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Confusion, uncertainty and pensions

Ring, Patrick; Webb, Robert

Publication date:
2014

Document Version
Peer reviewed version

[Link to publication in ResearchOnline](#)

Citation for published version (Harvard):

Ring, P & Webb, R 2014, 'Confusion, uncertainty and pensions' *Pensions Management Institute News*, vol. 2014, pp. 18-20. <<http://www.pensions-pmi.org.uk/documents/pmi-news-june-2014/>>

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CONFUSION, UNCERTAINTY AND PENSIONS

“sometimes pensions seem so complicated that I cannot really understand the best thing to do” (respondent comment in 2012 DWP research)

Introduction

Security in retirement is a key issue for savers, the financial services industry providing pension solutions, and a government wanting individuals to plan for retirement. In that context, pension confusion is a continuing challenge.

This article is based on research using the Scottish Social Attitudes Survey. It examines attitudes of savers in Scotland as expressed in that survey and suggests that, whilst there is significant confusion about pension provision, some of the confusion may arise from concern about the inherent uncertainty of pension saving. In turn, this emphasises the importance of trust in the current automatic enrolment reforms, and the problems that may arise if that trust is broken.

Pension confusion

One explanation of pension confusion is complexity. Previous research indicates pensions are considered the most complex of all financial products. Attempts at simplifying legislation, or introducing ‘simplified’ products, have not altered the position.

Other research points to a lack of ‘pensions literacy’. In one study only 5% of nearly 2,000 respondents believed they had a ‘good’ knowledge of pensions. A different survey found only 23% of respondents agreeing that they knew enough to decide with confidence how to save for retirement. The position seems to be most difficult for those who are not good at planning ahead. Our own research, confirming previous findings, showed that older people and those educated to higher degree level appeared more capable of planning ahead. It also underlined the relevance of general levels of education, with university graduates significantly less likely to find pensions difficult to understand.

Interestingly, we found housing tenure to be a strong predictor of pension knowledge, with owner occupiers appearing to have greater knowledge than social tenants. Our research also found that women were much more likely to report pension confusion, which is consistent with other evidence. This may partly be explained by disparities in pay and career interruptions, since acquiring more assets generally corresponds with greater experience, and a better understanding, of pensions. Research also shows such experience is closely associated with competence in choosing financial products.

Those in Scotland aged below 25 were found to be significantly less likely to report pension confusion. This seems counter-intuitive. Other research indicates pension saving, and long-term planning in general, are less likely to be undertaken by younger people. It may be greater confusion arises once one they begin to address pension saving.

Confusion, Uncertainty and Trust

We also looked at pensions uncertainty, which we considered to be expressions of a lack of confidence in the ability of occupational pensions to provide adequate retirement benefits. When we included this variable within our model we found that the largest determinant of confusion is uncertainty.

We believe this is an important finding. It suggests that expressions of pension confusion are not just an indication of lack of understanding about pensions, but may also be an expression of uncertainty about the retirement income that pension vehicles can deliver. This uncertainty may be related to a lack of confidence in the pensions industry itself, or government's ability to regulate the industry – reflecting attitudes towards the financial services sector more generally. Alternatively, individuals may be indicating uncertainty about the action and behaviours needed to achieve security in retirement. When looking at the characteristics of those more likely to express uncertainty we found, as with 'confusion', age, education and experience of dealing with financial products were all significant factors in explaining uncertainty.

Those owning their own home were more likely to express uncertainty about pensions. It is unclear why, although it may be related to evidence that some homeowners consider their home to be their 'pension'.

The importance of pension literacy

Our findings have implications for the issue of pension literacy. They support the emphasis on delivering successful pension literacy initiatives. However, they also suggest that if increasing literacy does not lead to greater confidence in pension vehicles to deliver adequate pension outcomes, then many individuals may still express uncertainty and confusion.

Pensions, trust and automatic enrolment

Another way of managing uncertainty is by placing trust in the skills and capacity of others. Despite some surveys showing low levels of trust in the financial services sector, the picture is mixed. Whilst there is an attitude of distrust *in general*, individuals tend to express greater trust in *their own* employers or financial providers when it comes to pension provision.

Academic literature illustrates how trust is a key mechanism available to individuals to manage complex or uncertain futures. The relevance of trust to the financial services sector has been taken up in recent years in a number of significant publications and debates. In the present context, trust in the expertise of others can help overcome confusion or uncertainty without the need to develop a deeper understanding of pensions.

Our results show that many of the non-savers at whom automatic enrolment is aimed – less well off, young, less well educated – are likely to have low levels of pension knowledge, and be more confused about, or unaware of, pensions. It is here that trust will be significant if non-savers are to be turned into long-term savers.

Automatic enrolment provides a pensions architecture created by experts, with default contribution levels and default funds. Research indicates many individuals will view defaults, by their very nature, as being endorsed by the financial services firms and employers creating and adopting automatic enrolment arrangements. If, as we find, confusion indicates uncertainty about pension vehicles delivering adequate retirement benefits, then it is likely to be faith in this new pensions architecture (as opposed to increased literacy and understanding) that will be vital in ensuring increased pensions saving.

Pension scheme governance

The Pension Regulator's last Corporate Plan emphasised the importance of improving outcomes, reducing risks and enhancing scheme governance. Much recent industry debate has concerned the level of pension charges, enhancing the design of default investment strategies, and improving approaches to decumulation. These developments are concerned with improving outcomes and, by implication, certainty. Put another way, they are fundamental to maintaining and increasing trust in pension provision in general, and the automatic enrolment reforms in particular.

However, if automatic enrolment does not deliver what newly enrolled pension savers consider to be satisfactory pension outcomes, it is likely they will consider this a breach of their trust. This outcome could place significant strain on relationships between employers and employees, and create further problems for the reputation of the financial services sector. It could also have significant political implications for the governments who have promoted these reforms. It will therefore be interesting to await the reaction as the first cohorts of savers begin to see the fruits of their investments.

BULLET POINTS

- Pension confusion remains a key issue for pensions. It is often attributed to complexity and a lack of pension literacy.
- This research finds that what is expressed to be confusion about pensions may actually arise as a result of uncertainty about the ability of pension schemes to provide adequate outcomes.
- This finding suggests that there may be limits to the ability of pension education to overcome confusion and uncertainty, and emphasises the importance of trust in pension arrangements and providers.
- Trust is likely to be a key element in the success of the automatic enrolment, given the project's key target population.
- The focus of the Pension Regulator and pensions industry on scheme governance and improving member outcomes indicates recognition of the need to enhance and maintain trust in the appropriateness of pension provision.

Name: Dr Patrick Ring

Title: Programme Director, Finance Investment and Risk

Company: Glasgow School *for* Business and Society,
Glasgow Caledonian University

Name: Dr Rob Webb

Title: Associate Professor of Banking;

Company: Centre for Risk, Banking and Financial Services,
Nottingham University Business School