

Engagement & automation

Automation and member engagement strategies should be used in tandem to increase participation, says Matthew Craig



It is often said that 'you can lead a horse to water, but you can't make it drink'. The question for defined contribution (DC) schemes faced with poor participation is whether they should use automation to unwittingly lead members to their optimum level of saving or whether they should use engagement to make them 'drink' of their own accord.

Members of defined contribution (DC) pension schemes bear far more risk than their counterparts in defined benefit schemes and have to take many more decisions. Choosing how much to contribute, where to invest and ultimately how to take their benefits critically affects retirement income – but many members do not arrive at the decision that is best for them unaided.

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There is now a lively debate over the best way to meet this challenge. In one corner, member engagement stands for empowering scheme members so they can then make informed decisions concerning their DC pension. In the opposite corner is the automation of many of decisions that individuals need to make in DC pensions. The latter approach is

based on the premise that the great majority of scheme members are, for a variety of reasons, unable or unwilling to make active choices. Instead, processes such as automatic enrolment into pension schemes, automatic contribution increases each year and the use of default funds are employed to maximise the chances of a decent pension for members.

Automatic for the people

In practice, most DC schemes are likely to use both member engagement and automation to varying degrees. However, the balance could be shifting towards automation. For example, from 2012 onwards the National Employment Savings Trust (NEST), the planned low-cost, national pension scheme previously known as personal accounts, will use auto-enrolment and automated default funds on a huge scale.

Some of the latest thinking on DC pensions draws on behavioural science and this is seen as supporting automation. Professor David Blake of the Pensions Institute points to two competing models of human behavior as described in the book, *Nudge*, by Thaler and Sunstein. The first are 'econs', or rational economic agents: "Once they are educated about pensions and finance, they will be able to optimise their retirement savings with minimal interference, because they will then be skilled enough to do this themselves." The other model is that people are 'humans': "Humans may understand the importance of saving for a

pension, but lack the willpower to do so and would rather spend their money today – no amount of education will turn them into 'econs' and they need nudges or even compulsion to help them."

Based on the *Nudge* thesis, Blake says he supports well-designed defaults for the contribution rate, investment strategies and de-risking in the lead up to retirement, as well as for annuitisation. One of the beauties of automation is that it takes existing traits in human behaviour, such as an inability to make financial decisions, and uses them to push people in the right direction. B&CE Insurance director John Jory commented: "Apathy and inertia means that very few people take conscious decisions to save for retirement. Auto-enrolment will reverse that trend. People will find themselves enrolled in a company pension scheme or NEST as a result."

Keeping a prior engagement

The use of automation does not mean ending engagement with scheme members. Jon Pearce of communications specialists Ferrier Pearce says: "We haven't seen any changes in actual deliverables yet, but schemes are now talking seriously about improving communications and levels of engagement with the impending move to auto-enrolment in mind." Friends Provident national employee communications manager Neil Hawkins says pension providers initially thought that auto-enrolment would mean the end of pension communications, but the reverse has proved to be the case. "Nowadays this is even more so, because of all the complexities. Our strategy is for holistic education to try and get people to understand the concepts and then specific communications to get messages across."

As an example of the combined approach, Hawkins cites Friends Provident's approach to fund selection. This makes use of choice aversion, or the fact people find it increasingly hard to make a choice as the number of options rises. Knowing this, Hawkins says most DC members are only shown the core fund range of three to five funds, although there are up to 100 funds in the additional fund range for more sophisticated investors. Kevin Shilling of Shilling Communications believes that introducing auto-enrolment will make very little difference to how schemes communicate with their members. "The sad thing is that it is a licence

for lazy employers and incompetent trustees to do nothing. Those employers and trustees who have never given much importance to effective member communication will continue to churn out bland information with the belief that they are fulfilling their disclosure requirements."

Another use of automation to boost pension provision is to have automatic annual increases in member contributions, known as

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save more tomorrow (SMT), unless individuals opt out. SMT is a form of retirement savings developed in the US by Thaler (of *Nudge*) and Shlomo Benartzi. Under the SMT principle, an employee agrees to start saving in the future on a significant date, such as the date of their next pay rise. This is termed 'pre-commitment'. Using this approach takes advantage of inertia: once the payroll administration has been done to set up the future commitment, few workers will make the effort to cancel it. Hawkins says this has worked for Friends Provident's own pension scheme, as member contributions were raised from 6% to 10% in incremental steps at the same time as the annual salary review. "Most people had not realized that their contributions were raised, which proves SMT does actually work", Hawkins says.

At the other end of the scale, Hawkins says that in most cases less than 10% of scheme members will look at online modeling tools which are used as part of member engagement initiatives. Hawkins commented: "Stochastic modeling is a fantastic tool but it is only used by a very small proportion of people."

While automation can be effective, it does not address some fundamental points. AXA Corporate Benefits distribution and marketing director Colin Williams says: "Auto-processes are useful in that they overcome inertia but because employees aren't actively making the decisions about their pension, they remain apathetic. Employees need to be actively engaged with their pension in order to make the right financial planning decisions for

retirement and to ensure they truly value this element of their benefits package."

Horses for courses

In an ideal world, members will gather sufficient information in order to be able to make informed decisions, but in reality there will always be members who do not, or cannot, do this and automation can act as a safety net for them. One way to ensure the best balance of automation and engagement is to work out where each method is most effective. RSA group pensions director Jerry Gandhi says: "All avenues need to be explored and, within overall cost parameters, focusing on the best channels is the best way forward. That may mean profiling employees and using differing media processes and delivery structures relevant to the audience."

Mercer senior communications consultant Trevor Rutter says that his firm grades employees as spenders, savers, investors and planners in order to help it target communications effectively. "A spender is typically not in the scheme or is only paying in the bare minimum and doesn't see a pension as worthwhile," Rutter says. He adds that this type of person can be identified with an online

questionnaire and so the scheme can then provide the appropriate material to try and convince them of the value of saving in a pension. For a saver, automatic saving increases could help ingrain the pension habit, while for an investor, investor education and advice could help them decide where to invest. For a planner, modelling tools, projections and one-to-one advice would be appropriate.

Automation and engagement help scheme members from different directions but in practice they can dovetail together. The acid test for a DC scheme will be the adequacy of the eventual pension benefits and both automation and engagement are likely to contribute to this goal. As members will vary greatly in their financial expertise, DC schemes need a variety of tools to guide members towards 'correct' decisions. Automation can successfully lead members towards suitable levels of pension saving but that should not prevent schemes trying to use engagement to take them that one elusive step further. ■