NEST Insight

Liquidity and retirement savings: what's the right balance?

Authored by

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With thanks to our research partners, Money Advice Service.

About NEST Insight

NEST Insight is a research unit set up by NEST Corporation to help understand and address the challenges facing NEST members and the new generation of defined contribution (DC) savers.

About NEST Corporation

NEST Corporation is the Trustee of NEST. It was established by legislation to run the NEST pension scheme. As a non-departmental public body, NEST Corporation is accountable to Parliament through the Department for Work and Pensions but is generally independent of government in its day-to-day decisions.

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With the route to retirement becoming increasingly complicated, Vanguard believes that improving the understanding and accessibility of the UK pension system will be vital in generating practical solutions to the challenges ahead.

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Liquidity and retirement savings: what's the right balance?

At NEST Insight we're increasingly interested in taking a holistic view of retirement saving. We know that people's savings goals are highly connected and, particularly for those with lower to moderate incomes, seeing retirement saving in isolation can be a challenge.

We're interested in how short-term financial resilience and retirement saving can become better intertwined. A lot of work has been going on around the idea of hybrid products, which we think is a fruitful place to look for solutions to this kind of challenge. We think it makes sense to bring different products together, and create a simple solution. Hybrid products are incredibly helpful not least because of our behavioural tendency to mentally account, with different mental or physical savings jars for different goals, but they also give us the opportunity to be smart about the way we manage the flows of money.

We believe **the sidecar savings model** has the potential to improve workers' financial wellbeing today and through into retirement. Of course, there are number of questions about how the sidecar might work in the real world. Ahead of our sidecar savings field trial, we recently held a roundtable to help us explore these challenges and identify further considerations for our research.

The event provided us with invaluable insights. There were many observations about how the sidecar savings model might interact with other things, such as debt, under-saving, the benefit system, patterns of employment and defined benefit pensions. There's lots for us to think about in terms of where and how the sidecar model sits alongside other things. There were also several interesting ideas about the framing of the sidecar account. How you can signal to people's behaviours and add a bit of friction, but not too much that it negatively impacts accessibility.

Since then we've continued to create the coalition that will deliver the trial, most notably a banking partner and participating employers, and we've also been raising funding.

We've now formally entered the first stage of the project. This includes a series of planning and design workshops with our delivery partners, in which we'll address many of the questions and issues raised at the roundtable. In particular, this phase will enable us to make decisions on framing, contribution levels and the threshold for roll-over to the retirement account. It will also include a detailed impact assessment on the interactions between the sidecar and benefit or credit entitlements for the target market. To support this work we've conducted desk research and a number of focus group interviews, working with the Money Advice Service.

In our field trial, we won't be able to understand and examine everything but we will try to test the basic sidecar model. We can then start looking at variations on this central idea. To keep everyone with us on the journey, we'll provide regular updates and publish any developments and findings along the way.

Key topics and discussions

NEST Insight's roundtable event brought together pension industry, charity and civil service experts to explore the sidecar idea, and how the model might work in practice, and identify key design considerations for the research trial.

Positioning of the sidecar

How should we position the sidecar when describing the idea to savers?

Because there are lots of savings products on the market, we need to make it clear to users why and how the sidecar is different from a savings account.

The sidecar isn't an alternative to savings. The purpose of the model is to create an emergency fund to help people avoid desperate situations and dependence on high cost credit.

Some people may not think rationally about their financial decisions, whereas others may be financially savvy. I think it needs to be very simple, easy to get to grips with, and easy for users to understand what it's for. The average person on the street doesn't spend all their time looking at financial products.

I think the positioning should focus on the positive aspects of what it would enable savers to do.

Is there value in testing the framing of this as an insurance product rather than a savings product? The sidecar is effectively 'life event insurance'. The fact is we all buy insurances and, generally speaking, we're all very happy that we don't need to submit a claim.

If we look at the example of Payment Protection Insurance (PPI) it was taken out disproportionately by lower income borrowers, so this suggests they're quite keen to protect themselves.

The savings cap

What level should the sidecar savings cap be?

Research by StepChange indicates that £1,000 of accessible cash savings could reduce the likelihood of someone falling into problem debt by 44 per cent.

As you build up more savings you reduce your probability of getting into debt. However, once you've built up around £5,000 of savings it makes hardly any further difference to debt protection.

Research by the Money Advice Service (MAS) revealed that only 44 per cent of the UK working population have £500 or more available for emergencies, and 26 per cent have nothing. And, that figure's even higher when you look at the MAS Struggling and Squeezed segments. So if we think about who we're trying to help, and what they need the sidecar savings for, it's small amounts for people who have little or no savings at all.

Access to liquid sidecar savings

How accessible should the sidecar account be? In some other equivalent examples in the United States there are conditional hardship withdrawals and an administration system to police it.

Some large corporate schemes are adding an individual savings account (ISA) to their offer. Samsung for example offer an ISA that people can divert some of their pension contributions into, and it's proving relatively popular. When money goes into the Samsung ISA, there's a 'soft lock' on it. If they see that people are putting contributions in and then immediately withdrawing, they'll stop them doing that. But, in general, it seems that people don't. Whilst the users of the Samsung ISA are different from the sidecar model's target group, the findings are interesting.

Should the money be available for immediate consumption and gratification? When I started saving as a child I saved in a National Savings and Investments (NS&I) post office savings account that had monthly access. Back then, I thought about how I was going to spend my money and what I was going to buy. However because I had to wait a month, and immediate gratification wasn't possible, I ended up not spending it. On the other hand, if the lack of access ends up driving people to a payday lender then the whole concept could fail. I think there's some balance from a behavioural perspective between immediacy of access and immediacy of being able to consume that capital, versus urgency to.

There are two interesting aspects from a behavioural perspective, one is harnessing the idea of mental accounting, the other is the labelling of the account. Research by the Institute for Government for example found that when people were given unrestricted cash payments labelled as 'winter fuel payments' the money was disproportionally spent on winter heating costs.

There's also the opportunity to add small frictions to the withdrawal from the sidecar account, not to restrict access but to add an extra layer of thought and decision to taking that money out. Dilip Soman's research has produced some interesting ideas on how we can link frictions to people's goals and intentions of using the sidecar savings account.

Public commitment mechanisms could be used in which people would have to tell someone why they will be withdrawing money. It's often the case that if we have to tell someone what we're using the money for we're much less likely to use it on the wrong thing. There are lots of these types of mechanisms.

I think you need to be practical and pragmatic about how easy it is to access, and give the savers some personal responsibility around that as well. You're not going to want to be in the position of having to provide an invoice to prove what you want to spend the money on. By that point people will have needed to get the money from somewhere else. I like the idea of the nudge of asking them questions before they access it, so they have to say what they'd use it for, but it does need to be really easy.

I think if we start to say you can only use it if you do this and that, it could turn people off the idea very quickly.

What classes as an emergency? Some people may have different views on what an emergency is.

If you set criteria, how do you get people to buy into that idea? And, there's an administration cost of doing that. I think this comes down to adding a layer of friction that causes people to pause before they act, but doesn't stop them, because access needs to be quick.

I think being practical and not too paternalistic is critical. If you've borrowed before from a payday lender, you can get money in your account in 30 minutes. And, if you've never borrowed before you can still probably get money in your account within 24 hours. If that's the competition let's be practical. We also know that people borrow from payday lenders all the time around Christmas, for example. That's not wrong, it's that they don't have any other choice. If the sidecar is going to be a choice for them, let's make it accessible in their circumstances.

Benefits of the model

What additional benefits are there to using the sidecar savings account?

12 million people are under saving, even with auto enrolment, so I think it will be interesting to see how the roll-over mechanism works in terms of boosting retirement savings.

For people with busy lives, dealing with all sorts of things, the sidecar provides a simple way to ignite, or reignite, their savings habit. What they use those savings for is almost secondary, because once you get people to restart or start there's the potential that these problems around debt come into play. If they're saving, but also have debts, it may motivate them to do something. I think the ease of use of the sidecar is also really attractive.

Another thing is the belief that you can save money. How would people feel if they did save into a sidecar savings account for 6 to 12 months and actually built-up some savings? I think people proving to themselves that they can do it is really important.

One of the benefits of the sidecar savings model is that it does it for them and makes it easy. Lots of people know they should be putting money aside for emergencies but they just don't get around to it.

Signing up

If we can't automatically enrol workers into the sidecar model, what can we do?

The reason that auto enrolment has been so successful is that it harnesses inertia, and uses those defaults to get people in and keep them in retirement savings. I think in a world with an opt-in system, we need to be more deliberate about the behavioural choice architecture that goes around that decision, but I think there's a lot that can be done.

We could look, for example, at making it an active choice for people. When people are automatically enrolled, they could be presented with the option of using the sidecar savings account and be required to select 'yes' or 'no'.

I think there's a lot we can do about the framing of the benefits. We can also simplify the choice for consumers by hiding the wiring and the complexity of the product so it's a straightforward choice to save into a vehicle like this.

Switching to a more active choice for a product that's joined onto the side of a pension does create some risks around auto enrolment, and of course testing that is the right approach. And, we need to bear in mind that we've got the increases to 5 per cent and then 8 per cent on the way. Although we aren't expecting lots of people to stop saving, we don't know what the impact of that will be.

Perhaps we could introduce the sidecar savings account to people after a settling in period, maybe after 6 months, so they've had a chance to normalise saving into a pension pot.

I don't think we should overlook the flip side to this, that it could help reduce opt-out rates. There's the potential to make a pension look more attractive through this use of hybrids.

What's worked for auto enrolment is the behavioural nudge effect, so I think we should test which nudges can be used in the absence of a legal framework.

In the trials you're going to be working with the more paternalistic employers. How could the use of sidecar savings accounts be rolled out more broadly? I think the role of employers is key in 'selling' the idea to workers.

Education

Other factors to take into consideration

It's important to realise that the use of a sidecar savings account will not change people's spending habits. I think advice, debt management and education are also really important.

In terms of the rewards and benefits on offer, as well as things like debt management, I think employers should offer financial capability and financial education to their workers. Employers could help workers think about how to budget, how to save, and manage debts, and they could also help position the sidecar account as a fund for emergencies rather than just a current account.

Public policy challenges and implications

What are the public policy challenges and implications of the sidecar model?

The sidecar model encourages private individuals to save, so in this sense it doesn't necessarily touch the sides of public policy. It has a public benefit, that people can use savings to avoid going into debt, which would help reduce all the additional public costs that debt involves.

The people most vulnerable to debt are often tenants and those in work on low to middle incomes. When people use credit to cover a financial shock it makes them around 30 times more likely to fall into serious problem debt. There are a range of strategies where we can reduce the cost of high cost credit, but even that is probably second best to giving people a resource to use rather than borrowing. For the trials, think about how to capture the outcomes for those most vulnerable to debt and to capture data on those that have used their savings in a way that they might otherwise have used credit.

Further questions and considerations

- Does the sidecar savings model apply across defined benefit (DB) pensions as well as defined contribution (DC)? DB savers have problem debt too.
- How would you manage the tax status?
- Could the sidecar savings account be linked with the pensions dashboard?
- If someone moves job, how does the data move across as well? Is there a role for the dashboard to try and encompass these sorts of things as well?
- How would sidecar savings interact with universal credit? With a rainy-day buffer in place it could mean people aren't eligible for higher universal credit.
- Have you considered debt management services?
- How would this impact people who are already in problem debt?
- Could self-employed and gig-workers use the sidecar savings model? Some of them will have the same characteristics as the auto enrolment target group who also need rainy-day savings.

Section two

Desk research and focus groups

The need

We believe that many NEST members could benefit from having a sidecar savings account.

By mapping the Money Advice Service's (MAS) Financial Capability segmentation maps[1] onto the NEST membership, we can see that the 'Squeezed' segments are over-represented. Compared to the UK adult population as a whole:

- NEST members are twice as likely to be in the 'Squeezed younger adults' segment
- NEST members are nearly three times as likely to be in the 'Squeezed younger families' segment.

Struggling: the least financially resilient and most vulnerable group

	All	Over-burdened	Younger adults	Working families	Pre-retired	Retired
% of NEST	26.1%	12.0%	2.8%	5.7%	5.6%	0.1%
% of UK	22.7%	8.0%	1.5%	3.0%	6.0%	4.2%

Squeezed: have financial commitments and relatively low provision for coping with unexpected income shocks

	All	Younger adults	Younger families and couples	Older squeezed
% of NEST	42.3%	14.5%	13.2%	14.5%
% of UK	24.9%	7.1%	5.2%	12.6%

Cushioned: the most financially resilient group

	All	Young adults in affluent homes	Comfortable younger adults	Affluent couples and families	Affluent pre-retired	Comfortable pre-retired	Comfortable retired
% of NEST	31.6%	2.0%	7.8%	7.9%	9.7%	3.6%	0.1%
% of UK	48.3%	1.2%	8.2%	6.7%	13.2%	2.8%	7.4%

Note: whilst these segmentations are quite general, the evidence in the tables above is a strong indication of how the NEST population differs to the UK adult population in terms of their financial capability.

[1] To find out more about the MAS Financial Capability segmentation maps, visit: www.moneyadviceservice.org.uk/en/corporate/research and download the 'Market Segmentation - segmentation infographics - revised July 2016' PDF.

Factors influencing net financial wealth

We can't draw firm conclusions about the financial situation of any given NEST member. However, the following factors help us get a sense of the overall levels of net financial wealth in the membership as a whole:

- **Age**: People aged 25 to 34 years are more likely to have the lowest net financial wealth, averaging £300. With 58 per cent of our members aged under 39 years old, a significant proportion of the NEST membership could be at risk of financial stress.
- **Income**: Households with the lowest equivalised income have the lowest net financial wealth, which averages at £300. In comparison, people living in households with the highest equivalised income have a median net financial wealth of £66,800. This is relevant to NEST's membership because 65 per cent of our members earn up to £20,000 per year.
- **Employer size**: 28 per cent of people with a net financial wealth of £100,000 or more, work for large employers and have higher managerial roles. These people are under-represented in the NEST population as we know that many of our members work for small and medium sized organisations.
- **Routine jobs**: Negative net financial wealth is more common among people who have routine based jobs, and those with lower supervisory and technical work. However, we do not have information on the most common types of jobs among NEST members.

Source: ONS 2015

Equivalised income: is income that's been adjusted by the size of a household and the type of people within it. This calculation takes into account that larger households need more income than smaller ones in order to have the same standard of living. It also takes into account that the cost of living for adults and children is different.

Net financial wealth: is calculated by subtracting all of someone's liabilities from their assets. Liabilities include things like credit card debts and mortgages. Examples of assets include the money in someone's savings accounts, and anything the person owns that can be easily exchanged for cash.

Factors affecting savings

According to MAS[2], factors such as age, sex, and marital status, do not account for all of the differences in people's savings habits. Instead, according to the Department for Work and Pensions, situational factors, such as employment status and income level, offer a stronger explanation. Indeed, 79 per cent of households without savings include one or more working-age adult that's unemployed.[3] ONS data shows that households with negative net financial wealth also tend to have the highest percentage of people that aren't working because of sickness or disability.[4]

The biggest predictor of the frequency of saving in the working age population is household income. Working age households with the lowest incomes, below £13,500 per year, have the highest proportion of people who never save. On the other hand, half of working age households that earn between £30,000 to £34,000 per year save every month.[5] Given that 65 per cent of NEST members earn £20,000 or less we can assume that, other than their pension savings, most of them are non-savers.

[2] Money Advice Service (2017)
[3] Department for Work and Pensions (2017)
[4] ONS (2015)
[5] Money Advice Service (2015)

The demand

We asked our focus groups, of low to moderate income earners, what they thought about the sidecar model, and assessed the level of demand:

- People with low to moderate incomes liked the sidecar idea. They welcomed the prospect of having help to save money and many recognised the importance of having access to short-term savings to support them in emergencies.
- Many reported that a lack of short-term savings was a significant cause of stress and anxiety for them. They found the prospect of greater 'peace of mind' really motivating.
- Both younger and older people thought the sidecar would be useful for younger workers. However, respondents over 50 years old, those with young families, and those with variable hours of employment, were less optimistic about their ability to increase their savings.
- People liked the idea of 'having it done for them' in that savings contributions were automatically deducted from their salary. This was seen as a key benefit of the scheme. Participants thought it would help them with budgeting because it would limit the amount of money available for them to spend in their current account.
- Some respondents had concerns about their savings rolling over into their pension pot. A number of participants were confused by the joining together of two very different types of savings accounts. Others didn't like the idea of increasing pension contributions due to a lack of trust in pension providers and a perceived lack of transparency. Some also felt that they were already contributing enough.

Key target groups

NEST data and desk research suggests that our trial should include the following groups of people:

- Workers in the age bands: 22-29 years, 30-39 years, and 40-49 years.
- Workers in the earning bands: £10,000-£19,999 and £20,000-£30,000.
- Workers based in a range of different regions.
- Poorer parents, single parents, and unmarried couples that live together.
- People living in social housing.
- People living in privately rented accommodation.
- Members sharing the household with people who have an illness or disability, or members who themselves are ill or disabled.

Other groups that may benefit from an 'emergency' account include:

- Self-employed workers
- Workers that were not eligible for auto enrolment, but instead opted in.

Not all of these factors will be known to us, or to participating employers, when we're recruiting workers to take part in the trial. For instance, we're unlikely to know the structure of a worker's household. However, we can measure the frequency and relevance of this kind of factor by including suitable questions in a survey.

The evidence also suggests that we should target workers employed by small and medium sized organisations. However, although the majority of NEST members work for employers of these sizes, the practicalities of running a large-scale trial mean we currently expect to involve only those large employers who can provide the sidecar account to hundreds or thousands of workers at the same time. We are, however, working to ensure that workers who are offered the sidecar account by these employers will meet the target profile in other ways, such as income level.

The design

In this research trial, we'll be looking at people's 'emergency savings' needs rather than any additional 'goal based' savings they may have. However, we hope that for many a liquid account will be the first step that gets them into the habit of saving.

Emergency savings target

When researching the optimal level for the savings cap, we were conscious that we didn't want to give people an emergency savings target that was unachievably high. Whilst the Harvard research into optimal illiquidity suggests that three months' earnings is the most suitable level for a liquid savings pot, we think this may be unattainable for many lower or middle earners.[6] Instead, we've chosen to look at a range of evidence to enable us to judge what savings targets might be appropriate in this trial.

Key research findings from focus groups

What people say they want, and what they actually do in practice, are often very different. The focus group research does however provide a useful guideline on where to set the savings cap for the trial.

- Most people said that they want to save £500 to £2,000 as an emergency savings buffer. They tended to want to save higher amounts when they thought about medium term, goal-based savings.
- Participants also said they would want to contribute about £25 to 50 a month.

[6] Beshears, J. et al (2014)

The cost of financial shocks

- Research by StepChange recommends that £1,000 is sufficient to keep most people out of problem debt.[8]
- According to research by MAS, the mean unexpected cost per household is £1,545.[9]
- A number of the most common unexpected costs are between £300 to £500.

Unexpected costs experienced in the past 12 months	Mean cost
Car repair or replacement - 29%	£1,341
Opticians or glasses costs - 15%	£195
Technology breakdown - 15%	£294
Vet bills and other pet costs - 14%	£248
Washing machine - 13%	£245
Lending to family and friends - 12%	£2,482
Emergency dentists bills - 11%	£285
Emergency home repairs - 10%	£607
Child related costs - 9%	£224
Mobile phone breakdown - 8%	£120
Boiler repair or breakdown - 8%	£973
Unscheduled events and weddings - 7%	£423
Tax bills - 5%	£1,110
Legal bills - 4%	£839
Other - 3%	£777
None of these - 29%	-
	Mean cost overall = £1,545

Source: Money Advice Service (2013)

[7] StepChange Debt Charity (2017)
[8] Money Advice Service & Jigsaw (2013)

The delivery

Our focus group research revealed:

- Different terms and phrases used to describe the sidecar influenced the way people thought about how they would access and use their savings. For example, calling the sidecar account an 'emergency fund' often made people think about short-term savings, whereas the term 'savings pot' tended to make people think of more long-term savings.
- Describing the product as a 'tool' rather than a 'financial product' tended to make respondents less critical overall, less sceptical about the objectives of whoever might be providing it, and more likely to see the product as something that's there to help them. The description also invites less comparison with other savings products and their features, such as tax incentives and interest rates.
- Respondents often preferred seeing how their savings would build up over time, instead of being told how long it would take them to reach a savings goal. It was thought that focusing on contributions building up also had a better fit with the objectives of short-term 'emergency' savings.
- People would like to have some level of control over the level of the saving cap and contributions, but they also like the way this is done for them automatically to help encourage good savings habits.
- When communicating to workers about the sidecar savings model, it's important to be transparent about the goals of the product and to position it as a way of covering emergency expenses and as an alternative to short-term, high-cost credit.
- The benefits of the sidecar model using payroll deductions should be emphasised in the information given to savers.
- Communications should appeal to people's desire to save, and their appetite to receive help to do so.
- It's important to be clear about the reasons for, and benefits of, the overflow mechanism to the pension pot. The benefits need to be communicated clearly, alongside an explanation of how long-term and short-term savings can work side by side.

Transparency and ease of access

Respondents said that quick and transparent access was important to ensure the sidecar savings model is helpful in emergencies. Some wanted immediate and open access, but most respondents recognised that some delays or obstructions may be helpful in supporting them to build up their savings. A number of participants wanted to be able to place restrictions on accessing their savings. They thought that having an entirely liquid savings account would result in them 'dipping in' to their savings. A range of design features were put forward to address this and create a level of 'friction', including:

- Restricting access to savings by requiring people to make a phone call to withdraw cash.
- Enforcing minimum withdrawal amounts to prevent them taking money out on an impulse.
- Separating the savings into chunks, whereby a portion of it is made instantly accessible whilst the rest has restricted access.
- Reminding users that emergencies don't necessarily need to be dealt with instantly. This tends to be the fear that payday loan companies benefit from. Participants felt that the sidecar model has the opportunity to help dispel this myth.

In addition, some participants said they wanted to be able to choose restrictions that they felt would work for them. Being given decision making power over how they can restrict access to their savings, along with what they'll be able to do with their savings once they've reached their target, was welcomed by many.

Some thought it would be helpful to incorporate nudges or reminders for users when they're about to reach their target, along with suggestions for what they could do with their savings. Some suggestions included:

- allowing savings to flow into the pension
- transferring savings into longer-term savings accounts
- altering savings targets.

This approach may not directly improve the level of pension savings that people have if, for example, they're prompted to increase their savings target, or encouraged to move their savings into a longer-term savings account. It does however help to encourage financial forward thinking among users, and helps people building short-term financial stability. This in turn can have a positive impact on long-term financial security, including into retirement.

Further reading

More information about this research is available in the Money Advice Service and NEST Insight report, **Revealing Reality: Hybrid Savings Account Research**.

Next steps

Our roundtable event, desk research and focus group interviews have provided us with valuable insights. We'll take all of these considerations into account as we work with the team at Harvard University, the Money Advice Service, and with participating employers, to design the details of the trial. We expect to start rolling this out over the middle part of 2018, and as always we'll continue to share our findings widely and freely along the way.

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