Attitudes towards investment choice and risk within the personal accounts scheme: Report of a qualitative study

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Background

This report presents findings from a qualitative study exploring attitudes towards investment choice and risk within the personal accounts pension scheme. The study comprised of 14 focus groups conducted between January and February 2008 in locations across the UK with individuals who would be eligible for automatic enrolment under the Government's workplace pension reforms. This research was conducted by the Personal Finance Research Centre on behalf of the Department for Work and Pensions.

The Pensions Act 2008 sets out the Government's reforms introducing, from 2012, a duty on employers to automatically enrol all their eligible employees into a qualifying workplace pension scheme. Employers will also have to provide a minimum contribution towards the pension saving for those employees who participate. Employees will be able to opt out if they do not wish to participate. The Pensions Act also sets out plans for the establishment of the personal accounts scheme, which will be a trust-based, occupational pension scheme for employers that do not have, or wish to use, a qualifying scheme of their own. This pension scheme will be run at arm's length from Government by a body corporate acting as an independent not-for-profit trustee.

The personal accounts scheme will be required to offer a default fund into which the contributions of members who do not make an active investment choice will be automatically invested. It may also offer a limited choice of investment funds for those who do want to make an active choice. Investment decisions, including what the default fund will look like and the type of wider fund choice that will be offered, are legally a matter for the scheme's trustees and there is no guarantee that they will consider, or decide to offer, the funds discussed in this research as part of the personal accounts scheme.

Key findings

Participants viewed the idea of investment choice within the personal accounts scheme as wholly positive, provided members are able to make decisions that match their personal preferences. Simple and straightforward choices and the provision of clear and jargon-free information was seen to be important for this.

Generally, participants were in favour of the scheme offering members all the fund types discussed, although their personal interest in investing in them varied considerably and most interest was shown in low risk funds. The level of risk and return involved, the ability to choose their own mix of investments, and low charges would be the key factors in participants' investment fund decisions.

Although most participants thought that they would want to make an active investment choice, the idea of a default fund was well received. Participants strongly felt that the default fund should be low risk in order to protect members' pension pots.

Financial risk

Most participants were unwilling to take much risk with their money. This was the case even over the long-term (five years or more) and few participants mentioned the potential for risk and return to balance out over time. The most common reasons for being averse to taking financial risks included the responsibility of raising a family and the need to keep up with financial commitments, including mortgage payments and household bills. Participants generally had a grasp of the basic differences between saving and investing, although most saw pensions as involving the same or higher level of risk than stocks and shares.

Investment choice

Participants largely viewed the idea of investment fund choice within the personal accounts scheme as wholly positive. Their view was, however, conditional on scheme members being able to make decisions that match their personal preferences. Lack of understanding about pensions and investments and a lack of confidence in financial decision-making were perceived to be the main barriers to exercising personal choice. Participants therefore felt that the investment choices offered by the personal accounts scheme should be simple and straightforward. The provision of information was also considered key to enabling scheme members to make an active investment choice.

Most participants suggested between three and five funds would constitute a manageable number to choose between. Participants felt strongly that funds should be in distinct risk bands to aid differentiation and therefore choice.

Views on specific fund types

Generally, participants welcomed the possibility of the personal accounts scheme offering each of the key fund types discussed as they felt that giving scheme members investment choice was a good thing. However, personal interest in investing in each of the funds varied considerably.

Individually tailored funds: explained as funds which would give scheme members the opportunity to choose the mix of investments that make them up.

Participants by and large viewed this option positively as it was seen to offer scheme members the opportunity to make decisions in accordance with their personal preferences. Participants of all ages and incomes said they might be interested in investing in such a fund, however some respondents (especially younger ones) felt that this type of fund would require too much time, effort and financial confidence.

Risk-based funds: explained as 'off-the-shelf' funds in which financial experts choose the mix of investments that make them up. Scheme members would then be required to select the fund that best matches their preference out of a choice of low-, medium- or high-risk funds.

Participants overall felt that this fund type would provide a simple, effective and manageable level of choice and would potentially have broader appeal than the individually tailored funds. Asked whether or not they would be personally interested in the risk-based fund option, most interest was expressed by participants with no pension or investment experience, and younger participants who had been daunted by the prospect of individually tailored funds and found risk-based funds more straightforward and less confusing.

Guaranteed Minimum Return (GMR) funds[1]: explained as a type of risk-based fund in which the capital invested and a minimum level of return would be guaranteed, and as a trade-off some return over and above the minimum level would be lost.

Across the board, participants deemed the GMR fund to be a valuable option for the personal accounts scheme, however few participants were personally willing to accept the reduced opportunity for return associated with the fund as described. Participants, instead, spontaneously raised the possibility of investing half of their

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[1] Although it is unlikely that a guaranteed fund will be offered by the personal accounts scheme due to the high costs that providing it would incur, it was included in this study so that attitudes to a full range of funds occupying various points on the risk spectrum could be explored.

pension pot into the GMR fund, while having the opportunity to seek higher levels of return with the other half. This alternative was seen to balance the need for security and return.

Socially Responsible Investment (SRI) funds: explained as funds that might exclude and/or include shares in companies on ethical or environmental grounds, and/or which might aim to influence the companies they invest in to act in a more ethical or environmentally responsible way.

When asked for their general views, participants either considered the SRI fund to be a positive option for the scheme or felt it would have to be an option to reflect political interest in ethical and environmental concerns. However, the SRI fund held little personal appeal for most participants, who generally tended to prioritise returns over ethical principles in investments and spontaneously mentioned the concern that SRI funds would deliver below average returns. However, a few participants did have a strong interest in these funds.

Lifestyled funds: explained as funds which gradually move pension pots from higher risk investments into lower risk and potentially lower return investments in order to protect the pot from downturns in the stock market. Participants were told that in these funds lifestyling would be automatically implemented five to ten years prior to a scheme member's retirement age.

Generally most participants thought lifestyling was a positive feature, although on a personal level it held the greatest appeal for older participants and lower earners. Participants were however divided as to whether lifestyling should be an automatic feature or whether scheme members should be prompted to consider lifestyling their pension fund at an appropriate time.

Branded funds: explained as funds associated with big-name providers, although names of these possible commercial providers were not provided as part of the explanation. The prospect that these funds might attract higher charges than non-branded funds was introduced as well.

On the whole participants welcomed the idea of branded funds as a possible option within the personal accounts scheme to create choice for members and generate healthy competition. In terms of personal interest, views were mixed about whether or not participants might opt for branded funds if they were available. Overall, however, participants would generally be willing to consider branded funds alongside 'own-brand funds', and to assess factors such as which provides the 'best deal' when making a decision.

Key factors in investment decisions

Three factors stood out as being most important for participants when making decisions about investment funds: the level of risk and return involved, the ability to choose their own mix of investments, and low charges.

Least important were: whether the funds were socially responsible (SRI) and whether they were branded.

Default fund and making an active choice

The concept of a default fund option was well received by participants. They felt that the main advantage of such a fund was to kick-start pension saving for people who were not ready to, or did not want to, make an active investment choice. Most participants felt strongly that the default fund should be low-risk in order to protect the pension savings of members who had not made an active investment choice from potential investment losses.

Apart from a few participants who expressed a personal preference for staying in the default fund option, most considered that they would personally want to make an active choice[2] in order to select a fund that matched the level of risk they wanted to take.

[2] However, it is important to note that based on evidence from similar types of pension schemes in Sweden and the US, in reality it seems likely that most personal account scheme members will remain in the default fund.

The importance of information in helping members to make the choice about whether or not to stay in the default fund was raised spontaneously by participants. They expressed a wish for jargon-free information about possible investment options, in the form of booklets or leaflets or an information pack sent out in advance of the launch of the personal accounts scheme.

As well as written materials, participants mentioned a range of possible delivery channels for information and support including workplace seminars, internet-based resources, telephone helplines and television campaigns. There was also an appetite for professional advice among some participants.

The full report of these research findings is published by the Department for Work and Pensions (ISBN 978 1 84712 498 2. Research Report 565. March 2009).

You can download the full report free from: www.dwp.gov.uk/asd/asd5/rrs-index.asp

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