Saving Britain
A White Paper on
Rebuilding Britain’s Savings Culture
Foreword

Saving matters:
- to individuals and families, for whom it delivers financial independence and peace of mind, as well as clear health and well-being benefits
- to the Exchequer, since greater personal self-reliance releases scarce resources for other uses
- to the economy, because a larger supply of UK-based saving means more capital for businesses to invest, without the global imbalances that contributed to the 2008-09 crisis.

In this White Paper, AEGON UK and the Association of Independent Financial Advisers have joined forces to bring fresh thinking to the debate. Both our organisations have track records of innovative research and thought leadership on complex and important issues. By working together, we combine the experience and understanding of one of Britain’s foremost providers of retirement and savings products with the insights of Britain’s independent financial advisers. Every day we see among our clients and customers the benefits of well planned family finances, and the consequences when planning and provision is lacking. We help people who are in debt and need to stabilise their position before they can start saving, people who are putting a little bit aside for emergencies, people paying into pension schemes at work, and experienced investors and entrepreneurs.

Our paper sets out what a savings culture is. It proposes some practical ideas for policy development, which are based on today’s technology, infrastructure and legislation, and could therefore be done quickly. But at the same time it identifies an entirely new approach to the issue, which we believe will work because it’s based on how real people think and behave.

Politicians of all parties seem to recognise the idea that saving is a good thing, and there is high level talk of the benefits of a new ‘savings culture’. But no one has set out what exactly they would do to encourage it. We are publishing our thoughts now because a change of Government could signal an appetite for new ideas and new approaches to savings policy; because in the wake of unprecedented financial uncertainty there is a unique opportunity to lock in a new culture; and with barely two years to go before the scheduled start of auto-enrolment into pensions, we need a wider debate on how to apply behavioural tools to policy.

Saving is important, but a new savings policy is also urgent. We must work together now to rebuild Britain’s savings culture, before old pre-recession habits re-assert themselves.
Executive summary

Britain entered the financial crisis and recession with the lowest savings rate since the Second World War, the second lowest of all major economies, and with up to 13 million people saving inadequately or not saving at all. If we don’t act now there is a real risk that the situation will only deteriorate – data indicate a steady decline in the savings ratio over the past 20 years.

We are therefore calling on policy makers to act decisively to combat the savings problem today – the new Government needs to act immediately. An economy that saves more is better balanced and more resilient in the face of future economic shocks. Moreover, the events of the past two years have woken up the UK public to the importance of saving. The issue of savings is therefore at the forefront of people’s minds, and acting now can capitalise on that.

Recent approaches to boosting saving have seen Governments design products and stipulate their price, and shore up consumer confidence via ever-stronger regulation. This has limited the supply of products and affordable advice. And a societal preference for consumption has disengaged people from saving.

So the result of this supply-side approach has been limited. In the last few years, however, with the adoption of auto-enrolment, policy has begun to show an openness to a new type of thinking, based on behavioural finance.

This paper looks at how a behavioural approach can be extended to further improve outcomes, and, more ambitiously, restore a genuine savings culture, where well-managed finances are easier to achieve, earn the approval of social networks, and become a positive force in communities.

We have eight recommendations to help achieve this goal:

**Revolutionise demand by making saving easy and linking it to everyday decisions**
1. ‘Save back’ not ‘cash back’
2. Change product information so it ties saving to real targets, and explains progress towards them

**Build the foundations of a savings culture among school children**
3. Schools savings clubs
4. More demanding financial education targets

**Build a new infrastructure to support advice and savings**
5. Adjust regulation to boost the availability of advice
6. Remove the £150 tax limit for financial advice for employees

**Create networks to nudge and reward savers**
7. Networks make norms
8. New forms of support

We have also identified the practical steps that the Government can take to bring these ideas to life, via a careful programme of reviews, pilots and design trials in collaboration with technical experts from the industry and regulation.

There is a broad consensus that current savings levels in the UK are insufficient. It is fair to say attitudes towards savings have changed over recent decades and saving for the future is seldom regarded as a necessary activity. As attitudes have changed, pension savings have shrunk and the take-up of retail credit has expanded. There are currently around 9.6 million working people saving nothing at all – and another 3.8 million not saving enough – to meet the costs they are likely to face in their later years.

According to the 2008 Wealth and Assets Survey (WAS), 39% of respondents agreed with the statement ‘I would rather enjoy a good standard of living today than save for retirement’. Worryingly, agreement is highest among those with no current pension scheme.

Changing social attitudes towards financial planning, particularly amongst key demographics including the young and low earners, have already begun to shape Britain’s future. Over the course of the twenty years leading up to the 2007 recession, the UK has had the second lowest savings rate of any OECD country.

According to the Office for National Statistics (ONS), the UK national household savings rate has fallen to less than zero, reaching a post-war low of -0.5% in January 2008, from a peak of 13.4% in 1984. This trend towards consuming rather than saving has occurred despite persistent growth in real incomes over the same period – between 1971 and 2007, the household disposable income per head in the UK, adjusted for inflation, has increased by more than 160%.

The sharp decline in household saving has also been accompanied by a significant rise in private debt as a proportion of GDP. By the time the financial crisis hit in 2008, people were borrowing to the tune of 4.4% of their income. The UK’s record in this respect is worse than many comparable nations. While there have been signs of improvement since the recession took hold, this largely reflects paying down debt rather than generating positive savings. There is a risk that as the economy picks up, the supply of, and demand for, credit will return to previous levels, and behaviours that we see now will prove transient.
The State of UK Savings

Of course, it is well established that the amount households save varies with household composition. The ONS has found that households with two adults and no dependent children – where one or both were over state pension age – were the most likely to have substantial savings. One third of such households had savings of £20,000 or more. This is in part a reflection of life cycle effects, since older people may have been able to build up savings during their working lives and some may have received a lump sum pension on their retirement.

At younger life stages, the majority of lone parent households, for instance, have no savings (53%), as do more than one-quarter (28%) of couple households with dependent children.

The 16-24 age group has the lowest level of savings and, according to FSA reports, is least interested in saving. This is worrying for a number of reasons. Habits are formed at this age, which means that negative attitudes towards saving may have long-term behavioural implications. Moreover, in the UK, this age group starts earning earlier than in other countries, underlining a need to develop a savings culture early so that this cohort does not fall into debt as it ages.

Another group which is of concern is low earners. The 2006–07 Family Resources Survey (FRS) shows that 43% of lower-income households held no savings or assets, compared with 24% of all households. Only 37% of lower-income families actively save, and even fewer (18%) report having any formal savings.

Indeed, research has shown that while income level affects an individual’s ability to save, it is not an insurmountable barrier. In the United States, for example, the Individual Development Accounts programme – a range of schemes focused on encouraging welfare recipients to build savings through matched donations with the goal of creating more durable assets – have found that even amongst the lowest earners routine saving was possible, suggesting that the barriers to saving may be more than just financial. Therefore, given the right nudges, this group in society can also be part of a savings culture.

Not only has there been an attitudinal shift concerning saving over the past 20 years, but also barriers have developed which have made saving increasingly hard. These barriers prevent people from saving at all, as well as hindering people’s ability to save at particular stages of their life. These barriers fit into three broad categories – behavioural, economic and institutional. Unless we fully understand these barriers and the effect they have on individuals, it will be hard to overcome them.

Behavioural barriers

Previous policy interventions were guided by the principle that people are perfectly rational in their decision making, ... from the field of behavioural economics increasingly suggests these approaches, when used on their own, are insufficient.

The truth of the matter is that people aren’t always rational and, in the case of financial planning, simply do not think and act would generate better outcomes with less deadweight cost, and a lower likelihood of unintended consequences.

This is where ‘nudging’ can play an effective role. Nudging works because it enables an individual to make decisions that they themselves value and would like to make if only they had sufficient will power. There are two types:

- nudges that ‘go with the grain’ of existing biases and change the outcome of irrational decisions (eg auto-enrolment makes saving – rather than doing nothing – the outcome of inertia)
- nudges that overcome the barriers to rational decision making (eg the public declarations and feedback in a WeightWatchers programme helps prevent people ‘lapsing’ from their diet)

It is important to remember that the two types are complementary not mutually exclusive.

If we are to change behaviour we need a savings system which makes sense on a strictly rational basis. But then we need to recognise that most people aren’t perfectly rational, and put in place complementary policy measures which work with real thought processes and behaviours to encourage saving.

Earlier work has pointed to the need to review financial and behavioural incentives to pension saving in a rounded way. In future work, it would be interesting to examine how behavioural insights can be used to design financial incentives, which because of their basis in how real people think and act would generate better outcomes with less deadweight cost, and a lower likelihood of unintended consequences.

References

1 ONS ‘Social Trends’ (2009)
4 2006–07 Family Resources Survey (FRS)
5 Thaler and Sunstein, ‘Nudge’ (2008)
6 Pensions Crunch: proposals for change - AEGON UK, 2010

Barriers to saving
Barriers to saving

Economic barriers

The last 20 years have seen a progressive removal of credit restraints in the UK, coupled with low levels of price inflation, which have helped foster the willingness of people to spend and to take up ever increasing levels of personal debt.

Even among lower income groups with less access to formal types of borrowing, there have been options to increase spending (and decrease savings rates). Bridges and Disney (2004) found that low income families utilise a wide variety of credit arrangements when access to ‘high street’ credit might be limited. These hidden arrangements include the temporary non-payment of regular household bills, or loans from family and friends, which can be a cheaper alternative to finance current expenditure.12

The total amount of visible UK consumer debt, including secured debt (primarily mortgages and remortgaging) and unsecured debt (such as finance loans and credit cards), has grown substantially in recent years to a record £1.5 trillion.13

PriceWaterhouseCoopers estimates that on average, each UK household has total debt of around £60,000, made up of approximately £50,000 of secured debt and £10,000 of unsecured debt.

These debt levels mean that the average household will need to spend approximately 15% of its net income purely to service the interest payments arising from this debt. This obligation, rather than the actual level of an individual’s income, is often what makes it hard for people to even consider saving.

A 2004 IFS survey showed that poorer households generally displayed a greater risk of running into difficulties with repayment. Few had any savings to maintain payments in the event of reduced income. In addition, poor or non-existent credit scores locked poor families into non-mainstream lending with high APRs which pose major difficulties in repayment.14

Reflecting these developments, personal insolvency rates have increased sharply in the past couple of years and the Insolvency Service confirmed in September 2009 that the number of personal insolvencies in England and Wales was the highest since records began in 1960.

Institutional barriers

Regulation has increased in recent years, partly in response to industry changes, and partly to meet society’s expectations of minimum standards.

We believe in clear, consistent regulation, that is tough when needed, supports minimum standards for customers, and acts as a brake on detrimental competitive incentives. To achieve these ends, the FSA has sought to encourage better quality of advice but it has come at the expense of reducing adviser numbers and increasing costs, time and hassle for consumers.

Large numbers of mid and low earners are effectively excluded from financial advice, since the provision of regulated advice has become uneconomic.

The growing exclusion zone in the UK savings market

The evidence

In “Nudge”, Thaler and Sunstein propose a “Give More Tomorrow” nudge to encourage charitable donations. People are asked to sign up, committing in advance to increasing their donations to their favourite charity every year. Opt-out is easy, requiring only a quick phone call or email at any time. Anna Bremren ran a pilot experiment in 2006 using the “Give More Tomorrow” nudge. The experiment revealed that overall donation levels could be increased by 32% by asking donors to increase their donations starting in two months time rather than immediately.

The example

In a similar way to the ‘Give More Tomorrow’ scheme, people should be encouraged to ‘Save More Tomorrow’. It is being asked to increase their monthly savings contributions in, for example, two months time or at their next pay review, rather than immediately. This is an increasingly common feature of work place pension plans in the United States, applying the thinking of leading behavioural economists.

11 Thaler and Sunstein, “Nudge” (2008)
This section describes our proposals for rebuilding a savings culture in the UK. But first, we discuss what a savings culture is.

To us, a savings culture is a national environment in which:
- saving is easy, habitual, rewarding and commands approval from peer groups and social networks
- the benefit of saving is seen in the achievement of individual and collective goals in families and communities
- public policy and private enterprise are organised to reinforce the take-up of savings and to co-invest in desirable outcomes
- behaviour is self-sustaining because it is based on an awareness of innate desires and reinforced by appropriate “behavioural” nudges.

A savings culture encompasses all types of saving across all income ranges and all life stages: precautionary (rainy day) saving, saving to buy goods and services (instead of borrowing to pay for them and repaying the debt afterwards) to long term investing for retirement, via workplace and individual pensions.

In order to bring this about, we propose policy changes with three intertwined and mutually supportive objectives: the creation of demand, the formation of groups and increased access to advice.

If we can bring about a demand for savings through carefully-structured behavioural nudges, and support this demand with positive group and social norms as well as accurate, helpful and impartial financial information, we can build the virtuous cycle of a self-sustaining savings culture.

So, our recommendations are:

1. ‘Save back’ not ‘cash back’

We recommend moving to a system that allows people to save at almost any time and at any location in simple, intuitive and unobtrusive ways. People would rather spend than save.

People would rather spend than save.

The popular view, until the late 1990's too often true, is that you get a poor deal from medium/long term products.

The value of the lending/credit parts of the financial services industry has been rated more highly than the value of the saving/protecting parts.

As a consequence, there exists a vicious circle whereby:

Barriers to saving

Yet people still need financial advice and information, from general guidance on what they should think about (eg from the sort of generic advice service recommended by the Thoresen Review and being taken forward in the FSA’s Moneymadeclear initiative), to reassurance about buying products, through to full financial planning and lifetime financial counselling.

The FSA’s Retail Distribution Review (RDR) may result in a further contraction in supply, damaging access to advice even further. Yet people still need financial advice and information, from general guidance on what they should think about (eg from the sort of generic advice service recommended by the Thoresen Review and being taken forward in the FSA’s Moneymadeclear initiative), to reassurance about buying products, through to full financial planning and lifetime financial counselling.

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Access to Advice

Providing trusted expert help to do the right thing and maintain the savings habit.

Group Formation

Harnessing the will of local communities and associations to work together for shared goals, including boosting local economies.

Savings Culture

Making savings easy, gratifying and normal.

Demand Creation

The value of the lending/credit parts of the financial services industry has been rated more highly than the value of the saving/protecting parts.
We therefore propose that regulation should be re-balanced – not relaxed – in light of what we know about the behavioural and pricing obstacles it can create. FSA has itself admitted that the costs of implementing regulatory requirements has limited access to financial advice to more affluent consumers16.

An original objective of the FSA’s Retail Distribution Review (RDR) was an increase in consumer access to regulated, professional advice, alongside the new Moneymadeclear service, and with it, a re-engagement of people with their long-term financial well-being.

In order to increase access to regulated advice for the majority, we call on FSA to establish a review with the aim of removing barriers that have impeded easy access to personal financial advice on savings17. We also suggest that as the new Government considers changes to regulatory structures, it looks at the costs and benefits of adding a pool of professional regulated services to direct people to, and we see a risk that that pool will contract in future.

6. Remove the £150 tax limit for financial advice for employees

Currently there exists a £150 limit for financial advice offered as a workplace benefit by employers for employees before it becomes a taxable benefit-in-kind. We believe by removing this £150 limit, it will help encourage more people to seek advice in the workplace and, as a result, make more and better provision for themselves. The Government should look at how to extend these benefits to other affinity groups beyond the workplace.

7. Networks make norms

Social norms are powerful nudges. Our perception of peer group behaviour is particularly important in shaping our decisions. We therefore recommend that the new Government encourages the formation of savings networks, groups of people coming together to save individually, but given incentives on a group basis18. Incentives should also be given to those who sponsor, convene or create new groups.

These associations should be self-constituting, either around existing social networks such as extended family and friends, or by creating new networks such as neighbourhoods. Groups could also form around savings goals, such as wedding savers, and provide ‘weight watchers-style’ peer support and pressure to save.

Employment-based networks are highly effective for encouraging pension savings, helping to pay off debt via payroll deduction, and creating positive savings once the debt is paid off.

Workplaces are established networks with strong links to saving. We need to build on this success. As well as looking at how to increase the attractiveness of saving and advice benefits, we could look at new ideas like using workplaces to help people who want to save for the future to first break free of the debt trap. Employers could assist indebted employees by offering a ‘debt to saving’ programme, linked to their workplace pension scheme, through flexible benefits packages.

We also need to see whether similar approaches can be used in other settings.

Internet-based networks might also be created which utilise existing applications such as ‘Daily Dollar’, a daily budgeting Facebook application19.

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16 FSA’s DP 07/1 Retail Distribution Review (June 2007) – page 4
17 Essentially building on one of the original workstreams of the RDR
18 For instance, large balances often attract higher interest, so each participant in a group could get the interest rate that the total balance of the group would earn
19 facebook.com/LiveSolid
Our recommendations

Savings results could be published on individual ‘profiles’, helping to nudge ongoing and sustained savings. The internet is also useful in bringing to life the notion that small lifestyle changes can add up to big savings.

In short, a network can be used to reinforce the idea that ‘saving is the smart thing to do’.

8. New forms of support
People in these networks will still need help, support and advice. They need ‘savings champions’. These new ‘savings champions’ could be encouraged to play a facilitating role, a modern ‘man from the Pru’ who was already there in the community actively seeking out savers and encouraging the formation of groups. Trusted facilitators give context and power for savers and efficiency for providers: they will be a new model of intermediaries.

Making the policy operational

In order to make these recommendations operational, there needs to be decisive action from the Government, the regulator, and other key stakeholders.

Government action needed:
- Name savings as a Government priority and launch a high-profile awareness campaign to imprint the issue in the public mind.
- Launch a high-level review into how to restore a savings culture in the UK, using our recommendations as the terms of reference.
- Invite the UK Payments Administration, leading retailers and system suppliers, to discuss what would be needed to roll-out and promote the ‘save back’ model.
- Remove the existing £150 ceiling on financial advice in the workplace, and extend it beyond the workplace to other groupings.
- Amend the Financial Promotions Order to extend exemptions from financial promotions beyond employers to other group ‘facilitators’.

Other action needed:
- Specialist external consultancy to develop a pilot programme to incentivise retailers and suppliers to promote, collect and pay savings into accounts.
- Department for Education to set statutory target classroom time for budgeting and savings education.
- Financial Services Authority to review the barriers that have impeded easy access to personal financial advice on savings.
- HM Treasury to develop a detailed piloting strategy for group savings formation/incentivisation and operational model for interaction with providers.
- The financial services industry to develop and promote ‘real outcome’ material for key consumer needs.

There is one further factor, without which this discussion of encouraging saving would be incomplete. That is means testing. For many of those at the bottom of the economic ladder, savings currently makes little or no economic sense. The perception of means testing also has a negative impact on people’s attitudes to saving and providing for their own long-term financial well-being. The Government therefore needs to make it much clearer to people what the state provides and what it doesn’t. The message also needs to be conveyed to the UK public that providing for yourself comes first, and the state only provides when you can’t, not when you won’t. An initial move may be to disregard savings for all means testing up to a minimum ‘emergency funds’ level – say 3 months of UK average salary. It is critical for the success of our proposals that it genuinely does ‘pay to save’.

We also believe it would be highly beneficial to appoint a leading economist to review and improve the quality of the data the UK collects on savings habits. The Wealth and Assets (WAS) survey is a step forward, but we currently don’t measure the right things to guide a successful savings policy.
Conclusion

The benefits of restoring a savings culture to the UK should not be underestimated, both in terms of benefits to the individual and to the Government and wider society.

Increased saving helps to smooth consumption over individuals’ lives and over the economic cycle, cushions against risks, as well as allowing better debt management, and higher provision for retirement. There is also a strong association between financial capability and psychological wellbeing – FSA research found greater financial incapability is associated with greater mental stress, lower reported life satisfaction, and a greater likelihood of reporting health problems associated with anxiety or depression.18

Financial capability therefore makes for happier and healthier individuals, with an immediate pay-off in terms of improved public health and reduced pressure on the NHS. The more people save, the better they feel about themselves which encourages further savings and perpetuates a positive and virtuous savings cycle.

The more financially capable people are, the greater their engagement with the financial services industry – duly supported by appropriate nudges. This, in turn, results in improved industry competition and a larger market, which in turn results in an increased Treasury tax take, directly benefiting the Government’s finances. There are also significant societal benefits in terms of a reduced need for benefit payments and the beneficial effects to the economy of a more financially sound population.

The benefits are undeniable. We are therefore calling on the new Government to act decisively to restore a savings culture in the UK. The events of the past two years have woken up the UK public to the reality and importance of manageable borrowing, sound budgeting, and robust personal finances. The issue of savings is now therefore in people’s consciousness and at the forefront of their minds, therefore acting immediately will have the most significant effect. Acting now to re-establish a strong savings culture in Britain will be of immense value now and for generations in the future. We all desperately need a Saving Britain again.

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18 FSA Occasional Paper 34