becomes increasingly dependent on local authority care services. She lives on disability benefits and a small NEST pension pot.

Although we can probably expect this trend to continue, this cannot be guaranteed. Certainly, there are no irrefutable reasons to assume that retirement ages will keep pace with the rising state pension age, and whether people can be persuaded in large numbers to work beyond state pension age. Indeed, as will be explored below, if old age support ratios are to be maintained in an ageing society, it may be that average retirement ages need to rise even more quickly than the trend seems to indicate.

Pensions saving takes place, by necessity and design, over the long-term. Consumption smoothing means that individuals forgo portions of their income when they are economically active in order to maintain their standard of living, as far as possible, in retirement. This is the foundation of all forms of pension saving, whether based on compulsion by the state, the enabling role of employers, or individual decisions. Chapter 1 argued that pensions saving vehicles of whatever form must take into account the generational features of their customer base. Equally, however, they must be informed by the future. In order to plan effectively for retirement, individuals must know what kind of retirement they are likely to face, and providers in the public and private sectors must know what kind of retirement their customers are likely to face. For instance, providers generally take into account likely changes in longevity when designing pensions products. Yet a time when individuals are increasingly expected to provide for their own retirement, without the aid of the state, it is important to know *how* today's young people will live when they reach retirement, as well as *how long* they will live.

As such, this chapter outlines eight key propositions on how socio-economic trends already evident or emerging are likely to shape the context of retirement decisions for today's young people. They are: longevity will continue to increase; population ageing will create significant fiscal problems; flexible working will become the norm; care needs will increase; buying a house will become more difficult and risky; individuals will become 'established' later in life; the internet will continue to transform economic behaviour; and most people will be enrolled in defined contribution rather than defined benefit pensions.

#1 Longevity will continue to increase

Average life expectancy at birth was below state pension age until the 1940s. As late as 1970, life expectancy at birth was below 75 for women, and below 70 for men. It stands today at 82 for women and 78 for men. By 2050, when today's young people will be around retirement age, it will be almost 90 for women and more than 85 for men (Harper et al, 2011; ONS 2010a). Furthermore, while life expectancy at age 65 has increased in recent decades (it is currently 20 years for women, and 18 for men), it is the case that increases in life expectancy have been due principally to the near-elimination of mortality before the age of 65. However, it is expected that future increases will come primarily in post-65 years (Piachaud et al, 2009).

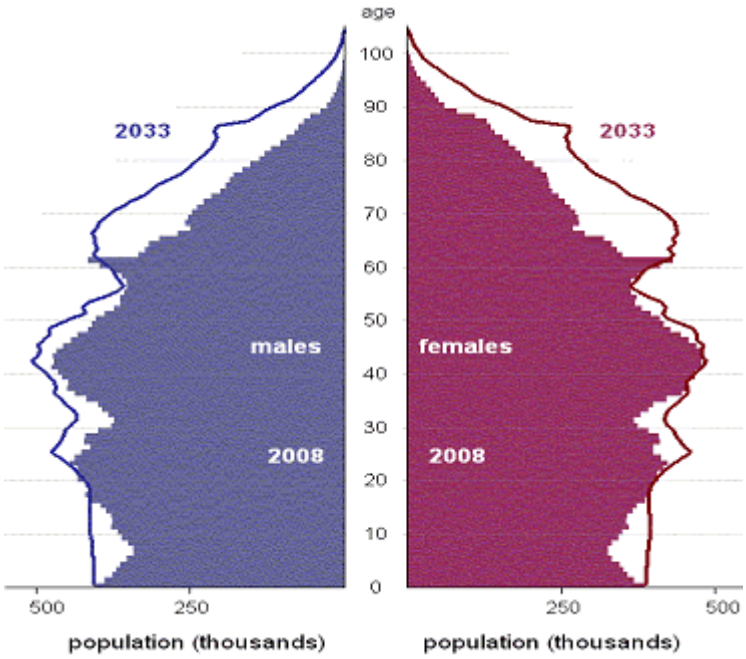
The implication is that today's young people will be living longer, and potentially spending much longer in retirement, than today's retirees. This is compounded by the fact that young people tend not to think about how long their retirement will be (see figure 1.15, above). Of course, it is likely that individuals' capacity to work for longer will increase, meaning they can save for retirement until later in life. However, this increased capacity cannot be taken for granted, and is unlikely to increase at the same rate as longevity. Healthy life expectancy (HLE) and disability-free life expectancy (DFLE) are not keeping pace with life expectancy in general (Mayhew, 2009). Even if increases in HLE and DFLE expectancy were to increase proportionately, we cannot assume that people would automatically extend their working lives. Retirement itself has become an embedded social institution which many people feel entitled to at a certain age, irrespective of how long they will be in retirement for (Berry, 2010).

#2 Population ageing will create significant fiscal problems

The total amount of age-related public expenditure is expected to increase more than 5 percentage points of GDP from around 19 per cent of GDP in 2007 to 24 per cent in 2060, rising steadily over this period (EUEPC, 2009; see also HM Treasury, 2009). Spending on state pensions alone is projected to increase from 4.9 per cent of GDP in 2006/07 to 6.1 per cent of GDP by 2050/51 (DWP, 2008). Increases in life expectancy, noted above, may be projected to occur at a slightly slower rate in future decades, yet it remains the case that longevity far outstrips the planned increases in state pension age (Harper et al, 2011). Concerns over the fiscal sustainability of an ageing population is the context in which the state is beginning to withdraw from funding long-term care for older people, placing more of the burden on individuals themselves – even though around 1 in 4 people believe that the state will pay for all of their care needs in later life (Wardrop & Beckford, 2009).

Figure 2.4 details the extent of the UK's ageing population. Clearly, old age support ratios are set to decline significantly (although extended working lives could mitigate the impact) – creating economic as well as fiscal dilemmas. The population pyramid will become much flatter, vividly demonstrating the scale of the challenge for today's young people in maintaining economic growth and fiscal sustainability as they take command of the economy in coming decades and begin to support today's retirees. The ONS publishes population projections as far into the future as 2070, by which time the mini-pyramid at the top of the age spectrum will flatten further – suggesting that as well as supporting older people during their working life, there will be a proportionately smaller working age population to support today's young people during their retirement.

Fig 2.4 UK population pyramid by gender and age, 2009 and 2033



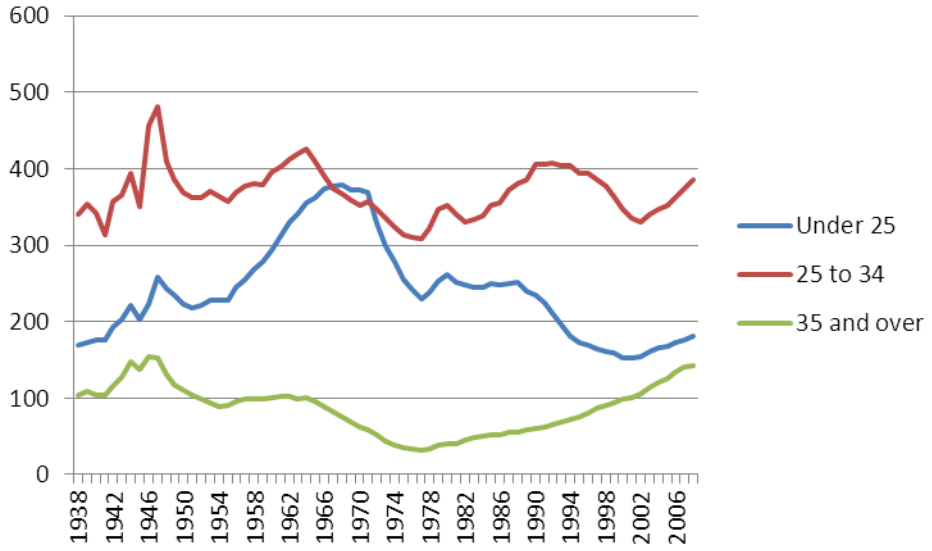
Source: ONS, General Register Office for Scotland, Northern Ireland Statistics and Research Agency

Population ageing could also create social and political problems by exacerbating conflict between different generations. While 'generational accounting' of public finances has been widely criticised as overly simplistic (see Piachaud et al, 2009), the impression that some age groups are more favoured than others in the distribution of financial and economic resources across society could lead to a decline in popular support for age-related public expenditure. The 2010 British Social Attitudes Survey confirms something found in other studies, that is, that young people have a strong sense of collective identity with each other – and that this fuels alienation from the rest of society. 55 per cent of people describing themselves as young believe they have been the victim of age discrimination in the previous year – far more than older people. The survey paints a picture of growing intergenerational conflict, between today's young people and their parents' generation, the baby boomers (NatCen, 2010; see also Howker & Malik, 2010).

#3 Individuals will become 'established' later in life

The previous chapter suggested that transitions between adolescence and adulthood are becoming more prolonged. It is worth exploring this in more detail here. Certainly, individuals appear to be having children later in life. Figure 2.5 shows that the number of children born to mothers aged 35 or over has been rising for several decades, with the number of children born to mothers aged

Figure 2.5 Live births by age of mother at birth of child, 1938-2008



Source: ONS Social Trends 40
1. Figures are thousands
2. Refers to England and Wales only

under 25 falling over the same period. In fact, population growth softens the figures statistically – the fact that on average individuals tend to have fewer children today makes the trend even more stark. Furthermore, the mean age of marriage for men in England and Wales increased by around 5.5 years in the decade up to 2008, to age 36.5; for women, mean age of marriage rose by around 4.5 years over the same period, to 33.8 (ONS, 2008).

Analysis of British Household Panel Survey data from 1991 to 2004 by Morten Blekesaune et al (2008) shows us that, generally speaking, later 'establishment' in adulthood leads to later retirement. This applies to family formation, but also to home ownership and career commencement. However, this is not because later establishment means people work for longer in order to 'catch-up' on retirement saving. Rather, later establishment has been associated with staying in full-time education for longer, and as a result enjoying higher levels of job satisfaction in later life. This mitigates the *early* retirement incentive of generous and accessible pensions that is more common among graduates (Blekesaune et al, 2008).

However, there are strong reasons to expect that the trends discovered by Blekesaune et al may not pertain in a straightforward sense in the future. There are now far more graduates – higher education may lead to later establishment without facilitating high earnings to the same extent. Furthermore, later establishment for today's young people cannot be explained simply by socio-economic status (see Kneale & Sigle-Rushton, 2010). We know that individuals are more likely to be in a pension scheme if they are married or cohabiting (ONS,

2010b); if greater numbers of young people become established later in life in the future, there will be more people for whom the lifestage in which they can accumulate assets for retirement will be further squeezed.

Furthermore, it is not simply that family formation will occur at a later stage, or that financial burdens on young people will increase. As James Lloyd (2007) has argued, burdens seem to be arising for young people at precisely the peak age of family formation. In 1995, those at the peak age of family formation had net liquid assets of £4000. By 2005 this had decreased to £430. The fact that those at the peak age of family formation had seen a huge increase in illiquid assets (from £12,000 in 1995 to £50,000 in 2005) should not be seen to compensate the former trend; the rise in illiquid assets has been matched by a rise in mortgage debt. It is not certain whether these trends will persist for future generations of young people. However, we can say that today's young people seem to be locking themselves into property ownership at around the time they become parents, which will affect their financial circumstances across the lifecourse. The costs associated with forming a family, while servicing mortgage debt, mean that the income available for retirement saving is minimised – in addition to the fact that they are forming families with much smaller cushions of liquid assets.

#4 Buying a house will become more difficult and risky

Problems associated with housing are a key element of postponed transitions, and how this could impact on pensions saving. In 2010, the Joseph Rowntree Foundation published a report examining the likely state of the housing market, from the perspective of young people, in 2020 (see Clapham et al, 2010). It outlined the significant financial barriers to buying property for young people – barriers extremely likely to persist in the next decade as young people seek to get a foot on the housing ladder. Young people's aspiration to buy property is likely to be undiminished over time, although there is evidence that young people are increasingly relaxed about buying property at a later stage of their life. This may be a reasonable response to the barriers faced by young people, but is nevertheless problematic, as the burden of servicing a mortgage until much later in your career is likely to reduce the amount of income available for pensions saving. The withdrawal of housing-related support services, including benefits, combined with the declining availability of social housing, means this will impact most on low-earners.

The National Housing Planning and Advice Unit within the Department for Communities and Local Government has forecast that demand for housing will increase substantially in coming decades, with the number of households in England alone projected to grow from around 22 million today to over 27 million by 2030 – with few indications that the construction industry has the capacity or

incentives to meet this demand (NHPAU, 2009). As such, house prices can be expected to rise, with periods of volatility. Generally speaking, this will make it more difficult for low-earners to buy property, especially without the financial support of their parents (Heath, 2008) – undermining their ability to save for retirement, while simultaneously leading to a higher cost of living in retirement if today's young people are compelled to rent in later life.

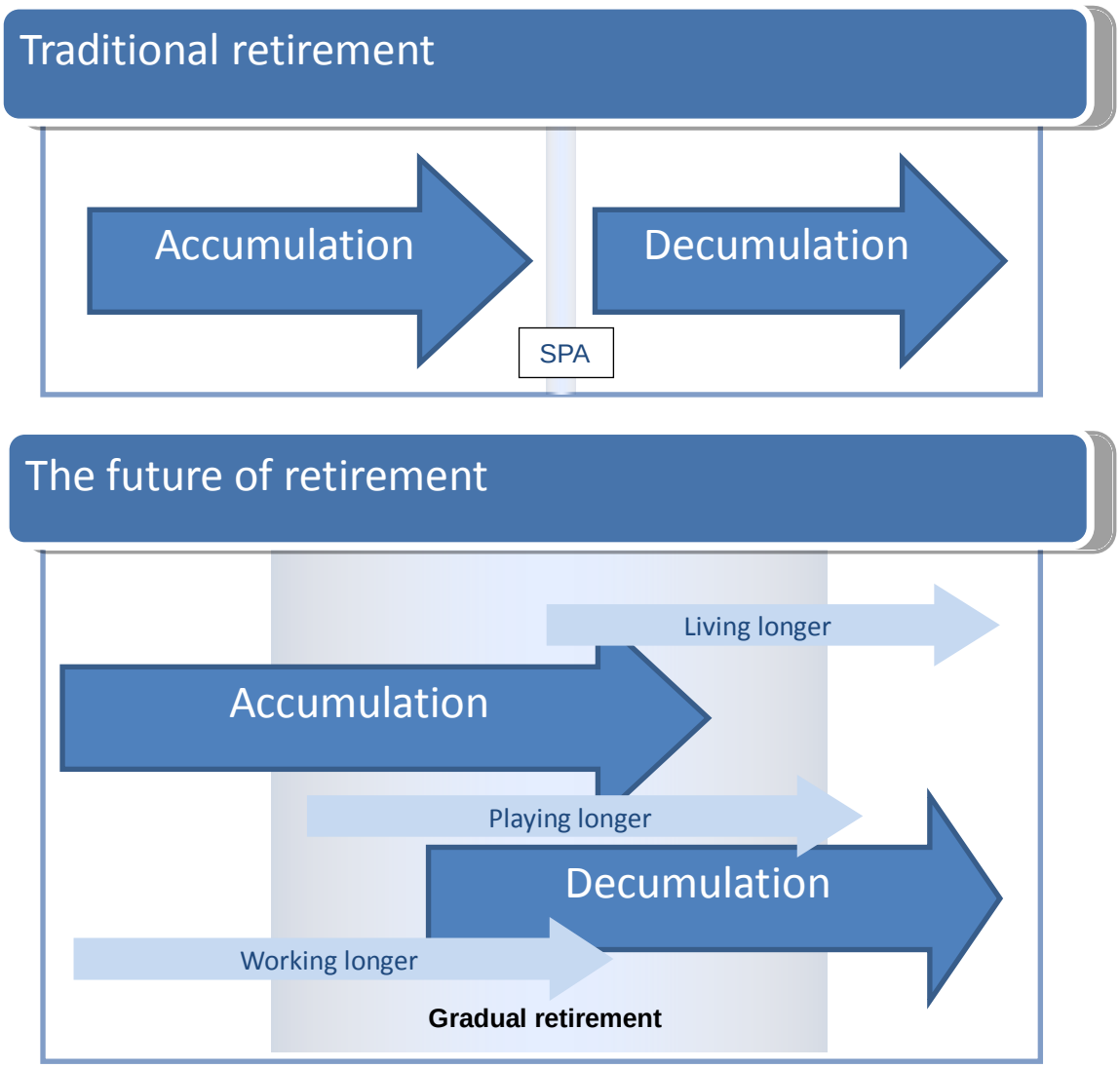
#5 Flexible working will become the norm

A growing number of employees, such as parents, now have a right to flexible working. Many employers of course offer flexible working arrangements to all of their staff. Although this is currently far more common among large employers (Woods, 2010b), the 2010 Queen's Speech announced the government's intention to extend the right to request flexible work arrangements to all employees; moreover, it is likely that a move towards flexible working has helped the UK economy to mitigate the recent recession (Corrigan, 2010). We know that today's young people favour flexibility in their working arrangements in order to maintain 'work/life balance' – the onset of care responsibilities, discussed below, is likely to augment this demand.

In terms of retirement, the move towards flexible working is expected to be reflected in the growth of 'gradual retirement'. As with flexible working more generally, gradual retirement is more amenable to employment in the services sector (Vickerstaff, 2004), which is likely to increase dominance in the UK economy. Demand for gradual retirement will reflect both an increased capacity and willingness to extend working lives, alongside a desire for greater leisure in later life. We know that today's young people are likely to change careers more frequently than previous generations; we may therefore see individuals moving into new careers and professions even as they approach retirement, in search of job flexibility as well as new experiences and challenges.

An increase in options of gradual retirement will offer 'the carrot' to stay in employment (or self-employment) alongside 'the stick' of the higher state pension age. One of the consequences of gradual retirement is that the accumulation and decumulation phases of pensions provision could become blurred, as individuals look to draw upon their retirement assets while 'winding down' their labour market activity, and indeed continue to accumulate assets despite having reached state pension age. Inevitably, there are risks to individuals in the move towards flexible working and gradual retirement; working less may mean a smaller income pot from which to draw retirement savings. More generally, individuals' careers prospects may be jeopardised unless employer practice evolves to accommodate flexible working.

Fig 2.6 The blurring of accumulation and decumulation stages



#6 Care needs will increase

The impending crisis in social care provision has been well-documented. In terms of longevity, we have been adding years to life but not necessarily adding life to years, and the older population with acute personal care needs is expected to rise dramatically over the next several decades. By 2031, there could be 4 million older people dependent on care in England alone, compared to 2.5 million in 2001 (PSSRU, 2006).

There are a number of ways this development could impact on today's young people. Many will become informal carers for their parents. It was estimated in 2007 that there were around 6 million unpaid carers in the UK, expected to rise to 9 million by 2035 as the population ages. Caring responsibilities significantly problematise work for many people, especially in later life (Arskey, 2005; Carers

UK, 2007). The burden of caring for parents may disrupt young people's ability to accumulate assets and save for retirement in the future.

Today's young people will of course themselves require personal care as they get older, especially given that they will live longer than any previous generation. Successive governments have made it clear that the costs of formal care will fall at least to some extent to individuals – but today's young people significantly underestimate the costs of social care, and believe that cost of living falls as you get older (Pettigrew, 2007). Even if the state intervenes to compel young people to contribute over their lifecourse to the future costs of care in later life, this may have the effect of reducing the funds available for retirement saving more generally. Furthermore, today's young people are less likely to be able to rely on their children for informal care in the same way that their parents will rely on them in the near-future. For both socio-economic and biological reasons, today's young people are likely to have fewer children, and at a later lifestage, than previous generations (see Kneale & Joshi, 2008).

#7 The internet will continue to transform livelihoods

We know that young people are far more likely to use the internet than older cohorts. Only 1 per cent of those aged 16-24 and 4 per cent of those aged 25-44 have never used the internet, compared to 22 per cent of those aged 55-64 and 60 per cent of those aged 65 or over. 74 per cent of those aged 16-24 and 79 per cent aged 25-44 have purchased something online on the last 12 months, compared to 58 per cent aged 55-64 and 22 per cent aged 65 or over. In terms of online activities, among those that have used the internet in the last three months, there are few significant differences in activities by age. The main exceptions to this are social networking, downloading or uploading content, and crucially, looking for career or training information and selling goods or services – all of these are far more common among younger people.

It is likely, therefore, that the internet will remain crucial to the social and economic activities of today's young people as they get older, and to society in general as future generations become proficient internet users from a very early stage of their life. Many commentators have encompassed this trend within the transition to a 'knowledge economy'. The knowledge economy is not defined by ICT but does feature a 'high and growing intensity of ICT usage by well-educated workers' (Brinkley, 2006). The Work Foundation reported in 2008 that knowledge-based industries and knowledge-related occupations have provided most of the new jobs in the UK over the past decade, and the UK has the largest trade surplus in knowledge services among all major OECD economies. Furthermore, while the knowledge economy remains concentrated in the South-East, labour market polarisation featuring 'more good knowledge economy jobs

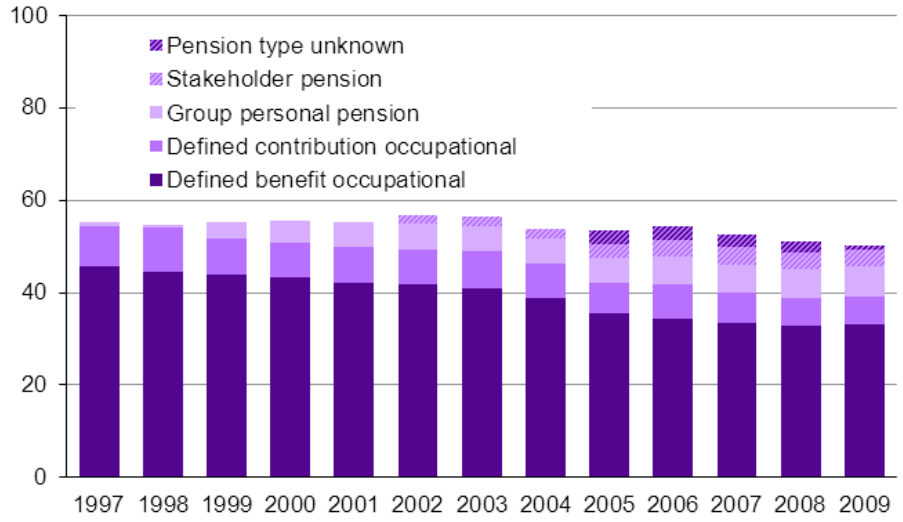
at the top, more bad poorly paid jobs at the bottom' has halted in the last decade (Brinkley, 2008).

#8 Most people will be enrolled in DC rather than DB pensions

The number of members of defined contribution occupational pension schemes – in which individuals rather than their employers shoulder the investment risk – currently stands at around 0.9 million. There are 2.7 million defined benefit scheme members in the private sector, and 5.2 million in the public sector. As figure 2.7 shows, the share of people in defined contribution schemes (both occupational and employer-sponsored personal pensions) has been rising steadily in recent years. However, there are a further 6.9 million individuals saving in personal defined contribution pension schemes.

It is extremely likely that the shift towards defined contribution schemes will be accelerated in the short-term, with significant implications for individuals over the long term. We know that medium-sized employers already favour defined contribution schemes – many large employers are now closing defined benefit 'final salary' schemes for new employers (Cohen, 2009). Most importantly, as noted above, the government's NEST scheme will automatically enrol low-to-medium earners not currently in an occupational pension scheme in a defined benefit contribution from 2012 onwards.

Figure 2.7 Proportion of employees enrolled in an employer-sponsored pension scheme by pension type, 1997-2009



Source: ONS Annual Survey of Hours and Earnings
1. Pension is arranged through an employer, main pension only

There are, of course, understandable concerns over the tendency for defined contribution pension schemes to be less generous than defined benefit schemes, in terms of outcomes in retirement income. It is worth noting, however, that defined contribution schemes are not by necessity less generous than defined benefit schemes. Indeed, many defined benefit scheme providers (such as the public sector) are moving towards schemes which are almost by definition less generous, that is, 'career average' in place of final salary schemes. Furthermore, NEST is designed to provide pensions for people otherwise not enrolled in an occupational pension scheme of any type. Therefore we should avoid interpreting the rise of defined contribution pensions as negative. The greater portability of defined contribution schemes appears to be favoured by today's young people, both in-itself and in that it facilitates career flexibility. Yet the trend certainly provides a challenge to government and providers to ensure that individuals are equipped to cope with the risk inherent in defined contribution pensions.

The propositions outlined above are clearly not exhaustive. They focus on demographic and economic changes, ignoring trends such as climate change, and indeed political and cultural change, which could transform the context in which individuals experience socio-economic trends in the future. Collectively, however, the propositions paint a picture of a fairly bleak financial future for young people – they will probably be able to rely on the state less than previous generations in the post-war era, while confronting new challenges in accumulating assets for their own long-term future. They will have the burden of providing for older generations, with less support available from future generations when today's young people reach retirement. Some of the generational features of today's young people, such as complacency about the future, may exacerbate these challenges. Yet there is good news: today's young people are likely to enjoy greater flexibility and freedom in the workplace, and their careers more generally, while being offered new opportunities through a knowledge-based economy dependent on ICT, and living longer, healthier lives.

New policy settlements in several of the spheres discussed here may alleviate some of the challenges facing young people. Increasing the state pension age further and faster than currently planned would ease the pressure on the old age support ratio and fiscal policy over the long-term. A greater emphasis on preventative health could also reduce spending through the health system, and delay the onset of acute care needs, and the burden this will place on today's young people. A sustainable solution to the care funding crisis may have a similar effect. A faster expansion of housing stock could make buying property less risky, and social and economic policies could be designed to minimise impacts on family formation. Box 2.8 considers the impact of some of these potential changes on exemplary members of 'Generation Y'. Clearly, there are no straightforward solutions, and some of these changes may have adverse consequences not considered here, or in fact impede progress in other areas.

Box 2.8 Potential impact of policy change on 'Generation Y' retirement paths

Increasing the state pension age to 72 in 2060 means that today's young people retire later in the future. For some, this prolongs working-age poverty and leads to health deterioration. But for others, working for longer helps to delay the onset of care needs, and enables them to pay off more debt before retirement. The change also funds a more generous basic state pension. **Jennifer** returns to work after her mother's death; additional NICs enable her to retire on a higher state pension. More confident of a secure income from the state in retirement, **James** buys a home without his parents' support, eventually inheriting a larger amount to fund his children's education.

Today's young people choose to spend larger amounts on preventative health, and place greater restrictions on unhealthy foods and foot outlets. **Matt** benefits from a personal health advisor part-funded by the NHS in his fifties; the service does not prolong his life but delays the onset of ill-health, decreasing his living costs and improving his quality of life in retirement. A whole-of-life health assessment enables **Lauren** to stay in work and remain independent for longer, allowing her partner to maintain steady employment and support Lauren in later life.

A sustainable solution to the care funding system mitigates the impact of care responsibilities for today's young people in later life. **Chris** has more freedom to use his savings to travel in his sixties, eventually marrying and settling in New Zealand. The change also facilitates employment growth in the care sector, enabling **Amanda** to find part-time work in her local community in her fifties; she works into her late-seventies.

A huge growth in house-building minimises housing market costs and risks for today's young people. **Ashley** is able to buy a house in her early-thirties; she downsizes in her retirement to fund care costs for her parents. **Michael** makes only a small amount of money from property development, and instead spends most of his career working for his father's boutique car upholstery business. But he is able to build up a significant retirement savings pot through an occupational pension, supplemented eventually by a small inheritance.

See also Box 2.3, above

Of course, young people may themselves forge new settlements across these spheres, just as previous generations have transformed the world around them. This report considers possible change in one area, that is, pensions saving. While it would be an exaggeration to claim that this challenge is the most pressing facing today's young people, it does appear that finding solutions cannot be left to young people themselves. It is necessary for individuals to commence saving for retirement at an earlier lifestage, and moreover, if they want to enjoy a decent standard of living in later life, it will be necessary for individuals to take greater responsibility for saving beyond the minimum contributed or guaranteed by the state or employers.

Chapter 3: What can be done?

The remainder of this report focuses on pensions saving. This chapter considers first how behavioural economics can support an increase in pensions saving. It then outlines the areas in which the public and private sectors could take action to encourage today's young people to save more for their own retirement, in terms of both pensions policy and wider challenges.

What can we learn from behavioural economics?

- Auto-enrolment will introduce a significant 'nudge' into the pensions system; it may be possible to learn more from insights from behavioural economics and psychology to encourage young people to save more for retirement, especially given the possibility that young people will opt out.
- Behavioural traits that may impact on pensions saving include a status quo bias, anchoring and the availability heuristic, a herd mentality (or social norms more generally), and hyperbolic discounting. Decisions are also affected by how choices are presented.
- NEST and auto-enrolment present an opportunity to counter some of these traits, but it is also necessary to consider how we can build trust and nurture a sense of control in encouraging young people to save for retirement.
- The evidence on the effectiveness of financial education, often contrasted with nudge, is mixed, although it is vital for young people to become more informed about pensions and financial issues in general. Insights from behavioural economics could improve the effectiveness of financial education.

Behavioural traits and young people

Asking greater numbers of people to start saving for retirement, or to save more for retirement, entails changing individual behaviour. This means challenging both the behavioural traits exhibited by today's young people, but also deeply-rooted habits evident across the generations. Young people are being asked to commit to behaviours that were not required of previous generations. Increasingly, policy-makers and stakeholders concerned with increasing saving are turning to techniques associated with the concept of 'nudge'. The concept is associated with a strand of thinking evident in behavioural economics and psychology that has become increasingly influential across the social sciences, which upholds that we need to understand that forms of behaviour are not entirely rational or instrumental responses to our circumstances. Certain behaviours become self-perpetuating through routine and tradition, even if they lead to sub-optimal outcomes, and there are some traits that most people seem to exhibit which act as barriers to rational decision-making.

To 'nudge' individuals is to seek to utilise our behavioural traits in order to help us make more rational decisions. For instance, if we are more likely to do *x* when we know that a large number of other people, particularly our peers, are doing *x*, those trying to change

our behaviour should seek to inform us about the popularity of *x* to make us more disposed towards it. There is already an extremely significant nudge soon to be introduced into the pensions saving system: auto-enrolment seeks to counteract under-saving by utilising a 'status quo' bias in individual behaviour. As such, eligible employees will be automatically enrolled into a defined contribution occupational pension scheme, on the basis that most people are content to save for their retirement, yet unprepared to proactively enrol in a pensions saving scheme.

Yet Chapter 1 argued that NEST and auto-enrolment may not be sufficient to significantly increase pensions saving rates among today's young people. There is, of course, evidence that people in certain circumstances will not be able to achieve the benchmark replacement rates set by the Pensions Commission, or indeed save enough to avoid means-tested benefits in retirement (see Curry et al, 2011). Auto-enrolment may also be inadequate, to some extent, in terms of influencing behaviour, among young people in particular. The behavioural traits of young people will be explored in more detail below, but it is possible to point out the discrepancy between auto-enrolment and an apparent desire among today's young people to exercise control over their economic circumstances. It may be that, for all age groups, generating a sense of personal responsibility – alongside initiatives such as auto-enrolment – will help to support the effectiveness of behaviour change interventions (Halpern, 2004).

Several behavioural traits and cognitive biases have been identified in the literature on behavioural economics and nudge. Those discussed here are: a status quo bias; hyperbolic discounting; anchoring and the availability heuristic; social norms; and, the presentation of choices. It must be noted that some of the features of these traits and biases will of course overlap. There is also a lack of evidence on how they apply specifically to today's young people – yet it is possible to speculate on how these traits manifest in young people's behaviour based on what we know about young people's financial and economic circumstances.

A **status quo bias** indicates that people tend to be conservative in their personal decision-making, even where there is little or no evidence that the status quo benefits them more than some alternative. This bias is actually a product of various different elements. In research for the FSA, David de Meza et al (2008) refer to procrastination, loss aversion, regret aversion and choice overload. People simply postpone difficult decisions; this is especially the case where the number of choices available, or the amount of information available, makes the decision particularly complex. Furthermore, people are generally averse to loss; they place more emphasis on retaining something they already possess than gaining something they do not possess. This applies even where investing current possessions may enhance their value in the future. People generally seek to avoid regrets, and as such do not want to be responsible for a loss through their own actions – they do not have the same sense of culpability if a failure to gain (rather than a direct loss) results from their inactions. Jessica Prendergrast et al (2008) also refer to 'effort' in order to explain the status quo bias. Where behavioural change requires effort by the individual,

they are much less likely to be receptive. It is worth noting here that 'know your customer' practice – designed to combat financial crimes such as money laundering – means it is often much easier to go into debt than it is to open a savings account.

Clearly, the nature of pensions saving contradicts many of these aspects of the status quo bias. Saving for a pension involves loss of the capacity to consume, and the possibility of regret that incorrect investment decisions are made. The decision to save is also, of course, often very difficult. The effort required to assemble the required information, as well as join an appropriate scheme, may dissuade many people. Clearly, auto-enrolment is designed to overcome the status quo bias – by utilising it. Through auto-enrolment, people are able to remain inactive yet still commence saving for their own retirement in an occupational pension. They would risk regret, and the loss of the employer contribution and tax relief, by taking action, that is, opting out. As Prendergrast et al note, NEST (and similar recent initiatives such as stakeholder pensions) also seeks to eliminate effort through branding. If NEST becomes a trusted brand the effort required to investigate its features and benefits is minimised.

A tendency for **hyperbolic discounting** means that people tend to over-value the present and under-value the future – they perceive the value of a certain good to be lower when it is only available in the future. The classic example, employed by Richard Thaler and Cass Sustein in their book *Nudge* (2009), is that people would rather be given £100 today than £110 next week. Tom Boardman and David Blake (2010) show how this trait is related to specific aspects of pensions provision, such as annuity choice (because people under-estimate the impact of inflation), it applies more generally to decisions around whether to save for a pension in the first place. People seem to value their freedom to consume today far more than their freedom to consume in retirement, even though their earning potential is far greater today than it will be in retirement. Hyperbolic discounting also feeds into the status quo bias; people are unable to imagine their future sufficiently, and therefore assume that the time and effort it would require to take certain actions will be less scarce in the future.

Clearly, hyperbolic discounting seems to correlate closely with some of the attitudes exhibited by today's young people. Whether young people today are more culpable of over-valuing the present than previous generations is arguable, but it is certainly the case that today's young people emphasise the importance of living for today – and therefore consuming today – and hugely under-estimate the costs of later life.

Anchoring and an **availability heuristic** are also important, and closely related, influences on individual behaviour and decisions. Anchoring means that people decide things in accordance with what they already know or do. For example, if asked to estimate the population size of a city, many people will automatically think of their own town or city, and then determine whether the city in question is larger or smaller. Decisions are often shaped by what is already known. This is a normal cognitive process, but the short-cut may lead people from different cities to a radically different answers. An availability heuristic means that people over-estimate the importance or extent of things for which they

can think of relevant examples. Thaler and Sunstein give the example of comparing the number of murders and suicides: even though there are far more suicides than murders in most countries, people tend to think the opposite, partly because we can all think of numerous murders, but hear about suicides less often.

These cognitive biases have a particular impact on issues related to ageing: people only grow old once, and therefore have not had the opportunity of experiencing later life before they are asked to plan for it financially. This applies, by definition, to young people of all generations. But it could be related to the tendency of today's young people to favour investment in housing rather than a pension. To the extent that they are able to learn from previous generations, they may have noted the growth in property values that their parents' generation has benefited from – and used this example to frame their own intentions, without considering the volatility of property investment over time.

The operation of **social norms** also shapes individual behaviour. Essentially, people are influenced by the behaviour of others – but this can range from a herd mentality whereby people deliberately follow the crowd, to less conscious influences such as tradition and cultural expectations. It may be that policy-makers seek to communicate that the majority of people undertake some activity, to encourage other to follow their examples – a technique used in campaigns on recycling. Alternatively, policy-makers may employ more subtle measures to engender cultural change – the ban on smoking in public places could be seen in this way. It may be that some norms can be utilised rather than challenged: for example, Scotland's Violence Reduction Unit exploits the 'norm' of gang loyalty to tackle gang-related violence in Glasgow. If a gang member commits a serious crime, rather than simply punishing the individual culprit, law enforcers will target the entire gang on more minor charges, such as drugs, weapons possession, parole violation, etc. The gang's norm is pushed to its logical extreme, whereby all are members are held responsible for the crimes of individual members (see Dolan et al, 2010).

Interestingly, while auto-enrolment is designed primarily around the status quo bias, publicity around NEST's introduction may help to create a positive norm on the importance (and popularity) of pensions saving, and the mutual responsibility of individuals, employers and government in this regard (Prendergrast et al, 2008). The apparent unwillingness of today's young people to save for their retirement may be evidence of a herd mentality – most do not save to a significant degree, so there are few peer examples to learn from. It is perhaps also evidence of the absence of a norm regarding pensions saving, given that previous generations have benefited from relatively straightforward savings vehicles, minimising the need for a savings culture. Moreover it may be that living for today – irrespective of the long-term consequences – has become a normal part of the lives of today's young people. Pettigrew et al (2007) found some evidence in this regard; while young people participating in the study seemed to accept the importance of pensions, they also upheld largely negative images of the types of people that do save for retirement.

Individual decisions are also influenced by the way they are presented with choices. While the burgeoning interest in behavioural change within public policy incorporates a wide

range of traits and biases, it is modifications to the 'choice architecture' faced by individuals that is most associated with the 'nudge' agenda. The literature on nudge identifies several presentational issues. Firstly, **messengers**: the decisions we make will depend upon the people or institutions that provide certain options. Secondly, **salience**: people are more attracted to options they see as relevant or appropriate to their life. There is evidence, for instance, that people are more attracted to annuities when presented as consumption insurance rather than asset management (Elliott et al, 2010).

Thirdly, **priming and framing**: people are influenced by sub-conscious cues such as smell, the urge to fill an empty space, images, etc., and whether the message is presented as positive or negative. In terms of public policy, Thaler and Sunstein (2009) use the example of a doctor informing his or her patient about survival rates. If your doctor tells you that 90 per cent of people with a condition you have been diagnosed with live for at least five years, you are likely to think this is good news, but being told that one in ten people receiving your diagnosis die within five years will probably feel like bad news. Similarly, Boardman and Blake (2010) demonstrate that people are more likely to choose index-linked annuities if they are shown a graph comparing them to level annuities over time, rather than simply a list of figures which details how payments will compare at various stages of their life. With the visual image of a graph, people can imagine the line representing the index-linked annuity rising, but a list of figures instead requires them calculate the potential benefit – their choice is likely to be inadvertently framed by the first figures in the list, which will show much higher payments for level annuities compared to inflation-linked annuities. More generally, Prendergrast et al (2008) argue that in order to encourage individuals to save more for retirement, it is necessary to transmit a sense of urgency – without suggesting that all hope is lost.

Clearly, different generations will respond differently to various messages and messengers. Other things being equal, young people may be more swayed than other age groups by the notion that pensions savings protects their ability to consume in later life. Certainly, there is evidence that today's young people trust different types of people than previous generations; this will be important for considering which messengers are most likely to be effective in delivering advice on pensions.

Nudge versus education?

Alongside auto-enrolment and NEST, one of the main tools employed by policy-makers in seeking to increase savings by individuals is financial education, although of course the objectives of educational schemes may be much wider, and less prescriptive, than encouraging people to save in a pension. As will be noted in the next chapter, the previous and current governments have been very active in recent years in this area. Bodies such as the Consumer Financial Education Body (CFEB) – set up by the FSA in 2010 – and the charity Personal Finance Education Group (PFEG) - backed by several key financial service providers - work together to deliver the National Strategy for Financial Capability,

and related initiatives. In early 2011, more than 120 MPs joined a parliamentary campaign group to call for more financial education in schools.

The FSA baseline survey indicates that today's young people are much less able than older cohorts to choose the correct financial product for their circumstances. The report by Atkinson et al (2006) argued that 'the current cohort of young people are finding it difficult to make appropriate purchases, and that their age has a significant impact on their level of capability even when taking into account, for example, the number of product purchases they have made and their qualifications'. Clearly, education will be necessary to support a group of people being asked to make financial decisions potentially affecting their entire lives at a very young age. Financial education is, however, often contrasted with the nudge agenda. To simplify, there are quintessential differences between providing information so that individuals can decide for themselves what to do, and manipulating the presentation of choices or individuals' innate behavioural traits so they will make decisions irrespective of their (lack of) knowledge.

As such, many evaluations of the National Strategy, and financial education more generally, have been undertaken from a behavioural economics perspective (see Schwartz, 2010). Focusing mainly on financial education provided through employers, David de Meza et al (2008) find very little evidence of the effectiveness of financial education programmes. It is not possible to demonstrate whether individuals that change their behaviour through financial education were not already disposed towards greater financial planning and frugality – this may explain why they undertook the educational scheme in the first place. In a study for CFEB, Antony Elliott et al (2010) report that 'individuals who do solicit advice are more likely to follow that advice than individuals who receive unsolicited advice'. Moreover, many evaluations of financial education are based on self-reporting - people may report that education is useful even if they do not intend to change their behaviour, or indeed may report that they intend to change their behaviour yet ultimately fail to do so. There is also what de Meza et al refer to as 'the curse of knowledge'. Offering a large amount of information may contribute to 'choice overload' and therefore produce inertia. Alternatively, it may breed over-confidence in financial matters, leading to complacency or sub-optimal decisions taken without sufficient guidance.

There is evidence that education at a younger age is more effective – while it does not increase knowledge it may help to improve capability over the long-term. In particular, while there is evidence that children learn financial skills predominantly from parental role models, education improves financial skills for those without a suitable role model (Atkinson, 2008). There is also evidence that precisely because a propensity to plan financially is 'the outcome of a complex web of material, social, cultural and psychological factors', teaching 'whole of life' planning may be more effective in encouraging individuals to save for retirement than focusing more narrowly on financial knowledge (Anderson et al, 2000).

Building upon this insight, Elliott et al consider how behavioural change interventions can be used to make financial education more effective. For instance, they argue that feedback

based on actual decisions taken by individuals has the advantage of being salient to those being educated. Similarly, Jackie Wells' (2011) research on savings behaviour indicates that wanting to avoid the fate of friends or relatives that become worse-off in retirement is an important trigger for pensions saving. Knowledge about such real-life scenarios should therefore be incorporated into financial education for young people in a more systematic manner – although the gravity of an eye-witness account can, of course, never be fully replicated in an educational setting. Elliott et al also point out that education is less effective when compulsory, so the emphasis needs to be on voluntary education, albeit incentivised through financial reward. Paradoxically, however, they also argue that education is more effective when it is paid for rather than obtained for free. Making people pay, financially or otherwise, for education may reduce take-up, but could improve its effectiveness.

Pensions policy

- Financial education should lead to 'thinking skills' and whole-of-life planning, and involve peer-based and interactive learning.
- There is evidence that the incentives already present in pensions saving, which will be rolled out through NEST, are not understood by today's young people.
- However, auto-enrolment could prove to be a blunt tool; enabling personal choice alongside auto-enrolment may increase the attractiveness of pensions saving.
- Given that today's young people appear to be attracted to more liquid forms of saving, there may be a case for allowing people below a certain age to convert liquid capital into pensions saving. A version of this scheme could be considered as a 'Plan B' if young people opt out of occupational pensions in large numbers after 2012.
- While simplicity should not be valued for its own sake, simplifying the language and information around pensions saving is vital.
- Reducing complexity in the state pension, and pensioner benefits more generally, is also important – but should not detract from making state pension entitlements more flexible.

Education

While evidence on current educational schemes is mixed, as discussed in the previous chapter, there remains a clear need for education and advice (see Wicks & Horack, 2009). This is especially the case given that young people's likely demands for flexibility over their retirement, in conjunction with the rise in defined contribution schemes, are likely to result in and even necessitate a more complex pensions product market. Whether education is deemed effective or not, individuals will increasingly bear greater risks in relation to pensions saving, and it is therefore right that more information and educational schemes are made available (the role of financial advisers will be discussed below).

It may be possible, however, to design educational schemes more effectively. Most importantly, the content of financial education needs to be wider than simply knowledge of financial products and services. De Meza et al (2008) argue that developing 'thinking skills'

is just as important as providing information. Furthermore, as noted in the previous chapter, it is important that individuals are assisted in lifecourse planning more generally; education should not focus only on pensions or even savings, investments and insurance in general, but also income, debt, cost of living, household budgets, the impact of inflation, family formation, etc. As part of this, young people should be informed about the risks associated with different forms of investment, including housing – and taught to evaluate for themselves how their assets should be allocated in different circumstances. The ideal setting for financial education in this form is surely in schools. The knowledge acquired may not be fully retained, but there is a greater possibility for individuals to develop transferrable skills. It is also important to recognise today's young people do not necessarily learn most by reading, unlike previous generations (Weiler, 2005) – financial education should therefore incorporate visual and interactive elements.

Policy on financial education certainly seems to be travelling in the right direction. The Moneymadeclear website was launched in 2009 to provide online advice on financial issues – it includes interactive tools which enable people to received tailored, albeit limited, advice related directly to their circumstances. The service also now incorporates the 'What About Money' website designed specifically for 16-24 year-olds. The website includes case studies of other young people 'so you can learn from the experiences of other young adults', therefore acknowledging the importance of salience and peer-based learning. In terms of other tailored advice for young people, increasing numbers of youth workers are receiving training on young people and money. CFEB is also working with PFEG to deliver more financial education in schools, through personal, social, health and economic education programmes. In order to provide specific feedback, the government has asked CFEB to develop an annual financial healthcheck for families.

Clearly, however, while the effectiveness of education can be improved, financial education alone is not a panacea for under-saving by young people. There are seemingly inherent barriers to financial education, certainly once young people reach adulthood. Moreover, studies of young people suggest that the most appropriate messengers for advice are their peers – yet it is impractical to suggest that financial education can be delivered by young people, to their peers, to any significant degree.

Incentives

There is strong evidence that financial incentives encourage individuals to save more for retirement (see Wicks & Horack, 2009). However, the evidence is mixed on whether the incentives currently built into the UK private pensions system are effective (Eich & Swarup, 2008). There appears not to be a strong argument, in terms of direct financial incentives, against the previous government's planned reforms to the pensions tax relief system, which would have gradually withdrawn tax relief to higher-rate tax payers. However, any reform could contribute to a *perception* that the government is less committed to incentivising pensions saving. The current government's allowance to reduce tax relief

through the allowance rather than tax bands is probably less likely to produce this outcome. Furthermore, the proposals also reduce complexity in the tax relief arrangements, therefore minimising an important disincentive related to the effort required to understand the private pensions system.

Complexity will be discussed in more detail below. However, it is worth noting here evidence that people do not understand the incentives already present in the system – which perhaps explains the lack of evidence around the effectiveness of the current incentive structure. Wells' (2010) consumer research led to individuals calling for the introduction of incentives that already exist within the system. Pettigrew et al's (2007) research on young people and pensions also found current incentives misunderstood by today's young people. However, once the incentives included in schemes such as NEST – the matching contribution from employers and the state – were explained by researchers, the young people interviewed declared strong support for the policy.

The previous government had sought to introduce greater savings incentives via the Savings Gateway for low-income individuals – after individual Savings Gateway accounts that had been open for two years, the state would contribute 50p for every £1 saved (restricted by a maximum monthly deposit of £25). The current government has abandoned the Savings Gateway; at a time of fiscal austerity and economic strife, it may be unrealistic to expect the government and/or employers to offer significantly more incentives than already planned through NEST in the short-term. However, it is clear that the value of existing incentives is not being communicated strongly enough. Certainly, it seems that the additional incentives provided through NEST have not yet been recognised by young people. It may be that the message around pensions saving remains a 'bad news' story, that is, the urgent need for individuals to save more for their own retirement. Surely the 'good news' around the incentive structure should feature in communications in this regard. Moreover, given that people seem to be more eager to avoid loss than acquire new things, the message that individuals will lose the matching contributions they are legally entitled to if they opt out should also be prominent in how NEST is communicated.

In seeking to introduce a flat-rate state pension at the current minimum income guarantee level, therefore largely eliminating means-testing in pensioner benefits, the government has seemingly accepted the view that means-testing acts as a savings disincentive. Indeed, in opposition, current pensions minister Steve Webb (2010) commented that 'a single, simple, decent state pension must be the goal of all pension policy… it would mean people could save with confidence, knowing that their savings would not be clawed back through means-testing'. However, there is mixed evidence on the strength of the means-testing disincentive (see Wicks & Horack, 2009; Wells, 2010). Are young people sufficiently aware of the nature of pensioner benefits for means-testing to act as a disincentive to save? Yet whether or not the current means-testing arrangements discourage pensions saving, there may nevertheless be an opportunity cost of not moving towards a single, flat-rate state pension; the positive message that any such reform would send out to today's young people about private pensions saving may alone justify the

policy.

Incentives are also offered by government regarding other forms of saving, such as ISAs – arguably these incentives, although less generous, or more widely appreciated than those associated with pensions saving. It may also be the case that young people prefer saving through ISAs given that it enables a greater degree of control over their finances. The debate on whether pensions saving should be more closely integrated with more liquid forms of saving tends to exaggerate the difference between the two – those who fail to save for a pension are unlikely to be saving through other mechanisms, and both suffer from a general 'under-saving' problem in the UK (Lloyd, 2010). There may be grounds, however, for allowing people below a certain age that have built up liquid savings to convert them into pensions saving. Young people may be more positively inclined towards liquid saving for various reasons; the pensions system should seek to utilise this phenomenon.

Auto-enrolment

Given the necessity for individuals to save more for retirement, auto-enrolment utilises the status quo bias to nudge people into a decision they otherwise may not have made, even though most people recognise the need to save more. There have been calls for NEST to introduce elements of the 'save more tomorrow' (SMT) plan popular in the United States. Whereas auto-enrolment into NEST, or an equivalent scheme, seeks to overcome biases such as hyperbolic discounting, SMT plans in fact utilise hyperbolic discounting to further increase individual pensions saving rates over time. Through SMT individuals are enrolled into schemes which build in increases in the proportion of income contributed by employees as earnings increase. Individuals are seemingly more willing to commit to higher savings rates in the future, in return for lower rates in the short-term.

Evidence on the proportion of their income spent by today's young people seems to suggest that young people are particularly prone to hyperbolic discounting, therefore incorporating SMT into NEST may serve to increase pensions saving over time. However, the extent to which young people support the current plans for auto-enrolment is unclear. Chapter 1 suggested that there may be high opt-out rates among young people – although it is not evident whether this is due to lower earnings, or a generational preference against auto-enrolment. It also seems, however, that young people strongly support NEST and auto-enrolment once the incentive structure is explained to them.

The report by Jessica Prendergrast et al (2008), which considered the UK pensions system from the perspective of behavioural economics, labelled auto-enrolment 'a relatively blunt tool'. This may be particularly applicable to today's young people, wanting to retain greater control of their economic circumstances, and less trusting of government, employers or the financial services authority. Prendergrast et al suggest the possibility of maintaining auto-enrolment but making it compulsory for individuals to choose between several different contribution plans (one of which, presumably, would be 'none of the

above'). Prendergrast et al admit that this system is likely to lead to a higher opt-out rate. However, it may be that a greater emphasis on choice, in conjunction with auto-enrolment, is the correct fit for today's young people.

The extent to which the government has in place an alternative to auto-enrolment, in the event that young people do opt out in large numbers, is unknown. There are features of NEST that appear to be most appealing to today's young people, such as the mobility of accounts, and the availability of personalised information online, which should be central to communication strategies. While generating awareness of auto-enrolment may increase opt out rates, it is also possible that early communication will help to avoid a backlash against pensions saving among young people following auto-enrolment. Ultimately, a 'Plan B' for auto-enrolment could encompass the introduction of more liquid savings accounts for young people, which are invested in through employment and benefit from the same guarantees around employer contributions as NEST (auto-enrolment would therefore involve a compulsory choice between a pension and the more liquid alternative). At a certain age, this account would convert automatically into a pensions saving account. This scheme would utilise young people's apparent preference for short-term saving but offer incentives to retain capital over the long-term to provide a retirement income. Clearly, however, any scheme would have to be informed by extensive analysis of why young people opt out from occupational saving (if this scenario comes about).

Simplicity

Complexity is endemic in the UK pensions system. Hugh Pemberton (2006) has described a 'systematic tendency towards growing complexity in the system as a whole'. He relates this to the paradox of the long-term nature of pension contracts, whether state or private, and the short-termist nature of politics and policy-making. Complexity probably contributes to a sense of choice overload for young people, but more generally makes acquiring knowledge about pensions more difficult, therefore causing inertia. Housing, by contrast, probably seems like a very straightforward investment – in addition to the fact that young people tend to have more tangible experience of the housing market via their parents. Eliminating complexity is therefore vital to increasing pensions saving.

Simplifying pensions saving is, invariably, partly about the vehicles through which individuals save and invest for their retirement. The real challenge, however, may lie in simplifying the language around pensions saving. There is evidence that the majority of people do not understand the terms that are necessary to make informed decisions about pensions saving – the NEST Corporation has therefore called for pensions saving to be discussed in 'everyday language' rather than technical jargon. To this end, the organisation has produced a plain-speaking phrasebook, and an online game which allows individuals to test their understanding of what key pensions terms might mean to them in practice (see NEST Corporation, 2011). Moreover, the introduction of NEST should assist in enabling people to understand occupational pensions, and the respective obligations of

individuals, employers and the state – due both to the publicity around the introduction, but also to the simple benchmarks that NEST will establish. The pensions industry in general should take this opportunity to simplify the way options for pensions saving are communicated.

While we should be wary of reducing individual choice in private pensions saving solely for the purpose of simplicity, the state pension system can surely go much further regarding simplification. The government recently introduced individual pensions forecasts to help people navigate the complex array of benefits available in retirement. However, it may be necessary to simplify the benefits themselves. Currently, the state pension exists in two main forms, supplemented by means-tested benefits such as Pensions Credit and Council Tax Benefit for low-income pensioners. Various additional benefits – such as Winter Fuel Payments for both men and women those aged above female state pension age, and free TV licenses for all aged 75 or over – are also available. The rules on entitlement to, and accrual of, state pensions and means-tested benefits are also extremely complex.

As noted above, the government has indicated that it will introduce a single, flat-rate state pension, and eliminate the main forms of means-testing. This should be a key priority for pensions policy, but there are strong grounds for reforming additional pensioner benefits alongside this change. David Martin (2010) has also called for the abolition of National Insurance Contributions (NICs), which govern entitlement to benefits such as the state pension. NICs may once have had political value in embodying the social-insurance model of pension provision, enabling individuals to recognise they were investing, at least in theory, in their own retirement. Yet the state pension has always been pay-as-you-go, (meaning that NICs do not actually fund state pensions), the line between National Insurance and income tax has become increasingly blurred, and the introduction of pensioner benefits not linked to NICs has undermined the model. As such, Martin argues, NICs simply add to the complexity of the tax and benefit system, undermining public support for the state pension and other entitlements.

Again, however, simplicity should not be valued in-itself. It may be desirable in fact for the state pension to become *more* complex in some ways, if it is to incentivise a flexible and graduated approach to retirement. The UK's state pension age stipulates a single point of retirement (albeit different pension ages currently apply to men and women). This is a product of the UK's social-insurance model of state pensions. However, many other European countries have graduated state pensions – pensioner benefits are available in part at a particular age, although not in full until several years later. While flexibility will exacerbate complexity, arguably the language of graduated state pensions or flexible state pension entitlement is more straightforward than current terminology around 'deferral'.

Wider challenges

- Rebuilding trust in financial services is vital to enabling pensions saving, although we should not expect trust to develop automatically, and should instead look to build upon existing relationships of trust experienced by today's young people.
- The pensions system requires the creation of a wider savings culture among young people. It may possible to develop straightforward messages on the importance of retirement planning, but also to build upon existing cultural norms by emphasising that pensions enable consumption-smoothing.
- Today's young people seem to exhibit high levels of 'self-efficacy' in terms of accessing financial services online; it may be possible for pensions providers to utilise this.

Trust

The lack of trust exhibited by young people has been widely reported. This has been applied to financial institutions in particular, which has clear implications for pensions saving (CII, 2010; Pettigrew et al, 2007). A recent survey conducted by the Future Foundation found that young people also trust their employers far less than other age groups in terms of retirement planning (Future Foundation, 2010); this has been related by some commentators to the unravelling of employer-based welfare and the fact that young people are likely to move jobs several times during their career. Of those surveyed, only around 30 per cent of 16-24 year olds and 40 per cent of 25-34 year olds surveyed agreed that 'employer pension schemes are better than private [sic.] pension schemes', compared to significant majorities among older cohorts. A study of young people in Australia found that whereas people born between the world wars place trust in authority figures, and baby boomers place trust in data and facts, younger generations are far more likely to make decisions based on 'the experiences of their core group of three to eight friends' (see McGrindle, 2002).

In the face of evidence that, for instance, people do not trust the advice they receive from independent financial advisers, the government plans measures that will lead to IFAs being paid directly by those receiving advice rather than through commission from providers, to ensure their independence. Increases in up-front costs for customers could, however, lead to fewer people taking up financial advice. Yet part of the reason people tend to follow advice they pay for may be that they have greater confidence in its independence, and therefore the effectiveness of financial advice should improve (other things being equal).

There does, however, seem to be widespread distrust in financial services in general, as well as in IFAs. While advice on products from IFAs may not be trusted, a lack of trust in financial services may inhibit engagement with the industry more generally, therefore undermining opportunities to save for retirement, as reported in consumer research by Jackie Wells (2010). The 2008 financial crisis led to an erosion of trust in financial services, exacerbating an existing trend, and trust can only be fully restored over the long-term. The problem is particularly significant in relation to young people, who are much less

likely to have prior experience of engaging with financial services to draw upon – most people believe their own providers are more trustworthy than the industry in general. Behavioural economist Saul Schwarz (2010; see also de Meza, 2008) argues, in a study of financial behaviour in Canada, that greater regulation of the financial services industry is key to increasing saving by individuals. Of course, higher regulatory burdens on financial service providers may increase the cost of savings products (and advice). This report is not the place to debate the content of regulations on the financial services industry, but it should be recognised that, other things being equal, a regulatory system which enjoys widespread public support would be likely to encourage individuals to save more.

It is worth pointing out that that the most popular answer among 16-24 year-olds in the Future Foundation study (cited above), in terms of the relative benefits of occupational and personal pensions, was 'I don't know'. There is clearly a lack of understanding of the role played by employers in pensions provision. This situation is likely to be improved by the introduction of NEST which, as well as providing a clear message on the responsibility of employers, should also shed light for young people on the role that employers already undertake in pensions provision.

In terms of advice, the group most trusted for advice by today's young people appears to be their family and friends, precisely because of their trustworthiness:

> Whether in their interactions with corporate organisations or with government and politicians, [today's young people] want transparency and openness. Trust is the main driver motivating [today's young people] to seek financial advice from family and friends – it is not something they feel they get from the financial services world (Bosanquet et al, 2008).

Financial advice from IFAs seems cold and overly-bureaucratic – family and friends are stepping in to fill a void left by the decline of more personalised form of advice previously available from local building society managers or 'the man from the Pru'. The difficulty, of course, is that we cannot necessarily rely on friends and family to provide accurate advice. They may be equally culpable of biases such as anchoring and the availability heuristic – it is generally negative experiences that are passed on through word of mouth. And there is not reason to assume that our relatives has the technical proficiency to provide advice on financial advice. Nevertheless, it is important for policy intended to increase pensions saving by young people to build upon existing relationships of trust – the challenge is therefore to ensure that resources are available so that young people can have informed discussions with their families and their peers.

A savings culture

Young people seem to place a high value on spending and consumption – often going into debt in the process. Spending, in contrast to saving, is equated with 'having a life'. Hyperbolic discounting suggests that individuals tend to exaggerate the value of the

present compared to the future. Yet if the importance of spending and consumption is embedded within young people's lifestyles, it may be unfair to suggest that the present is being over-valued by young people – they are simply abiding by cultural norms.

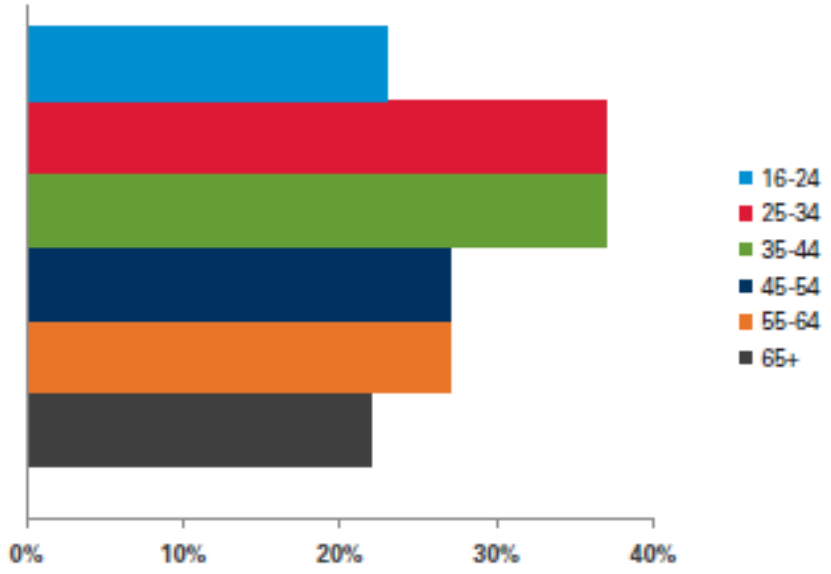
It is necessary therefore to nurture or renew norms on saving, an activity which tends to be viewed fairly negatively by young people. Prendergrast et al (2008) suggest the establishment of a World Savings Day. It may also be possible to learn from the Department of Health's '5-a-day' campaign to encourage healthy eating. This campaign offered individuals a 'rule of thumb' regarding the quantities of fruit and vegetables that should be included in their diet; similar basic guidelines for pensions saving, and retirement planning more generally, could be promoted by government, with the assistance of other stakeholders. Of course, we should not exaggerate the impact of such campaigns, especially on young people. For example, Georgia Herbert et al's (2010) evaluation of the impact of the 5-a-day campaign on young adults found confusion among young people regarding the detail of the dietary advice, and the extent to which the campaign itself achieved behavioural change is unclear. However, the campaign has achieved near-universal awareness of the importance of healthy eating. Herbert et al argue that such campaigns should coincide with skill-based campaigns to enable young people to incorporate the advice into their own management of their diet. Alongside more education and advice, therefore, such campaigns can be successful. Herbert et al also note the importance of gender-specific advice, given that young men seemed less susceptible than young women to the healthy eating message. For pensions, however, existing evidence suggests that young men are more likely than women to save for retirement, and have a greater understanding of pensions.

It may be possible to build upon existing norms exhibited by young people, or individuals more generally, to generate a savings culture – note the example from the previous chapter, whereby exist norms around gang loyalty where used to tackle gang-based criminal behaviour. For instance, it is important that savings plans for young people build in monthly and/or annual 'rewards' to incentivise saving, thereby reducing the emphasis on frugality and providing assurances that their lifestyles can be maintained as far as possible. Additionally, Boardman and Blake (2010) recommend the message of 'spend more today' in order to convince people of the value of annuitisation; the phrase is a deliberate echo of 'save more tomorrow' retirement plans. One of the main benefits of annuities is that they are paid until death. There is therefore no rationale for saving any proportion of annuity payments – they can be used in full to ensure the highest possible standard of living in retirement. Boardman and Blake argue that this aspect of annuitisation has not been adequately publicised, despite the fact that it correlates closely with individual preferences. Indeed, Elliott et al (2010) report consumer research which shows people are more inclined towards annuitisation if it is described as consumption insurance rather than asset management. It is likely that communication strategies which utilise norms around spending and consumption will be particularly effective on today's young people.

Financial services and the internet

We know that young people are far more likely to seek financial advice online. Analysis by the Future Foundation (2010) links this with a 'personalisation of authority' – individuals are now more likely to place trust only in people and organisations they are close to or have a relationship with. The internet is to some extent a proxy for this among today's young people. As such, the pensions industry is increasingly seeing the internet – and particularly social media and smartphone applications – as an important means of communicating with young people (Scott, 2010; Woods, 2010a). Social media may be a particularly important tool for engaging young people in pensions saving, because young people are so accustomed to sharing information with their peers using social media (Bosanquet et al, 2008).

Fig 3.1 Proportion of different age groups reporting the internet as their main source of financial information, 2010



Source: Future Foundation (2010)

Yet the internet may have wider applications than simply a source of advice. Increasingly, financial services themselves are being purchased and accessed online. Evidence from focus group research suggests that young people value the instantaneity and sense of control enabled by online financial services (see Bosanquet et al, 2008). Online banking, for instance, enables people to quickly and frequently keep track of their finances; this is surely positive from the perspective of financial planning, and crucially, young people appear to desire this kind of feature.

Vinh Sum Chau and Liqing W.L.C. Ngai (2010) have studied young people's attitudes and

behaviour regarding online banking, surveying 164 individuals, around half of which were aged 16-29 (and around half of these were regular online banking users). They found that young people had far more positive attitudes and intentions towards online banking than older groups. In particular, young people exhibited high levels of 'self-efficacy' in relation to online banking; that is, they perceived the activity as something in which they have competence and confidence. Chau and Ngai also noted that, again, young people valued the instantaneity of online banking, but also the privacy. Clearly, while pensions and banking are very different in nature, there may be much that pensions providers can learn from young people's experience of online banking.

Any strategy for increasing pensions saving among young people which utilises online resources must note, of course, that internet access is unequally distributed, even among young people (Bosanquet et al, 2008); online financial services must not become a new frontier of the digital divide. Furthermore, online financial services are not in themselves a panacea. As Chapter 1 noted, young people are savvy in their online activities. For instance, CFEB (2010) research has shown that young people are 'protective' of social networking sites – they may be useful for peer-to-peer learning, but their utility for selling pensions products to young people may be limited.

Conclusion and recommendations

Population ageing is transforming the context and operation of the UK pensions system. It has become apparent that young people need to save more for their own retirement. Yet today's young people appear not to be inclined towards retirement planning; alternatively, they are experiencing broader financial strains which inhibit saving. It is not necessarily the case that today's young people are radically different to previous generations, in terms of attitudes or behaviour. Yet for young people today the transition between adolescence and adulthood is more prolonged. The time available for pensions saving and retirement planning more generally is therefore squeezed – while working lives should be extended, it is unlikely (and probably undesirable) that retirement ages will increase in proportion to the postponement of adulthood. Today's young people are forming habits in the period between adolescence and full adulthood that seem to prevent pensions saving. It is important that this situation is challenged, and that government and other stakeholders uphold a generational perspective in doing so.

The government's plans for NEST and auto-enrolment mobilise aspects of the 'nudge' agenda in order to resuscitate retirement saving. Most notably, auto-enrolment utilises a status quo bias – but more generally, NEST encompasses a set of financial incentives and an attempt to develop a trusted pensions saving brand. Yet it may be possible for occupational pensions reform to go further in this regard – not least due to fears that young people will opt out in large numbers. For instance, this report has argued that today's young people exhibit a desire for greater control over their finances – reconciling personal choice and the use of default options is not a straightforward task, but one that perhaps must be tackled in order to engage young people in pensions saving. A series of more specific recommendations are outlined below.

2012 is an opportunity that cannot be missed. There is evidence that young people are attracted by the incentives in occupational pensions saving that will be fortified by NEST once they become aware of the incentive structure – but most do not know enough about pensions to make informed decisions. While NEST will establish a benchmark for minimum provision, it can also be used to inform young people about pensions more generally. An awareness campaign should be enacted to this effect, which emphasises aspects of NEST likely to appeal to young people, such as the mobility of accounts.

Auto-enrolment may prove to be a relatively blunt tool. The government should be planning for the next stage of occupational pensions reform, considering both 'save more tomorrow' plans to increase savings rates over time, and offering a compulsory choice between different savings plans.

There is also a strong need for a 'Plan B' in case young people opt out of occupational pensions saving in large numbers. We know that young people are the least supportive of auto-enrolment among all age groups. This may be related to a desire

to retain greater control over their finances, although equally could derive from concerns over more short-term financial circumstances. One alternative is for the government to offer young people vehicles for saving in a more liquid format; funds could be converted into pensions saving at a certain point. This would offer greater flexibility while reinforcing the message that retirement planning cannot be delayed indefinitely.

Financial education remains vital but it could be delivered in more innovative ways. The government's promotion of online, interactive and peer-based learning should help to improve levels of financial literacy among young people. Greater emphasis should also be placed on whole-of-life planning and the development of broader thinking skills, not least to help to young people make more informed decisions around different forms of investment – an appetite for home-ownership seems to be inhibiting pensions saving, with potentially damaging consequences. Existing relationships of trust should also be utilised in delivering advice; educational schemes should seek ways to assist parents in helping their children make financial decisions.

Pensions saving must become less complex. This could be achieved at least in part by simplifying the discourse and terminology around the pensions system; the NEST corporation has been active in this regard, and its example should be followed by the pensions industry more widely. The government is also seeking to simplify the state pension, but should go further by simplifying the wider pensioner benefits offer. Simplicity should not, however, be valued for its own sake. In terms of the state pension, greater flexibility and personalisation may be required to enable the pension system to better fit expectations around gradual retirement.

Initiatives to encourage pensions saving must be founded on a wider savings culture. The government should consider the adoption of a rule-of-thumb message on pensions saving along the lines of the 5-a-day healthy eating message. The fact that pensions enable consumption-smoothing should also be central to communications, utilising existing norms around consumption. There also needs to be greater awareness among young people of what later life is like, to generate an understanding of how a decent retirement income can make a crucial difference to quality of life.

The rise of online financial services is an opportunity that should be seized by the pensions industry. Young people are attracted by the control afforded by online access to financial services, given that it resonates with their lifestyles more generally. NEST will make information available online to individual account holders; other providers should build upon this initiative.

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