Engagement of young adults with pension savings

Introduction

Engagement with pensions by young adults has advantages, however it has been traditionally low in this age group. There are multiple barriers preventing young people from engaging with pension savings. In particular, stereotypes about later life might encourage or deter engagement with retirement.

This Briefing Note explores barriers to engagement for young people and the ways in which negative perceptions of ageing can impede engagement with pension saving. It also outlines how tackling these psychological barriers can be used as part of effective financial advice.

There are benefits to engaging at younger ages

Early engagement in pension saving can allow more opportunities for preparation and long-term planning. Starting pension contributions at younger ages also makes accruing sufficient savings easier. Compound interest, in which returns are accrued upon contributions and any prior returns, makes contributing from younger ages particularly advantageous.

For example, if a 21 year old contributed £50 a month continuously, they could accrue a pot of £135,305 by age 65 (nominal amount, before charges), whereas someone contributing from age 31 would need to contribute 90% more than that amount, £95.42 a month, to accrue £135,305 at age 65 (Chart 1).[1]

Chart 1: A 31 year old would need to contribute 90% more than a 21 year old to accrue the same pot at SPa

Young people traditionally save at low levels

Saving levels among young people have traditionally been quite low. However, evidence suggests automatic enrolment is bringing proportionally more young people in to pension saving.

Prior to automatic enrolment 25% to 35% of 22-29 year olds working in the private sector were active members of a pension scheme. As a result of automatic enrolment, this rose to 54% by 2014, the largest increase across all age groups.[2]

However, participation is still higher among those of older ages with 64%-66% of people aged 30 to State Pension age (SPa) contributing to a pension in 2014.[3]

Based on current trends, automatic enrolment should see a greater proportion of young people saving in the future which could have a positive impact on the pension income of future generations and the promotion of a savings culture. The exact proportion of young people who will be saving in a workplace pension in future is less easy to predict as it will depend on economic forces, labour market forces and how young people respond to rises in minimum required contribution levels taking place over the next three years.

Automatic enrolment might not be enough to solve the engagement deficit

While automatic enrolment can make the difference between saving and not saving, it is not necessarily a substitute for engagement. There are still impediments to people accruing sufficient levels of savings to provide themselves with an adequate retirement income.

Automatic enrolment regulations include default minimum contribution levels

The 8% minimum contribution level (on band earnings of £5,824 to £43,000) required under automatic enrolment regulations may not be sufficient for people to achieve adequate incomes in retirement.

A 22 year old median earner might need to contribute between 13% to 17% of band earnings to have a three-quarters chance of replicating working life living standards in retirement (Chart 2).[4]

The precise amount that people will require in retirement will differ in relation to their household's income levels, needs and resources. Early engagement around desired levels of retirement income could allow people to adjust contribution levels accordingly, while waiting to engage at older ages could result in people needing to make an unaffordable level of contributions in order to secure an adequate retirement income.

Barriers to engagement

There are a number of barriers facing young people in relation to engaging with pension savings and financial planning.

The next section of this note considers each of these barriers in turn before exploring the role that attitudes towards ageing play in preventing engagement with pension savings:

- A live for today attitude
- A lack of perceived affordability
- A lack of knowledge
- Low levels of trust
- Hyperbolic discounting

A live for today attitude

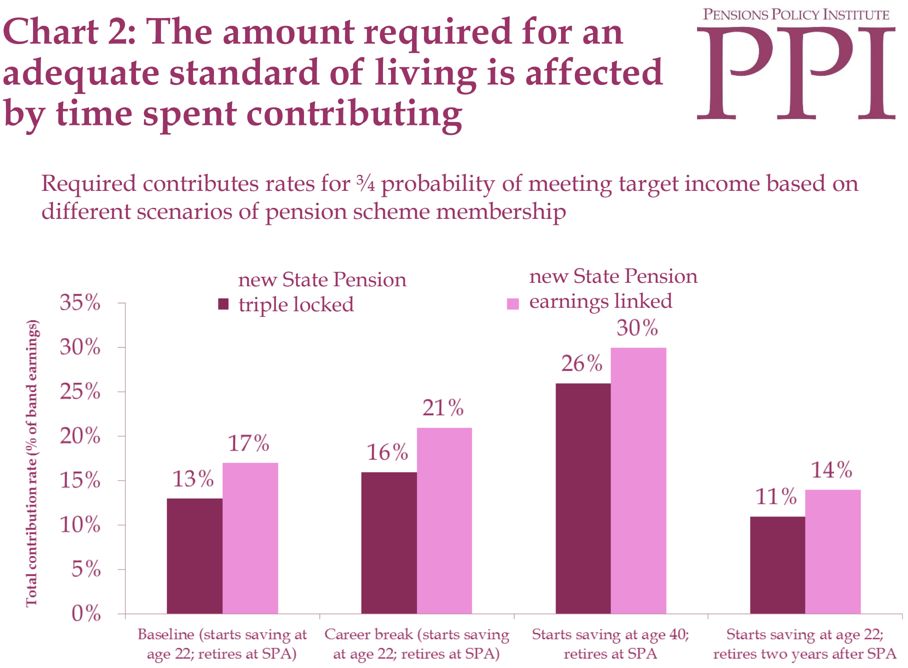
One of the most persistent barriers to saving among the under 30s is a belief that young people should make the most of their freedom and enjoy their money before they have greater responsibilities. There is a widespread belief among younger people that saving is something that one does when one "settles down", meaning having a family and/or buying a house.

Retirement is generally viewed as a bleak time when people will no longer be able to enjoy their income. Some young people report trying not to think about retirement or older age if they are able.[5]

A lack of perceived affordability

Though many younger adults have sufficient income to save a small amount in a pension, a lack of perceived affordability coexists with the "live for today" attitude whereby, though young people recognise that they have disposable income,

Chart 2: The amount required for an adequate standard of living is affected by time spent contributing



they do not feel that saving should be a detriment to their current lifestyle.

Some younger people believe that saving for the future will become appropriate only after a promotion or pay rise or reaching a sufficiently high income.

Many younger people, particularly students, are in debt to credit companies or **through** student loans. There is a common perception among those in debt that saving did not make sense until debts were paid down.[6]

Debts and the need to save for a specific purpose, such as a mortgage, can occur at any age, therefore this lack of perceived affordability may not be a unique barrier to younger adults.

A lack of knowledge

Misapprehensions about the tax and benefits system can occur among people of all ages. Many younger people have little understanding of how savings interacts with state benefits. For example, some younger people believe that accruing private pension savings will reduce entitlement to State Pension income.[7]

There is also limited knowledge among all age groups of how tax relief and other regulations on pension saving operate. A lack of understanding about the potential benefits and the potential drawbacks of pension saving act to hinder engagement.[8]

Low levels of trust

Young people are more likely to be sceptical about private pension savings due to pension scandals, frequent changes in policy, and the fact that pension providers are generally for-profit companies.

Low levels of trust of the motives of employers and financial services also play a role in preventing engagement with pension saving. Younger people report a higher level of trust in the State Pension and in the advice and guidance of family and friends than in private pension providers or employers.[9]

Hyperbolic discounting

Young people are more likely to value a small reward today than a larger reward in the future. This is known as hyperbolic discounting and is relevant to saving in that £1 spent today will buy less (generally) than £1 that is invested during working life and withdrawn in retirement. The inability to value a reward that will be realised far in the future is a particularly common barrier among younger people, for whom older age is relatively further away and therefore seems less relevant.[10]

One barrier that is not often considered is whether perceptions of ageing influence financial planning

Alongside the barriers listed above, one which has not yet been thoroughly explored by the industry or researchers is the extent to which negative perceptions of ageing lead people to ignore later life; and therefore make no provision for retirement.

The ability to think about, visualise and plan for later life is important as it is a prerequisite part of the process of being engaged and making practical plans for retirement.[11]

Those who avoid thinking about older age may face a fundamental stumbling block right at the start of the planning process.

Old age is viewed negatively in the UK

Within the UK, older age is often associated with discomfort, ill-health, bleakness and poverty.[12]

Negative views are reinforced in the media, with over two thirds of newspaper articles on older adults (over an 11 year period) painting old age negatively, for example, proposing that older people are a burden to society, frail, and/or an "economic time bomb".[13]

Younger adults view retirement as a relatively negative period of life

Younger people are particularly likely to have negative associations with older age. 20-29 year olds are more likely to associate words like "poverty", "ill health", "boredom", "dependence", "loneliness" and "tired" with retirement, than the population as a whole.[14]

Visualisation is an important element of financial planning

People who visualise and make goals for the future are likely to find it easier to plan for later life.[15]

On the other hand, negative views of ageing inhibit thought and anticipation of later life and can undermine incentives to financially prepare, resulting in non-engagement with pension saving.[16]

Researchers from Stanford University ran fMRI scans on subjects while they described themselves in the future.[17] Individuals who had a bigger change in brain activity when describing their future selves thought about themselves in an unrealistic way and favoured small immediate rewards during a asset allocation task. The individuals were shown aged photos of themselves and in a follow up test they were more likely to favour long-term investments. Using the digitally manipulated photos helped them have an emotional connection to their future and realise that their future self is dependant on their current actions.

To overcome these barriers, advice and guidance might wish to use a multi-disciplinary approach

Alongside financial advice and guidance methods, psychological support might also be necessary to help consumers overcome barriers to financial planning. A multidisciplinary approach that encompasses both of these can help younger adults overcome psychological barriers and promote effective financial planning and decision making.

For illustrative purposes the next paragraph explores how current methods of tackling psychological barriers might be used in the context of advice and guidance.

In psychological practice, clients are often encouraged to visualise problems and difficult concepts before practical work is done on dealing with the barriers to action caused by the difficulty of facing problems.

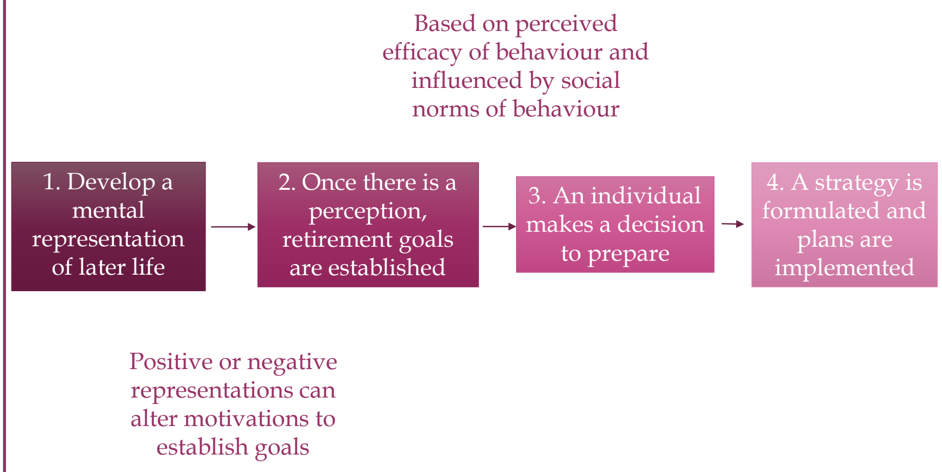
If this, or similar techniques, were to be integrated into financial advice and guidance they might help those wary of older age to start visualising retirement, looking at positives and negatives, developing expectations, and exploring hopes and fears.

Those who can realistically visualise the future will generally find it easier to develop concrete goals and take preparatory action. (Chart 3).[18]

Conclusion

While there are obvious financial benefits to engaging in pension

Chart 3: The Process of Planning



saving at younger ages, saving levels among young adults have traditionally been low in the UK. Automatic enrolment is undoubtedly bringing more young people into pension saving, but on its own, automatic enrolment is not sufficient to achieve an adequate income in retirement.

Unfortunately young people face age-specific barriers to engaging in planning for older age. Alongside many recognised and accepted barriers, one area which has not yet been thoroughly explored by the policy community is the way in which negative perceptions of ageing impede engagement among young people.

Anxiety and negative perceptions of ageing are endemic within UK culture and are particularly pronounced among younger people. Negative associations can impede planning and preparation for old age, and in many cases may present a barrier which needs to be overcome before effective practical planning can take place.

Engagement strategies may need to recognise the age differences and use different techniques to target young adults. It might be beneficial for advice and guidance to use a more multi-disciplinary approach and use elements of psychology alongside other financial support techniques.

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