Savings in the Balance

Managing Risk in a Post-Crisis World

Katie Evans
Emran Mian

Social Market Foundation

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EXECUTIVE SUMMARY

Savings in the UK are on a long-term trend downwards. Among advanced economies, only Greece saves as little as we do. As a consequence, households are vulnerable to financial shocks and the economy struggles to fund investment from domestic sources. Looking ahead we also face longer lives, but savings rates have not adjusted to the reality that we will be spending more time out of work and in retirement. Within a decade the UK's population of centenarians will have doubled.[1]

But individuals face significant barriers to saving more, and in more efficient ways. Our new opinion research finds that people have a strong bias towards keeping the savings that they do have easily accessible. Most people are reluctant to make the move from this type of saving to investment, despite the higher returns they may be able to achieve. Put simply, we are investing too little, with returns too low, to pay for our retirement.

However in a deeper sense people are behaving rationally. Professional financial advice is less accessible than it was. Riskier, and hence higher return investment, is subject to more regulation. Interest rates are low by historic standards, and the crisis has put many consumers off investing by dramatically demonstrating the risks involved. Although memories of the crisis will fade, the Bank of England forecasts that even when interest rates begin to rise they will remain significantly below the levels that most savers and investors remember from before the financial crisis.

In other words, we live in new economic times – a safer financial system, slower growth, lower interest rates – and saving and investing behaviour has responded to these changes. The rewards of saving are low by historic standards and so people are saving less. Although there have always been substantial barriers to investment, reaching the stage of investing is now harder and fewer people are getting there. Bringing people back to saving and investing will require policy changes that both respond to the new macroeconomic reality and address the obstacles at individual level.

Our proposals go with the grain of government policy. At the macro-level, it is obvious that bringing back systemic risk is not the way to achieve higher returns for investors. But we should recognise that macro-prudential regulation has diminished the scope for even pension funds and insurers to invest in equities on behalf of individuals.

To bring savers and investors back to the equity market, we recommend removing stamp duty on all share transactions by retail investors, building on the success of abolition of the tax in the AIM growth market.

This will create the conditions under which people take a second look at investing in shares, will expand the options for businesses to finance themselves and help to shift the long-standing bias in our capital markets away from debt towards equity. It should help consumers to achieve higher returns and provide much-needed capital for British businesses.

The other element of that shift since the financial crisis is the higher issuance of bonds by companies. These bonds – long-term corporate debt instruments - can offer ordinary savers and investors better returns than many of them get at the moment while still providing a high level of safety. While these instruments have traditionally been inaccessible to retail investors, the UK now has a transparent and public retail bond market and we should ensure consumers can make the most of this. The challenge is how to make bonds accessible to people and we recommend meeting that challenge through using the trusted ‘wrapper’ of the ISA.

The government should create an additional £2,000 tax-free threshold for people to invest in bonds via an ISA.

Doing this will raise awareness of bond opportunities among investors and encourage the creation of accessible products and guidance material by firms offering ISAs, increasing demand.

Making a success of these changes requires more focused attention on the barriers to saving and investing facing individuals too. Our opinion research shows that people are averse to putting their money out of reach for long periods of time. The only exception to this is pension saving and even in that case the government is introducing more freedom and choice for savers in how they can access and invest their money in a bid to encourage more saving.

We recommend that there should be an earlier window for exercising freedom and choice in pensions saving at age 35 – when our survey finds savers are most likely to drop out of their pension plan due to cash flow pressures.

This window would provide an opportunity to educate consumers about their pensions goals and savings behaviours, increasing awareness of the need to save more at an earlier stage of peoples' working lives. This, together with ensuring individuals continue to engage with their pensions savings, would outweigh any negative impact of withdrawals. It will also spur a new wave of innovation from the industry, create an opportunity to and overcome the issue that people are reluctant to lock their money away until they turn at least 55.

The second big barrier to better savings behaviour by individuals is the perception of risk. Our work finds that many people have more savings in cash than might be ideal and this limits the returns they can achieve. The evidence is that long-run annualised returns on investment are much less volatile than many people might assume, and that over the lifetime of a long-term investment like a pension higher risk assets like equity will significantly outperform cash in almost all instances. We need to ensure consumers can see the benefits of investing, not just the potential costs.

We recommend that advertising and marketing material should focus on this long-run information rather than merely present year-by-year returns. Equally people could be reminded that holding savings in cash puts them at risk of losing their value by way of inflation.

Finally, we argue that for too many people the journey towards having confidence in planning their financial affairs is incomplete. There have been recent improvements in developing financial awareness among young people at an earlier age and there are initiatives to increase financial literary. But financial confidence is a step beyond.

We should be using life-stages such as getting a National Insurance card, taking out a student loan and reaching 35 – as mentioned above – to help more people to achieve financial confidence.

This means targeted learning and engagement at each of these opportunities, delivered by the industry and enabled by government within the existing regulatory framework on the provision of advice.

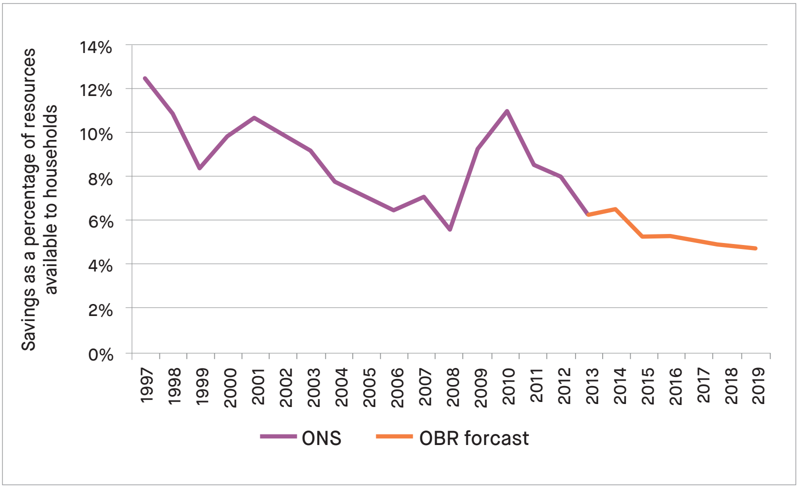
The structure of this report is as follows. Chapter 1 provides an overview of the state of saving and investing in the UK, including a discussion of the macroeconomic conditions in which this behaviour takes place. Chapter 2 reports our new opinion research findings on the prevalence of saving and investing, the reasons that people report as being behind the choices they make and their perceptions of risk. Chapter 3 presents our recommendations first of all on how to encourage more saving and investing given the needs and behaviours of consumers. We conclude by returning to the macro-level picture and describe our proposed policy responses to increase saving and investing in the 'new normal' of a safer financial system, slower growth and lower interest rates.

CHAPTER 1: THE STATE OF SAVING AND INVESTING IN THE UK

TWO SIDES TO 'SECULAR STAGNATION'

Household saving in the UK is on a downward trend, dropping from around 12% of available resources in 1997 to near 6% on the latest figures - and forecast to fall yet further. Figure 1 depicts the change over time. Saving did spike in the immediate aftermath of the financial crisis, a predictable cyclical response to uncertainty and labour market stress, but since last year the 'secular stagnation' in saving – a phrase more well known in another context that we will go on to discuss – has set in again.

Figure 1: Household savings ratio – savings as a percentage of available resources

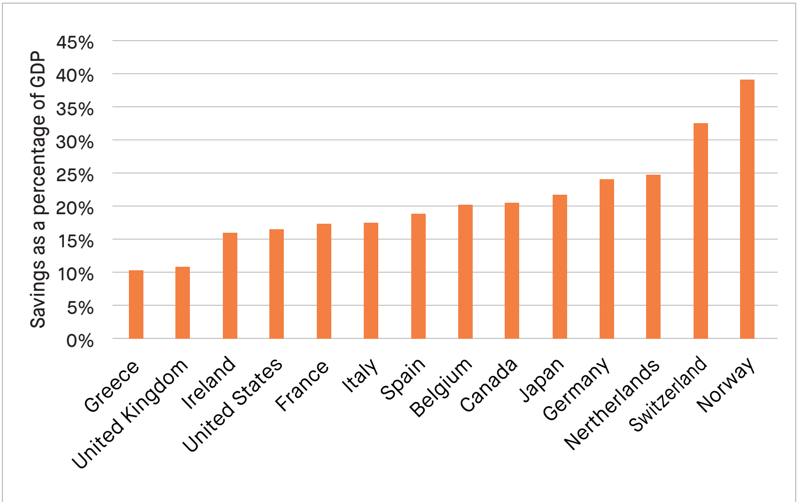


Source: Office for National Statistics, Office for Budget Responsibility

Recent changes to how saving is measured - to include defined benefit pension funds - have led to upwards revisions of the figures[2] but the trend remains the same: even the adjusted figures show a long term trend of falling savings.

On a comparative basis, the UK saves a much lower proportion of GDP than other countries, as shown in Figure 2, and low household saving is a significant driver of this. While in Germany nearly a quarter (24%) of national income was saved rather than consumed in 2012, the UK put aside just 11% leaving us at the bottom of the league table, alongside Greece.

Figure 2: Savings as a percentage of GDP, selected advanced economies, 2012

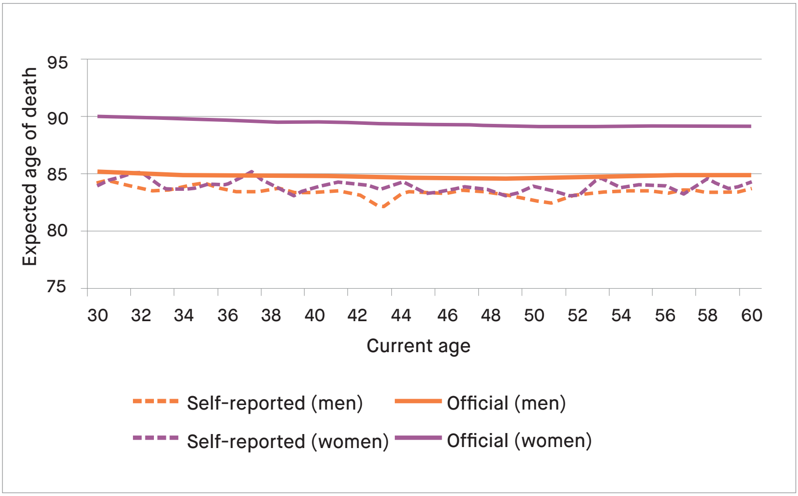


Source: World Bank

One consequence of the lower saving ratio is that UK households are less resilient. The buffer that most households have against a loss of income or unexpected expenditure is small. But stating this is to underplay the issue. The single biggest demographic change that we are experiencing in our society is increased longevity. We are living for longer, which for most people means living for longer out of work and in retirement as well. Auto-enrolment into workplace pensions, already begun in large firms and rolling out across small firms, should mean more households put money aside for this future. However, contribution levels to these pensions are low, and although the default is set to rise to 8% of income by 2018, many experts suggest that a contribution level more like 12% is necessary to provide an adequate pension.[3]

At the same time, while our expectations of longer life are changing, they fall some way short of the actuarial reality. The gap is shown in Figure 3 . The practical consequence of this is that we not only need more saving for the longer lives we predict we will have but for some years on top of that.

Figure 3: Official and self-reported life expectancy in the UK

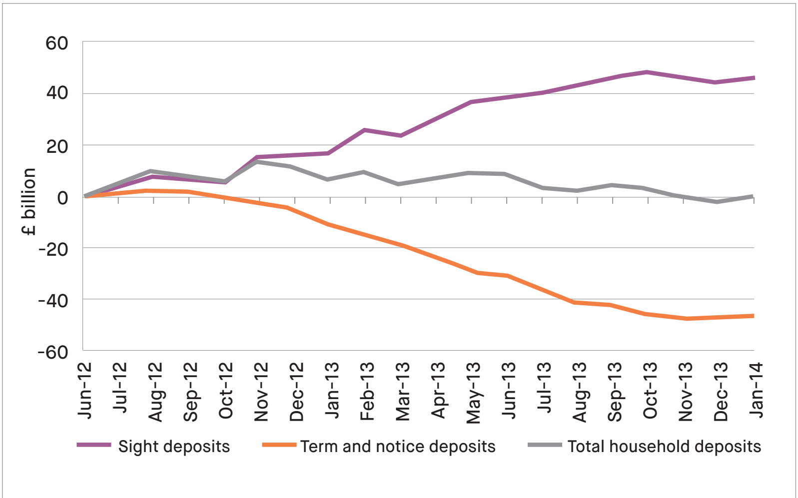


Source: Crawford and Tetlow (2012), IFS Report R73, Figure 2.2, Institute of Fiscal Studies[4]

In one sense, all of this analysis is fast becoming conventional wisdom. The puzzle is why people are not responding to the practical reasons to save more. This is where the other better known version of the secular stagnation thesis is relevant.

Figure 4 illustrates a trend among UK savers towards instant access "sight" deposits and away from long-term notice and term deposits, where money is locked away for a set period of time. Conventionally, we would say that this means savers are missing out on higher returns but that is to an important degree no longer the case: in the low interest rate environment that we live in the differentiation on returns is more limited.

Figure 4: Cumulative change in annual deposit flows



Source: Bank of England

Low interest rates are a disincentive to saving and especially to long-term saving. So although people ought objectively to be saving more, this does not translate into more saving in practice.

The more worrying aspect of this picture is that these economic conditions may persist for the medium- to long-term. As the Nobel Prize-winning economist Paul Krugman has commented, "It used to be said that the chance of hitting this zero lower bound [on interest rates] is very small and surely no more than 5 per cent in any given year. But … we have spent 7 out of 30 years in this bizarre world where virtue is vice and prudence is folly. It suggests that we have a very serious problem."[5] Even Mark Carney, the Governor of the Bank of England, predicts that interest rates will rise only slowly over the next few years and will remain significantly below the levels that many savers and investors remember from before the financial crisis.[6]

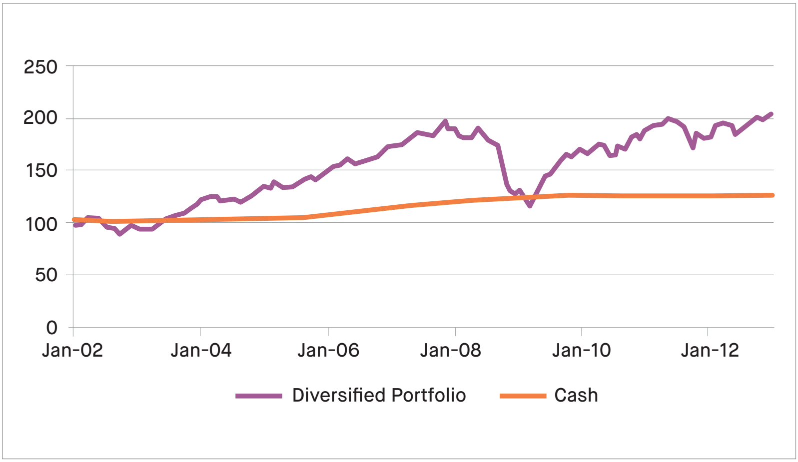
The other side of secular stagnation, as described by economists, is persistently lower economic growth rates. There are a number of trends that may be coming together to produce a weaker outlook for future growth: the ageing population in many advanced economies; the slowdown in emerging economies as they catch up to others; or a slower rate of technological change and innovation. Professor Charles Goodhart calculates that the annual increase in output per worker in the UK will diminish from an annual average of 2.8% in 1990-2000 to 1.5% over the long-term until 2050.[7]

If these predictions about a future of slower economic growth are correct, then they are likely to have the obvious consequences for real wages and the affordability of saving. In other words, the outlook for saving may be one of stagnation too, unless we take further steps to address that risk.

THE FLIGHT TO SAFETY

A similar association between individual behaviour and macroeconomic conditions may be observed in how people use their savings. We have already seen that they are less likely to put them out of reach in term deposits than they were previously. Equally evidence suggests that people are more cautious in seeking returns. While prudence will always be the watchword for most retail investors they have a tendency to underestimate the returns available. Figure 5 shows in a stylised form that holding a diversified portfolio of investments – even with a low level of risk – is likely to yield much higher returns than if savings are kept in cash. The returns to a diversified portfolio only fell below those of cash once, at the height of the crisis, and quickly recovered.

Figure 5: Indexed cumulative returns to cash and a diversified portfolio



Source: Barclays (2013), Overcoming the cost of being human (or The pursuit of anxiety-adjusted returns)

Despite this, households are much less likely to use their savings for certain kinds of investment than was once the case. According to the latest ONS Wealth and Assets Survey, for example, only 12% own UK shares. It's not surprising in that context that, though just a decade ago, 32% of UK shares were owned by individuals, this has fallen to 11%.[8] Some households seems to have invested in property instead, adding to pressures on the housing market[9] and reducing the productive benefit of their cash, which could otherwise have been used to finance investment through equity or debt.

Ordinary investors have stepped back from owning shares and the pension funds and insurers who could hold these shares on their behalf are expected to do the same. New solvency rules for insurance companies due to come into force in early 2016. The European Commission's impact assessment suggests that they may shift away from equities to holding more fixed income assets.[10] The Bank for International Settlements predicts a similar outcome.[11]

Underlying this forecast there is a move – like in the investment portfolios of individuals – towards greater safety. This is understandable in the shadow of the financial crisis, and reducing systemic risk is critical. But it does mean that there is less equity investment going into UK firms than could otherwise be the case. The Bank of England calculates that net equity issuance was only £1.4bn per year in the years immediately following the financial crisis, even while bank lending was contracting; it was negative in 2013 though has come back into positive territory in 2014.[12] One factor that has often been noted in this context is that there is a structural bias in the tax system which favours the use of debt over equity in how firms finance business growth. Debt interest can be written off against profits before taxation while dividends on equity cannot; hence the return on equity for investors is after tax. Then they are taxed on that return again. Finally, share transactions are subject to stamp duty. Combine that tax treatment with a bias towards safety among retail investors and it's hardly surprising that equity investment has become a minority pursuit. At the end of the report we will look at what can realistically be done to address this.

By contrast to the complex picture on equity issuance, the use of bonds – a form of long-term debt instrument - by firms is rising strongly. Net issuance is up in every year since the crisis, averaging over £3bn per year and over double that in the figures available for 2014 to date. These instruments, traditionally the preserve of professionals, were made available to retail investors in 2010. Returns reflect the low interest rate environment but are close to 5% for investment grade instruments according to the Bank of England's November Inflation Report. The added benefit of bonds is that they are liquid and tradable, meaning the capital sum remains within reach for investors.

Most ordinary savers and investors, however, do not have the level of savings available – or the financial confidence – to invest directly in bonds. Barely 1% of people own either bonds or gilts according to the ONS.[13] The route to accessing the returns offered by bonds for most people is via intermediaries and that route depends on their level of trust in financial services providers and the ability of providers themselves to provide the guidance that individuals will need. We will return later in the report to exploring the issue of whether a trusted ‘wrapper’ such as the ISA, used widely by ordinary savers, may be the way to boost the level of investment in bonds.

Before returning to these macro-level issues we will describe our findings from new opinion research on the prevalence of saving, the reasons for doing it and the choices made by ordinary savers and investors between different products. It is by combining structural and behavioural insights that we will have the best prospect of increasing the savings rate and the rewards of saving.

CHAPTER 2: TAKING A CLOSER LOOK AT SAVING AND INVESTING BEHAVIOUR

To inform this study we carried out opinion research with Populus. 2014 adults were surveyed online on 1-2 October, with the resulting data weighted to be representative of all GB adults over 18.[14] This data provides an insight into which households in Britain are saving and investing, what products they use to do so, how they make savings and investments decisions and how savings and investment behaviours vary over a lifetime.

PREVALENCE OF SAVING AND INVESTING

Just over half the public (55%) are currently saving or investing; a further 22% have saved or invested in the past but are not doing so at present. Nearly a quarter of people (23%), however, report that they have never saved or invested.[15]

Three quarters of people (75%) will undertake some formal savings activities[16] in their lifetime, according to our polling data. The remaining quarter are likely to undertake some informal savings activities – such as putting money aside on a weekly or monthly basis to cover bills.[17] Saving of this sort is crucial to allow households to balance their budgets and avoid debt in the event of unexpected expenses or a loss of income. An initial problem with formal savings behaviour in the UK, therefore, is that a significant minority are not participating at all.

> A quarter of households in the UK do not undertake any formal savings or investment activities, leaving them vulnerable to unexpected bills or loss of income.

Investing is much less common than saving, with just over half (53%) of savers ever making the leap to investment products. Where saving is precautionary (to provide a reserve of cash for emergencies, when access could be needed at short notice) or to meet a short-term goal sticking to cash savings products will be the right choice. For many consumers, these types of products fit well with the type of saving they engage in.

However, given increasing life expectancies we need more long-term saving – through pensions and other tools – to pay for long-term objectives, like care costs. For these objectives, investment products will provide better returns and make it easier to achieve long-term goals. Those with adequate cash savings to cover emergency expenses could extract higher returns from the rest of their savings if they used investment products.

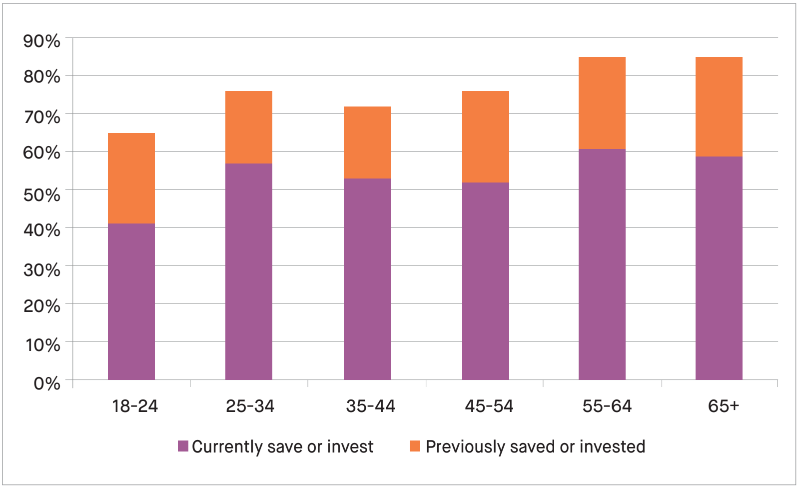
Pensions are the most important long-term savings product. Pensions are more common than other investments: more than half of the population (56%) have at some point used a workplace or private pension (or both). Pension funds do the same job as other investment products, particularly investment funds, although with an in-built long-term commitment. This preference for pensions over other investment products could be used to drive higher levels of saving. We return to looking in more detail at what products people use later in the chapter.

Relatively few people use investment products for long-term savings, limiting their potential for above inflation returns. Pension products are more popular.

WHO IS SAVING AND INVESTING?

To understand the barriers to savings and investment in the UK, we need to explore who is currently participating in these behaviours, and where the gaps are. Figure 6 shows how savings and investment behaviour differs across age groups.

Figure 6: Proportion of consumers who are currently saving or investing or who have previously saved or invested by age group



Source: SMF/Populus Savings in the Balance Survey 1-2 October 2014

Saving rises through early adulthood but is constrained by the spending pressures of family life as consumers enter their mid-thirties. The proportion of people who have previously saved or invested but are not doing so at the present time is similar across the age range. Dipping in and out of saving like this may be a sign of myopia – short-sighted households may fail to adequately anticipate their precautionary and life-cycle savings needs. Alternatively, it could be a simple result of cash-flow issues. Households may wish to save or invest consistently, but find themselves forced to withdraw when it becomes unaffordable.

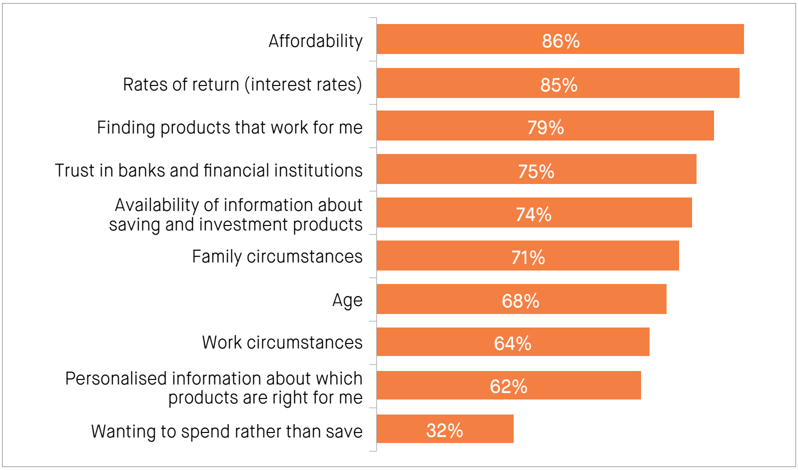
Some people dip in and out of saving and investment rather than consistently putting money aside for the future. The squeeze is the strongest in the period after people enter their mid-thirties.

Savings behaviour is also closely linked to social class – just 13% of those in managerial or professional or higher administrative professions[18] have never saved, compared to 36% of semi and unskilled manual workers, casual workers and those dependent on the state.[19] Moreover, and unsurprisingly, savings and investment behaviour is closely related to incomes. Those on relatively low incomes (less than £21,000 a year) are twice as likely to have never saved as those on more than £34,000 a year, and those with higher incomes are most likely to be currently saving (64%, compared to 44% of those on up to £21k and 60% between £21 and £34k).

WHAT FACTORS DETERMINE WHETHER PEOPLE SAVE?

Unsurprisingly, affordability of savings is the key factor in savings and investment decisions, cited by 86% of savers. In close second place are rates of return, which 85% of those who have ever saved suggest are important or very important. The availability of suitable products is also important to 79% of savers, and three-quarters (74%) suggest that availability of information about products is crucial. Finally, family circumstances, age and work circumstances are important determinants of savings and investments, suggesting that life-cycle factors have a significant influence on savings and investment decisions.[20]

Figure 7: Share of population reporting factors as important or very important in savings and investment decisions



Source: SMF/Populus Savings in the Balance Survey 1-2 October 2014

WHY DO PEOPLE START SAVING AND INVESTING?

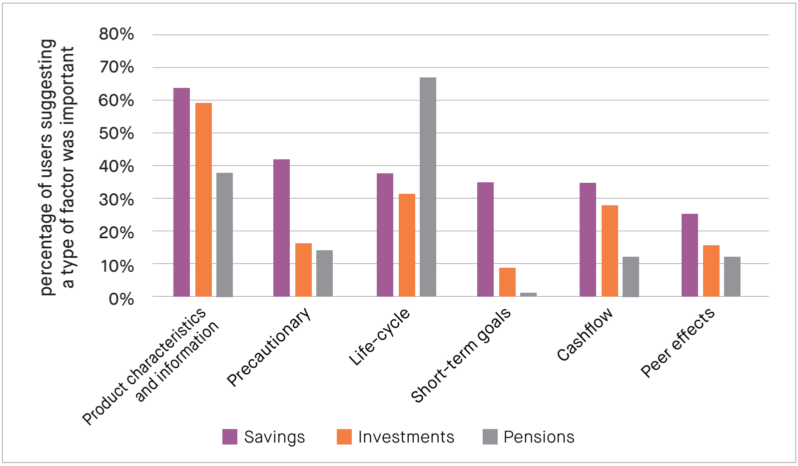
The survey for this study included a question on why individuals began to use particular products. We grouped these reasons to examine the motivations for using different types of products (the underlying survey responses for each group are detailed in Annex A). The results of this analysis are presented in Figure 8.

Firstly, it is clear that individuals weigh up multiple factors when making savings and investment decisions – an illustration of the complexity of these choices. Product characteristics and the extent to which consumers feel able to access information and understand products is the most important factor in savings and investment decisions, cited by 64% of savers and 59% of investors. It is clear that consumers are keen to understand the products they are using, and to make sure they are suitable.

For the most part, consumers report doing a good job at choosing products appropriate for their needs. Nearly half of all consumers say precautionary motives – "for a rainy day" - were important in their decision to open a savings product. In these cases savings products are the ideal choice, providing a safe haven for cash and easy access in an emergency. A third of people (35%) also cited short-term goals as a reason for opening savings products, like saving for a holiday, a car, or for a house deposit. But many people (38%) also use savings products to cope with variation in spending needs over the life-cycle – for example, to save for a family expense, like a child's education, or to provide a bequest. Where these goals are a long way off and the household does not need the liquidity in the short term, investment products may be a better option for some.

Cash flow issues, like changes in income level or receiving a windfall, also had a substantial impact on decisions to begin saving, playing a role in 35% of cases, reflecting the importance of affordability reported in Figure 7. Peer effects are also relatively strong in savings – a quarter of individuals (25%) suggested that they had started using a savings product because their parents or another family member suggested it, or because all their friends were saving or investing.[21]

Figure 8: Factors influencing decision to start using savings and investment products



Source: SMF/Populus Savings in the Balance Survey 1-2 October 2014. A breakdown of each category is provided in Appendix A.

Relatively few people, meanwhile, report that short-term goals were part of the reason why they started using investment products – understandable, as the long time horizons of most investment products would usually clash with short-term savings goals. For similar reasons, investment products are not often used for precautionary savings – just 16% suggest that this was among their motives when purchasing an investment product. We would expect investment products to be more useful for life-cycle goals, which are usually relatively predictable and long-term. However, a smaller proportion of investors suggest that life-cycle goals played a role in their choice of products than savers, suggesting that consumers are perhaps not making sufficient use of investment products for this type of saving. The majority of life-cycle saving appears to be taking place through pensions – but given that we know pension saving is not sufficiently high to sustain living standards after retirement, this suggests that we need to encourage other forms of life-cycle saving.

Investment products are under-used for long-term life-cycle savings, where they could provide better returns than savings.

WHY DO PEOPLE STOP SAVING AND INVESTING?

Looking at the reasons given for stopping using a particular product type in Figure 9, it seems that the risk involved in investments is a major barrier for UK consumers. Over a quarter of investors who have stopped using a product suggest that a desire to reduce the amount of risk they were taking was a determining factor. This is indicative of the emotional stress that can accompany investments, the value of which can fluctuate substantially. The strain of watching this volatility takes its toll, and the emotional cost may be too high for the returns on the investment to provide adequate compensation. Decisions involving significant uncertainty, like the value of investments in the future, are influenced by anticipated emotions. Investors anticipate that they will feel regret if the outcome of their investment is negative, and this anticipated regret is stronger than the anticipated happiness of a success.[22] This loss aversion creates "cash bias" – a preference for holding cash to avoid potential losses, although this means missing out on the returns available through investment.

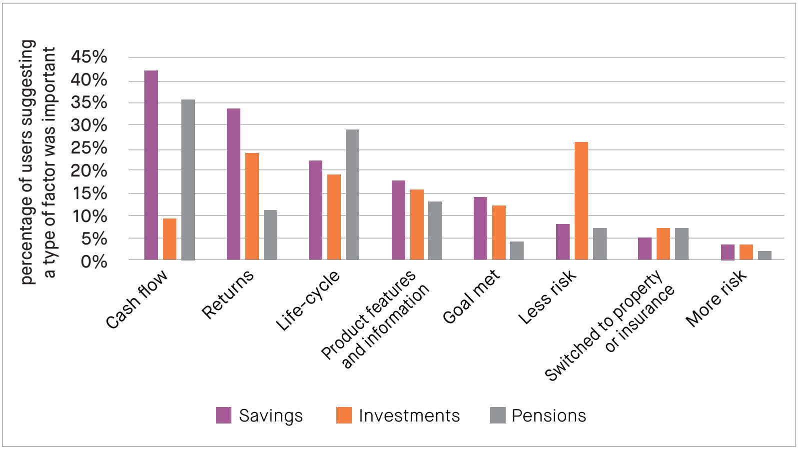
The experience of the financial crisis appears to have worsened this reluctance to take risk, with 54% of all those who have ever invested agreeing that they are not interested in investing since the crisis.

> The volatility associated with investment is a major barrier for many consumers, and leaves even many of those who could afford to invest reluctant to do so.

Cash flow is the most frequent reason why consumers stop saving, cited by 42% – further evidence that many people dip in and out of savings behaviour as income levels change and again reinforcing the importance of affordability as reported in Figure 7. This implies that cash management may be a problem for some consumers. Cash flow is also an important determinant of pensions saving – cited in 35% of cases where an individual stopped using a pension product. When broken down by age, we find that affordability is particularly strong barrier between 35 and 44, when nearly half (48%) of all cases where someone stops saving into a pension were influenced by cash flow problems.

Over a third of customers who have stopped using a savings product suggest that returns were an important reason for this, although it is not clear whether this drove them to switch products or to stop saving altogether from the data available. On a more positive note, it is relatively uncommon for households to stop using a saving product because they achieved a short-term aim. This suggests that households who start saving for a particular reason are likely to continue saving even after this imperative passes, and that the cyclical saving behaviours observed in Figure 6 are driven by issues of cash flow, rather than ignorance about the need to save. Encouraging goal-driven savings behaviour may thus be a useful gateway to other forms of saving, as long as households have sufficient financial skills to manage their cash flow.

Figure 9: Factors influencing decision to stop using a savings, investment and pension product



Source: SMF/Populus Savings in the Balance Survey 1-2 October 2014. A breakdown of each category is provided in Appendix B.

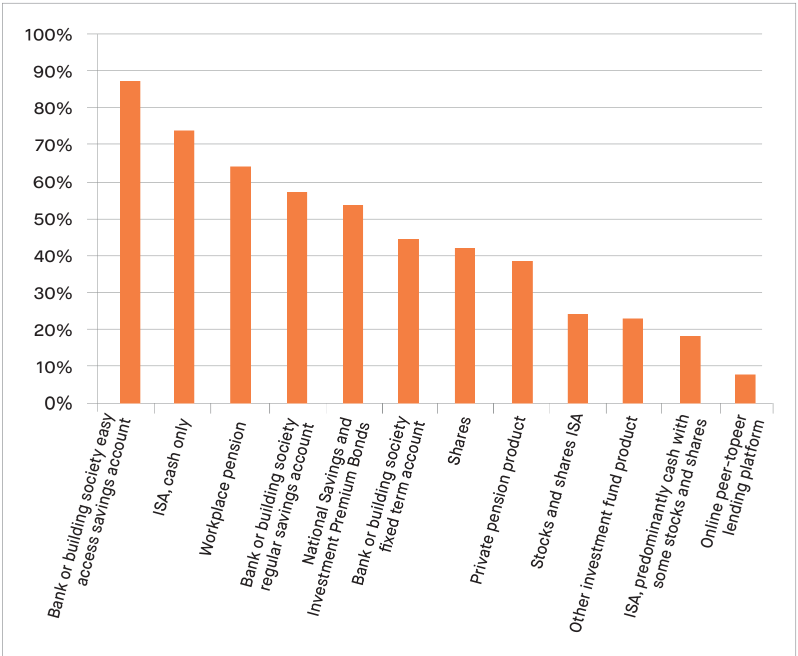
This data provides an insight into the factors individuals consider when making savings and investment decisions. Our next question is how does this map to the products they choose? Are consumers in the UK sufficiently well informed and financially literate that they can choose products that match their preferences?

HOW DO PEOPLE SAVE AND INVEST?

The most popular products are those which give easy access to cash; nearly nine in ten savers have used an easy-access savings account (87%), and nearly three quarters (74%) have used a cash ISA. It is not clear, however, that the tax advantages of ISAs are the main reason for this preference. Indeed, given the low proportion of savers who stop using a product to switch to a more tax-efficient alternative (3.2%), it seems that the tax advantages of ISAs are not what makes them so attractive to savers. Instead, given the reported importance of information about products in the decision making process (see Figure 8), it may be that their visibility, and the information available about them through advertising campaigns around the deadline is a key factor in their popularity. More than half of savers (57%) have also used a regular savings product, suggesting that despite affordability concerns consumers value the commitment mechanism of scheduled payments.

Pensions products are far more common than any other investment product, suggesting that consumers see the utility of these vehicles where they don't necessary feel other types of investment are "for me". This may be partially due to companies' commitment to pension provision and the automatic deduction of pension payments in the workplace, which removes the need for employees to investigate and choose products themselves. Nearly two-thirds (64%) of savers have used a workplace pension at some point, while four in ten (39%) have used a private pension product. In contrast to the popularity of cash ISAs, only 24% have ever used a stocks and shares ISA, and just 23% have used other investment products. The most popular investment tool overall is shares, which 42% claim to have held at some point.

Figure 10: Products ever used - a proportion of all those who have ever saved or invested



Source: SMF/Populus Savings in the Balance Survey 1-2 October 2014. Figures only reflect those who have ever used a formal savings or investment product; those who have not used formal savings or investment products are excluded from the analysis

The average size of savings and investment products varies significantly, as illustrated in Table 1. The median value of a savings product is typically much smaller than the average size of an investment product. The median cash ISA, for example, contains £4,890, while the median stocks and shares ISA is worth £17,390. Moreover, most products have a wide distribution, with the mean dragged up by a relatively small proportion of high value products. This is particularly the case for investment products – with share ownership, for example, the mean value is more than ten times higher than the median value, suggesting a small number of people hold a large amount in these products.

Furthermore, the median value of most saving products is relatively low; particularly when we remember these values only reflect the savings of those who hold a given product, and completely exclude those with no formal savings. Given that many of these products were opened for precautionary or life-cycle purposes, this may be a cause for concern; although consumers have good intentions, the sums they are putting aside are not, on average, substantial enough to provide a substantial cushion in the face of serious shocks like redundancy or illness. In general, these figures suggest there is a serious divide between those who are putting significant resources into savings and investment products, and those who, while wishing to save, find themselves struggling with affordability.

Table 1: Average size of savings and investment products[23]

Product	Mean value (£,000)	Median value (£,000)
ISA, cash only	11.8	4.89
ISA, predominantly cash with some stocks and shares	7.78	2.44
Stocks and shares ISA	65.78	17.39
Private pension product	47.88	19.65
Workplace pension	30.26	8.6
Shares	47.29	3.98
Other investment fund product	34.54	13.78
Bank or building society easy access savings account	6.47	1.85
Bank or building society regular savings account	3.46	1.14
Bank or building society fixed term account	31.48	8.73
National Savings and Investment Premium Bonds	7.67	0.99
Online peer-to-peer lending platform	4.97	1.41

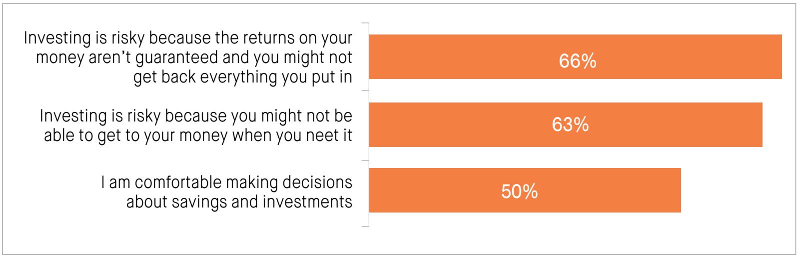
Source: SMF/Populus Savings in the Balance Survey 1-2 October 2014

STRIKING A BALANCE BETWEEN RISK AND RETURNS

Another major determinant of savings and investment behaviour is individuals' understanding of and attitudes towards risk and return. These attitudes, in turn, are influenced by a wide range of factors, including the individual's circumstances, past experiences and character traits, such as patience. Savings and investment products can be seen as sitting on a curve balancing risk and return – riskier investment products usually provide higher returns, while safer savings options usually earn less. The ideal position on this frontier for an individual is likely to fluctuate over their life course as their circumstances and objectives change.

The majority of the public perceive not one but two levels of risk involved in investment: the possibility of capital losses and the inability to access cash on demand, as illustrated in Figure 11. Two-thirds of consumers think that investment is risky because returns are variable and capital is at risk. However, nearly the same proportion (63%) feel that investment is risky because it locks capital away, making it harder to access your cash. Given the relatively low value of most savings accounts, it is not surprising that for most people the idea of losing liquidity is an alarming prospect. With low levels of precautionary saving, most households cannot afford to have cash where they can't get to it, and are right to be wary of some investment opportunities for this reason.

Figure 11: Perceived risk of investment decisions - share of people agreeing with statements



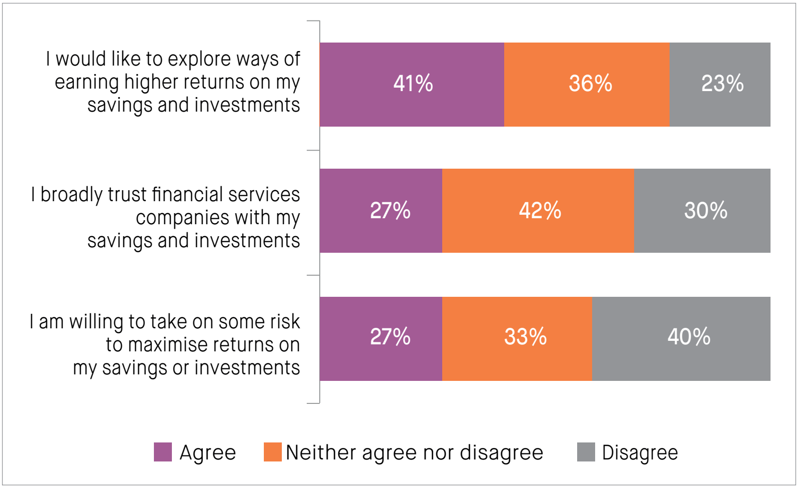
Source: SMF/Populus Savings in the Balance Survey 1-2 October 2014

Additionally, just half of consumers suggest that they are comfortable making decisions about savings and investments. This is predictable: research by the Money Advice Service in 2012 found that a third of the population could not identify a negative real rate of return when given an inflation and interest rate figure, rising to 44% of under 35s.[24] When these low levels of financial literacy are combined with the complexity of terms and conditions for financial services products, it is unsurprising that half of the adult population feel they are poorly equipped to make these decisions. This, in turn, may be influencing perception of risk: if people feel they do not fully understand products, they are likely to stick with simpler options, reflecting the importance of product characteristics and information available reported in Figure 8.

A lack of financial literacy and poor understanding of financial markets magnifies perceived risk.

In many cases – some of which are justified – the desire to earn higher returns on savings and investment is overridden by a desire to avoid risk, as illustrated in Figure 12; this is a classic demonstration of loss aversion, where potential losses loom larger than gains.[25] While 41% of consumers say that they would like to explore ways of earning higher returns, just 27% of consumers report that they would be willing to take on some risk to maximise returns on savings and investments. Reluctance to invest may be further compounded by low levels of trust in financial services companies. Only a quarter of consumers (27%) trust financial services companies with their savings and investments, creating a further level of hesitation among consumers.

Figure 12: Demand for returns - proportion of consumers agreeing with statements

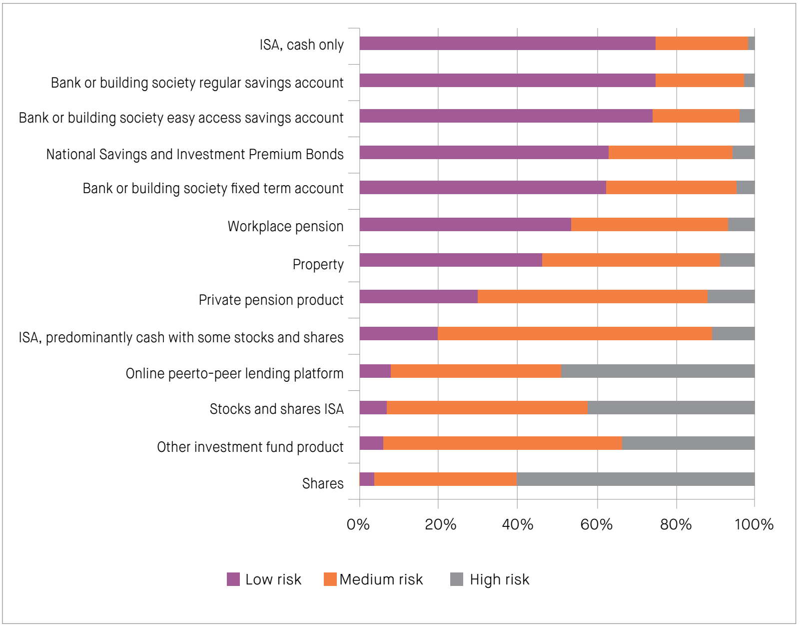


Source: SMF/Populus Savings in the Balance Survey 1-2 October 2014

PERCEPTION OF RISK AND RETURN ACROSS PRODUCTS

Despite the reported lack of trust in financial services firms, most people are relatively comfortable with common savings products. Around three-quarters of consumers view cash ISAs (75%), bank and building society easy access accounts (74%) and bank and building society regular savings accounts as low risk, as shown in Figure 13. Fixed term savings accounts are perceived as medium or high risk by over a third of people, despite their guaranteed returns, reaffirming that for consumers, locking money away is seen as risky even if returns are guaranteed. Consumers are also wary of putting their capital at risk, however: 59% of people think shares are high risk. In general, these ratings are a good reflection of the relative risk involved in different product types. Whether consumers can pick the level of risk that best suits their needs and tastes, however, is a separate question.

Figure 13: Perceived product risk - percentage of consumers selecting risk level



Source: SMF/Populus Savings in the Balance Survey 1-2 October 2014

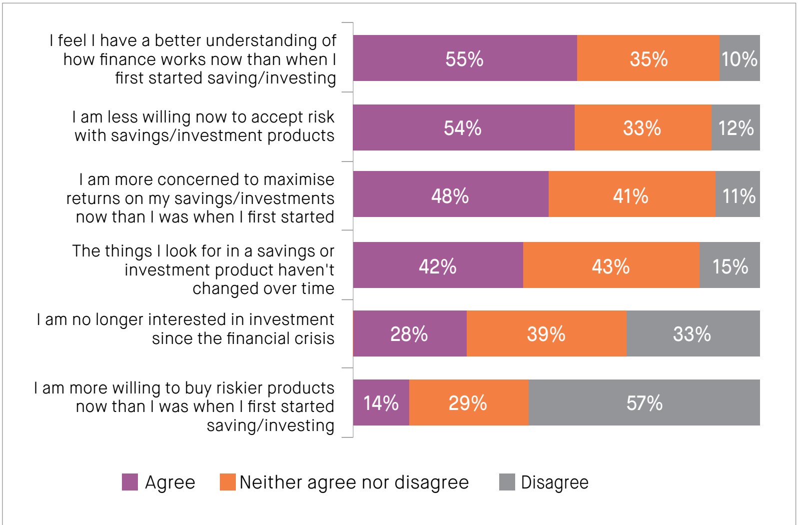
These figures also demonstrate an interesting effect of the ISA wrapper. It appears that products placed inside the wrapper are viewed as being lower risk, despite being no different to the underlying asset. For example, while 59% think that shares are a high risk option, this falls to 42% for a stocks and shares ISA.

Pensions are also viewed as being lower risk options, despite being similar in many ways to other investment funds: just 7% of consumers view a workplace pension as high risk, compared to 33% who view other investment funds as high risk. This suggests that certain product types and wrappers are viewed as being relatively less risky than other, similar products. These products could usefully act as a gateway to investment, helping to reduce the perceived volatility and emotional cost.

Most people feel that they their understanding of finance improves over the course of their life as they gain experience, as shown in Figure 14. However, consumers also suggest that they have become both more risk averse and keener to maximise returns over time. In practice, this could explain the fierce competition we witness on the high street over interest rates – those ISAs advertised as having market-beating rates on sites such as Money Saving Expert often become oversubscribed and withdrawn quickly from the market, while the biggest beneficiaries of the Current Account Switching Service in the 12 months since its inception have been companies offering higher rates of interest.[26] There is also some evidence that the financial crisis has reduced willingness to invest; more than a quarter of individuals (28%) suggest that this has reduced their willingness to look at this sort of product. Only 14% suggest that they have become more willing to buy risky products over time, while more than half (57%) directly disagree with this statement.

It is quite clear from this survey data that savings and investment behaviour does not evolve over the life course as economic models would predict. Although individuals between 35 and 54 have overcome some of the myopia of youth and are more aware of the need to make returns to finance retirement, they remain unwilling to take some risk. This may be a result of the relatively small pots most savers in the UK have, or a reflection of a mismatch between investment products on offer, consumer understanding of these, and risk preferences. As households save relatively small amounts, it is unsurprising that these savings are precious. Combine this with mistrust of financial services firms among some consumers and a lack of financial literacy and it does not seem unreasonable that many people choose to stick with cash, rather than diversifying into investment.

Figure 14: Reported change in attitudes to financial products over time

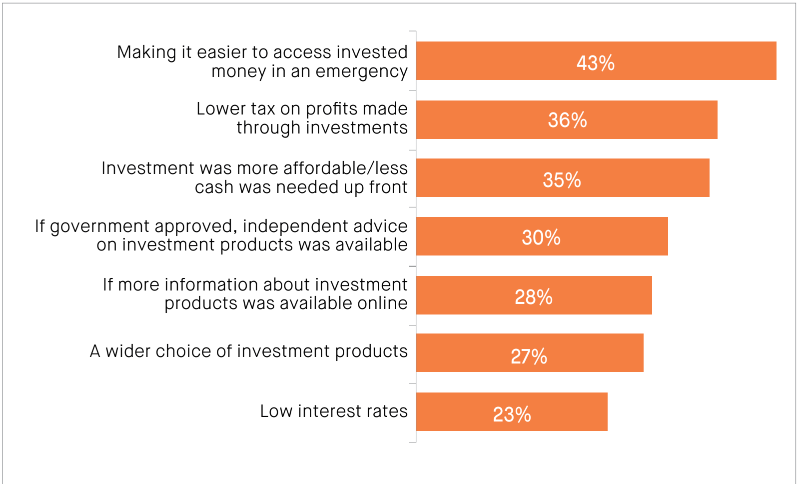


Source: SMF/Populus Savings in the Balance Survey 1-2 October 2014

ENCOURAGING INVESTING

The survey data unveil a paradox: consumers are keen to earn better returns, but are unwilling to take greater risks to procure them. For the majority of savers, with relatively small pots, this is unsurprising – the possibility of loss, or that the cash could be needed at short notice, loom too large for higher returns to be sufficient temptation to take on more risk. For those with significant cash savings, however, this reluctance to take risk is limiting the returns these individuals earn; returns they need to provide for a comfortable retirement. When asked what would make them likely to switch from savings to investment, only a quarter of consumers suggested that low interest rates would have this effect. Access to savings seems to be a key sticking point, with 43% suggesting that if cash in investments was easier to get to in an emergency, they would be likely to switch. Lower tax on investment would also be a pertinent factor for over a third, as would affordability - if less cash was needed up front to make investments.

Figure 15: Likelihood of switching to investments - percentage of consumers reporting that they would switch in each scenario



Source: SMF/Populus Savings in the Balance Survey 1-2 October 2014

HOW BIG IS THE ADVICE GAP?

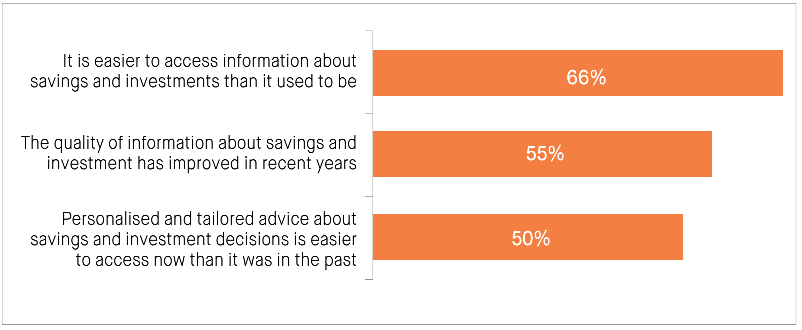
Advice has been a controversial topic in the financial services sector over the past few years. In January 2013, the Financial Conduct Authority (FCA) implemented the Retail Distribution Review (RDR), which dramatically changed the way financial advice was sold. Prior to the implementation of RDR, financial advisors had been able to sell their advice on a commission basis – a percentage of the sum invested being paid back to the advisor by the company holding the investment. For the consumer, the cost of the advice itself was wrapped within other fees, and often invisible. Many customers assumed that the advice they received was “free”, and there were concerns that this model could lead advisors to recommend products which offered them a better commission, rather than those which would best suit the client. Under RDR, advisors must now clearly state their fees upfront. At the same time, advisors must make clear whether they offered advice on only a limited range of products (a certain product type or restricted number of providers) or the full market, and the qualifications needed to provide advice also changed.

Many groups have expressed concerns that RDR would leave consumers stranded, without access to advice, as the economics of offering personalised advice without commission-based selling simply failed to stack up. Some high street banks stopped offering advice to investors, and stockbrokers withdrew advised investment services for those with relatively small pots (anecdotal evidence suggests less than £50,000).[27] The number of financial advisors fell from 40,000 at the end of 2011 to 31,000 at the start of 2013, as advisors decided their practice would not be sustainable under the new rules, leading to concerns that there would be a shortage of qualified advisors.[28] Survey evidence, however, suggests that demand for professional advice is relatively inelastic.

We asked consumers whether they would seek professional advice when receiving a windfall of either £50,000, £75,000 or £100,000 (with the suggestion that the advice would cost around 3% of the value of the windfall, in line with the findings of a Which? survey of IFAs).[29] The proportion of consumers willing to pay for professional advice rises slightly from 15% to 19% as the size of the windfall increases from £50,000 to £75,000, but remains stable above this level, with 18% saying they would seek advice on how to deal with a windfall of £100,000. Looking more closely at the demographics, those with higher university education or of higher occupational classes (AB) are consistently more likely to seek advice. It appears that this group are more willing to delegate management of their finances than others. This could simply be because they are time poor. However it could also be a cause for concern – suggesting that fees for professional advice are more likely to dissuade lower income consumers and those with less education, who may struggle to manage their cash flows and be more likely to benefit from advice.

Our survey evidence, however, suggests that the public are not overly concerned about a lack of access to advice and information. The main reason for this is that they are happy seeking advice from a wide variety of sources. For the majority of consumers, with relatively small pots and proportionately low risk tolerance, information, guidance and simplified advice are sufficient. These consumers are not concerned about complex investment strategies and diversification – they just want to secure the best interest rate they can on an ISA or other savings account, and for this simple information is sufficient.

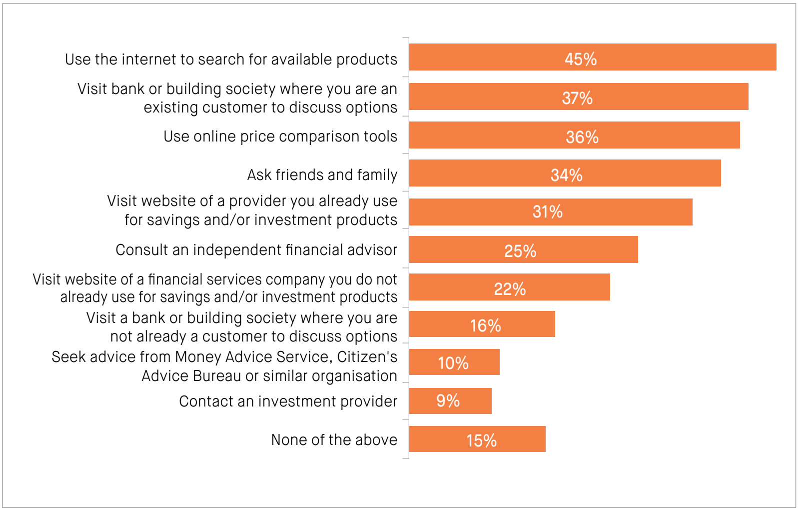
Figure 16: Consumer views on access to information and advice – proportion of public agreeing with statement



Source: SMF/Populus Savings in the Balance Survey 1-2 October 2014

Two-thirds of consumers agree that it has become easier to access information about savings and investments; presumably because the internet means consumers can now compare a wide variety of options without needing to visit bank and building society branches. Often, this information is collated into a single place by websites like Money Saving Expert or Money Supermarket. Nearly half of all consumers (45%) have used the internet to search for savings and investment products, while 37% have visited their bank or building society and 36% have used online price comparison tools, illustrated in Figure 17. More than half of the public (55%) also agree that the quality of information about savings and investments has improved in recent years. Moreover, half of consumers report that "personalised and tailored advice" about savings and investment decisions is easier to access now than it was in the past, despite RDR and the fact that only a quarter of consumers have consulted an IFA. This suggests that the consumer's understanding of "personalised and tailored advice" is different to the industry's. It seems that the sort of guidance that can be provided through online applications is, for many consumers, sufficiently "personalised". Personal, face-to-face advice will always be expensive and could only ever be cost-effective for a small number of consumers.

Figure 17: Sources of information and advice about savings and investments used by consumers



Source: SMF/Populus Savings in the Balance Survey 1-2 October 2014

Moreover, people seem to have greater trust in information they have gathered themselves: 74% followed recommendations found online. 80% also followed guidance provided by a bank or building society where they were not an existing customer – perhaps because they had chosen that organisation on the basis of behaviour or an existing advertised offer. The Money Advice Service also has a strong record, with nearly three-quarters of those seeking advice from it following it, although to date it appears to have reached a relatively small number of people. Advice from IFAs is followed less than half the time (44% of cases), though it should be noted that many of these consumers will have sought advice prior to the implementation of RDR and may have been sceptical of the value of advice offered by someone working on commission.

Table 2: Sources of information, guidance and advice used by consumers

	Have you used this?	Did you follow the guidance or advice?
Visit new bank or building society to discuss options	16%	80%
Internet to search for available products	45%	74%
Seek advice from Money Advice Service	10%	72%
Use online price comparison tools	36%	61%
In branch with existing bank or building society	37%	56%
Open account online with new provider	22%	54%
Contact an investment provider	9%	53%
Ask friends and family	34%	53%
Open account online with existing provider	31%	48%
Consult an independent financial advisor	25%	44%

Source: SMF/Populus Savings in the Balance Survey 1-2 October 2014

SUMMARY OF SAVINGS AND INVESTMENT BEHAVIOURS

Our survey evidence provides insight into how consumers make savings and investment decisions – their priorities, how these change over time, and how this is reflected in the products they use. We can observe that:

- Government-approved tax-savings schemes have been very effective at encouraging savings and have a wide appeal. Although the value of cash ISAs is typically low, we know that people who start saving, even if it is for something specific, tend to continue as long as it remains affordable. Thus nudging people into savings behaviours through these tools should help to encourage households to build up greater financial reserves over time.

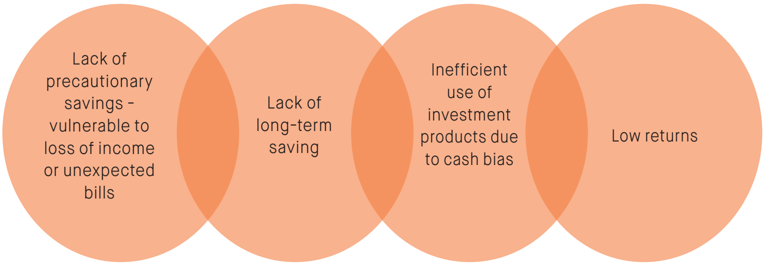
- On the whole individuals have a bias towards keeping their savings in cash. While this is sensible for emergency savings or short-term goals, it makes it harder to reach long-term goals. Concerns about risk prevent consumers from realising higher returns. But the ISA wrapper appears to be valuable here too. Stocks and shares ISAs are perceived as being less risky than their component parts, helping individuals to overcome their cash bias and move into investments.
- Pensions provide an accessible route to higher returns for many. Workplace pensions have the widest appeal of any investment product, and are a major vehicle for life-cycle savings. Pension saving may provide the readiest route to bring more people into investment and achieving higher returns.
- The advice gap is perceived by the public as less of an issue than we expected. Relatively few people ever sought advice from an IFA, and those who did were relatively unlikely to follow it. Helped by innovation and online provision of guidance, individuals are becoming more confident in directing themselves in choosing savings and investment products. While these methods may not be perfect, they potentially allow a broader range of consumers to access advice than expensive face-to-face models. Pursuing this trend in consumer behaviour towards self-direction is likely to be as fruitful as finding ways to provide more professional advice and developing consumers' financial literacy and confidence.

In the next chapter we develop these behavioural insights from the survey findings into recommendations to boost the level of saving and investment in the UK.

CHAPTER 3: RECOMMENDATIONS

Our survey analysis highlights four overlapping problems, illustrated in Figure 18. Our recommendations speak to each of these issues in turn.

Figure 18: Problems in UK savings and investment behaviour



Source: Social Market Foundation

OVERCOMING CASH BIAS AND ENCOURAGING INVESTMENT

Relatively few people in the UK make full use of investment opportunities when saving for the long-term. This makes it harder for them to reach their goals, and limits the productivity of their capital in the wider economy.

The Government's ISA policy, including the introduction of New ISAs (NISAs) in July 2014 has substantially increased the amount of tax relief available on savings, and is clearly popular; nearly half of the UK's population subscribed to an ISA in 2011/12.[30] A significant benefit of the ISA/NISA scheme is its visibility. The annual deadline becomes an opportunity for providers to run advertising campaigns, which may act as a prompt, combined with the threat of missing out, to encourage saving.

Prior to July 2014, the ISA also incorporated a nudge towards investment. Above a certain level of cash savings, individuals could only gain further tax relief through a stocks and shares ISA. In contrast to the old scheme, NISAs provide the freedom for individuals to choose how they allocate their resources – providing the ability to save up to £15,000 in cash tax free, if that is what the individual desires. While undoubtedly popular, this policy can be seen as accommodating the reluctance to invest felt by many consumers. Those who can afford to use their full ISA allowance will quickly accumulate a substantial amount of cash savings. Continuing to save this volume of cash for more than a single year under the new scheme, though this may be what the individual prefers, means missing out on returns, while the benefits to sitting on further liquid assets are likely to be very limited.

Some simple changes to the way long-term investment products are presented could help to overcome the behavioural bias towards cash.

PRESENTATION OF RETURNS

The way in which returns are presented is known to have an impact on investment decisions. When returns are presented on an annual basis, the volatility involved in stock markets increases the likelihood that a negative return will be observed. Over a longer time period, the effects of market cycles even out and returns tend towards long run averages. But when would-be investors are presented with a time series of the returns on a given product, this truth is likely to be obscured by volatility of returns in any given year. A change as simple as presenting long-run average annualised returns for a product, rather than a time series, could help to reduce the amount of risk perceived by would-be investors.[31] Presenting long-run average annualised returns would help make investments comparable with other products, particularly savings accounts, and could help to overcome cash bias.

ENHANCE THE SYMMETRY OF RISK WARNINGS

Additionally, there is an asymmetry in the way warnings are presented in advertising and other materials for financial products. Advertising materials for investment products must clearly state that capital is at risk and returns are not guaranteed, meaning that the minute a consumer views such materials the risk associated is highlighted.

Regulators should take care when designing warning statements, that they are proportional and do not make some types of products look disproportionately unattractive. With its new responsibilities for consumer credit, the Financial Conduct Authority (FCA) should ensure that consumers are equally aware of the risks involved in various financial services products, to avoid a scenario where investment is perceived as being potentially more costly than taking credit. Given that a significant minority of consumers are also unable to calculate real returns,[32] cash savings products should carry a reminder that the value of funds held in these products may be reduced by inflation. While a full statement of the cost of holding savings in cash may go too far and discourage worthwhile saving, a reminder to check returns on a product against inflation could help consumers to find the best savings deal for them. Initial action by the FCA in May 2014 to improve warnings on credit products was an encouraging start,[33] but we would call for a full review of risk warnings on all financial products, to ensure equal treatment.

GREATER PENSION FREEDOMS

Given rising life expectancy, many people are under-saving for retirement. Pensions are already the most widely used form of investment, and clearly have an appeal to those who are not interested in other investment products. As with the ISA wrapper, something about pensions seems to overcome risk aversion. Rather than trying to overcome the behavioural barriers to other forms of investment, it is worth exploring how consumers could be encouraged to invest more in their pensions, given that most are not saving an optimal amount.

Our survey data reveals that cash flow problems in early to mid-adult life are a significant barrier to further pensions saving. Nearly half of all those who stop investing in a pension between 35 and 44 years of age do so because of cash flow problems. The prevalence of affordability as a barrier to savings and investments also explains why consumers are reluctant to lock money away in investments. Consumers feel that making cash inaccessible is as risky as putting capital at risk in investments (see Figure 11).

To overcome this reluctance to save for the long-term, we propose an extension to the government's freedom and choice agenda, making savings more "flexible and attractive in order to encourage people to take greater responsibility for their financial future."[34] In addition to the new freedoms provided to pension holders at 55, consumers should be given an opportunity to access their pensions at 35, when the evidence from our survey suggests cash flow pressures are strongest.

The creation of a window of access at this point would allow consumers to treat pensions as a broader life-cycle saving tool, taking advantage of the preference for pensions saving to encourage long-term investment earlier in life. This could also help to avoid the myopia of early adult life and encourage those in the 18-24 age group to commit to pension savings, knowing that they will be accessible within a shorter time frame. As HM Treasury have recognised: "Additional flexibility may... encourage more people to save in pensions."[35]

This proposal would potentially raise fiscal concerns, as pension saving is given tax relief at the point of saving. We would suggest limiting the size of the withdrawal that can be made at age 35, and that this sum should be subject to marginal tax rates. As the visibility and information available about products seems to be more important to consumers than tax benefits, we do not anticipate that these restrictions would form a barrier to higher saving at a younger age.

A window of access at 35 would also mean an individual engages actively with their pension provider at this stage. This creates an opportunity for the provider to model the individual's saving behaviour forward to retirement and provide guidance about the impact of different future saving rates.

IMPROVING FINANCIAL LITERACY, CONFIDENCE AND FORWARD PLANNING

Even with these changes to products, the problem of poor financial literacy remains. The bigger problem, in many ways, is to ensure that the majority of the population are saving an adequate amount to provide a cushion in times of need, are aware of the various products available to help them do this and have sufficient confidence to plan for their financial futures.

We see the individual's financial development in three distinct stages:

Figure 19: Financial development

Financial awareness 5-12 years

- Developing awareness of money and its uses
- Awareness of trade off between consumption today and in future, but not luxuries and necessities
- Able to count money, carry out simple transactions

Financial literacy 12-18 years

- Developing awareness of concepts like interest rates and inflation
- Practicing making more complex financial decisions - choosing asset types, calculating compound interest etc.

Financial confidence 18+

- Understanding of personal risk preferences, character traits and how these influence savings and investment behaviour
- Ability to manage these traits
- Confidence undertaking long-term financial planning

Source: Social Market Foundation

The initial stage, financial awareness, is largely developed in the home, by handling money, managing birthday and Christmas money and the like.

Efforts to improve financial literacy have already made significant progress with the introduction of compulsory financial education in secondary schools. A further step, to ensure that these skills are established as young people enter adult life, could be to tie additional financial training to landmark points. For example, a young person receiving their National Insurance number at 16 could have to go online to activate it, and complete a short e-learning activity on financial skills to do so. Employers could provide a prompt to complete this, and the threat of a delayed pay day if the NI number cannot be used to complete a PAYE transaction would be sufficient threat to ensure compliance in most cases.

This would have the additional benefit of establishing the importance of good financial planning outside the classroom, at the very start of a person's relationship with the workplace. Training opportunities could also be tied to work experience placements, embedded within apprenticeship frameworks or within the application process for student loans, reaching a wide variety of young people as they first reach an age at which they a) first have an independent income and b) have access to credit.

Beyond this, as adults, consumers need to learn to implement this financial knowledge with confidence – to work out what their financial goals are, to develop a plan to attain these, and to choose the products that will help them achieve it. Our proposed pension access window at 35 would provide an ideal opportunity to build on consumer understanding of financial goals, risk and returns. Pension providers will engage with their customers and reinforce the connection between contribution levels, portfolio composition and the likelihood of meeting savings goals. Completing an e-learning experience at this point could be a condition of accessing funds, helping to ensure consumers understand what they are doing, providing them with an opportunity to actively engage with their saving goals and to explore the behaviours needed to achieve these.[36]

ADJUSTING TO THE 'NEW NORMAL'

In closing this report, we return to the macroeconomic context described in Chapter 1. If we live in a 'new normal' where economic growth and interest rates are lower, not merely as a temporary condition but for the medium- or long-term, then increasing saving and encouraging more investment among savers is bound to be an uphill struggle. Tackling the roots of secular stagnation – or even identifying them confidently – is beyond the scope of this paper. However, we will look briefly at whether the policy environment for saving and investing should be adjusting to the new economic conditions we live in.

The first issue we flagged in Chapter 1 is share ownership. This has declined among individuals and the Solvency II rules may mean that it has to decline among insurers as well. Yet the returns offered by equity investment are powerful on any long-run measure. They might be even stronger if it weren't for the fact that our tax system creates a bias towards firms using debt rather than equity. This is a much wider issue. The Mirrlees Review considered it at length and we have discussed it in earlier work.[37]

In the context of retail savers and investors, the most relevant issue for this report is the stamp duty payable on share transactions. It is charged at 0.5% on all transactions above £1,000. This can perhaps be considered a marginal amount when returns are high but, in an environment of lower growth, it is a much larger wedge of the returns that retail investors might aspire to achieve and is likely to deter innovation among financial services providers who may be in a position to offer an equities-based investment product to savers. This stamp duty has already been removed for transactions in the Alternative Investment Market (AIM) and we recommend that it is lifted for all retail investors. With 36% of consumers in our survey reporting that they would be likely to switch from savings to investment if the tax on profits made through investments was lower, this reform could help to overcome cash bias and inject capital into the economy.

This same type of adjustment in policy to the new environment of saving and investing is relevant to bonds as well. Bond issuance has been rising since the financial crisis and, while returns are lower than they would be against the backdrop of higher interest rates, they remain close to 5% for investment grade instruments. Bonds are also tradable which means that they can fit with the desire of savers and investors not to put all of their savings out of reach.

Bringing retail investors towards bonds is on the agenda for policy makers and market participants. The London Stock Exchange created the Order

Book for Retail Bonds in 2010 which enables firms to go direct to individual investors. The minimum investment required – typically, £1,000 - is lower than for traditional bonds. Close to £1bn was invested in these retail bonds during 2013. The challenge for individuals though is that buying these bonds may mean that their investment portfolio becomes too reliant on the performance of a particular firm or handful of firms. The advantages of diversification that a fund manager can offer are still valuable. The way to spur the creation of such funds for retail bonds may be to create an ISA – a 'wrapper' that, as we have discussed, is popular and trusted among savers – for retail bonds. The government is consulting on making a similar innovation for peer-to-peer lending, to draw retail savers into that new form of investment via an ISA. Retail bonds can offer the same advantages of a manageable level of investment, attractive returns and perhaps crucially a sense of personal connection to the firm or type of firms in which they are investing. Practically, creating a new ISA for this purpose will be most effective in boosting the level of investment if there is a separate tax-free allowance for savers (on top of the existing ISA limit) specifically to invest in retail bonds.

This does raise the question of whether it is equitable to provide a further tax advantage to people who may have relatively high incomes or savings already. But that concern should be weighed against the benefits of bringing an attractive class of investments closer to retail investors who may, in the absence of stronger returns, save less or save in ways that do not provide investment directly to the businesses in our economy that are seeking to prosper and grow.

While it may be true that we are living in new economic conditions there are pockets of growth and innovation and linking savers and investors to them is the challenge that these recommendations take up.

Appendix A: reasons for starting saving or investing with a particular product

Type of saving	Survey responses coded within group						
Cash flow	Pay increase	Household expenses fell	Had a windfall - an inheritance or prize win or similar	Finished paying off a debt or mortgage			
Peer effect	Suggested by parents or other family members	My friends and peers were all saving or investing					
Short-term goal	Had a short-term savings goals e.g. a holiday or car	Saving for a mortgage deposit					
Life-cycle	Decided to start saving for pension	Pension saving prompted me to save some money I could access more easily	Wanted to fund family expense - education of children or help get someone else on the property ladder	Wanted to provide inheritance when I die	Had children	Change in work situation	Other change in family circumstances
Product characteristics/ information	I found a certain product particularly attractive	The product was packaged with my mortgage	High interest rates on offer	Information available about the product	The product was recommended to me by a professional	I felt I understood the product and how it works	
Precautionary	Wanted protection against uncertainty - 'for a rainy day'						

Appendix B: reasons for stopping saving or investing with a particular product

Type of saving	Survey responses coded within group					
Cash flow	Pay increase	Pay decrease	Became unaffordable	Wanted more to spend immediately	Needed to be able to access money more quickly	Accessing money quickly became less important
More risk	Became willing to use a riskier product					
Goal achieved	Met short-term goal e.g. bought holiday or car	Bought house				
Switched to property or insurance	Switched to investing in property	Bought insurance to replace savings				
Life-cycle	Decided to start saving for pension	Change in family circumstances				
Product features and information	I became aware of other products which suited my situation better	I was advised to stop using this product by a professional				
Less risk	Wanted to minimise amount of risk taking	Wanted to make sure my money was safe				
Returns	Wanted to seek higher returns	Wanted to take advantage of government policies reducing tax on interest	Low interest rates/ returns			

ENDNOTES

1. ONS principal population projections. The population of centenarians is estimated at 15,000 in 2014, and is expected to rise to 32,000 by 2023
2. ONS, "Introducing developments to measurement of pensions data and the impact on household savings 1997 to 2011", http://www.ons.gov.uk/ons/guide-method/method-quality/specific/economy/national-accounts/articles/2011-present/introducing-developments-to-measurement-of-pensions-data-and-the-impact-on-household-savings-1997-to-2011/index.html (last accessed 02/12/2014)
3. The default contribution level at present is just 2%. Scottish Widows, "Retirement Report 2014", (London: Scottish Widows, 2014), see Appendix 1 http://reference.scottishwidows.co.uk/literature/doc/46273-2012 (last accessed 02/12/2014)
4. Sample is individuals aged 30–60 who are not yet retired, and who reported both a planned age of retirement and an expected number of years of retirement. Sample size = 3,745 men and 2,602 women. Individual 'expected date of death' is calculated as the sum of the age at which they plan to retire and the number of years of retirement that they expect to finance. Period and cohort life expectancies are 2008-based projections by the Office for National Statistics. Source: Wealth and Assets Survey 2006–08. Office for National Statistics
5. Paul Krugman, "Do We Face Secular Stagnation?", Juncture (London: Institute for Public Policy Research, 2014), http://www.ippr.org/juncture/do-we-face-secular-stagnation (last accessed 02/12/2014)
6. Mark Carney told John Humphries on BBC Radio 4's Today programme that a new normal for interest rates was 2.5%, and that a return to "normal" rates of 5% was unlikely in the medium term on June 27 2014. Audio here: http://www.bbc.co.uk/news/business-28056274 (last accessed 02/12/2014)
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9. Mark Carney, Governor of the Bank of England, recognised house prices as the biggest threat to the UK economy in an interview with Dermot Murnaghan on Sky News, 18/05/2014 http://news.sky.com/story/1263732/carney-house-prices-biggest-risk-to-economy (last accessed 02/12/2014)
10. European Insurance and Occupational Pensions Authority, EIOPA Report on the fifth Quantitative Impact Study (QIS5) for Solvency II, (Frankfurt: EIOPA, 2011 "EIOPA Report on the fifth Quantitative Impact Study (QIS5) for Solvency II")
11. Bank for International Settlements, Fixed income strategies of insurance companies and pension funds, CGFS Publications No.44 ("Fixed income strategies for insurance companies and pension funds" Basel: Bank for International Settlements, 2011)
12. Bank of England, "Inflation Report: November 2014" (London: Bank of England, 2014)
13. Office for National Statistics Wealth and Assets Survey 2010/12

14. Survey data reported in this report was collected by Populus for the SMF. Populus interviewed 2014 GB adults online between 1 and 2 October 2014. Results have been weighted to be representative of all GB adults. Populus is a member of the British Polling Council and abides by its rules. For more information see www.populus.co.uk
15. There may be concerns about the veracity of consumer survey data on a subject as delicate as household wealth. However, comparison with the Office for National Statistics' (ONS) Wealth and Assets Survey 2010/12 shows that our findings are well in line with official statistics constructed using a larger sample. The ONS found that 75% of households reported ownership of a financial asset other than a current account, and 58% of households reported owning at least one savings or deposit account. The minor discrepancies between the two datasets are likely to be a result of individuals who hold accounts that they no longer actively contribute to. These accounts would still be counted in the Wealth and Assets survey, but as the individual is not currently adding to their value they count as previous savers in our data. The close resemblance between these headline figures should give us confidence in this survey data.
16. By saving we mean products provided primarily by banks and building societies which are relatively low risk – it is highly likely you will get the money you put in back, and in many cases it will be guaranteed by the government. The returns on these products are usually a fixed rate of interest, set by the bank or building society providing the product. Products include cash ISAs, regular savings accounts, fixed-term savings accounts and National Savings and Investment (NS&I, the UK's state-owned savings bank) products such as Premium Bonds.

    Investments, by contrast, are provided by a wider range of companies, including specialist investment firms and individual businesses in need of capital. These products are often more risky than savings products; there is no guarantee that you will get back all the money you put in as the value of the underlying assets can rise and fall. The rate of return is often higher, but it is also likely to vary with the performance of stock or bond markets, or the entity the asset is attached to (company performance for shares, or national solvency for government debts). Products include investment funds, shares, bonds and peer-to-peer loans.
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18. NRS AB group
19. NRS DE group
20. Thomas Crossley, Carl Emmerson and Andrew Leicester, "Raising Household Saving", (London: Institute for Fiscal Studies, 2012)
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27. Craig Berry, "The Retail Distribution Review and Small Pension Pots", (London: ILC UK, 2012)
28. Andrew Clare et al, "The impact of the RDR on the UK's market for financial advice: Challenge and opportunity", (London: Cass Business School, 2013) http://www.cass.city.ac.uk/__data/assets/pdf_file/0016/202336/The-impact-of-RDR-Cass-version.pdf (last accessed 02/12/2014)
29. Which? suggest that the average cost of advice is 3% of the lump sum, so we use this as a baseline in our examples http://www.thisismoney.co.uk/money/investing/article-2543997/Which-probe-finds-financial-advisers-charge-average-1-579.html (last accessed 02/12/2014)
30. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/348071/Full_Statistics_Release_August_2014.pdf (last accessed 02/12/2014)
31. Thomas Crossley, Carl Emmerson and Andrew Leicester, "Raising Household Saving", (London: Institute for Fiscal Studies, 2012); Maarten Van Rooij, Clemens Kool, and Henriëtte Prast, "Risk-return preferences in the pension domain: Are people able to choose?", Journal of Public Economics, 91, pp701-722 (2007)
32. Money Advice Service, The Financial Capability of the UK 2012, (London: Money Advice Service, 2013)
33. http://www.fca.org.uk/news/consumer-credit-firms-must-raise-advertising-standards, (last accessed 02/12/2014)
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35. HM Treasury, "Freedom and Choice in Pensions", (London: The Stationary Office, 2014)
36. J. Michael Collins and Colin M. O'Rourke, "The Application of Coaching Techniques to Financial Issues", Journal of Financial Therapy 3:2 (2012)
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Savings in the Balance
Managing Risk in a Post-Crisis World

The UK's household savings rate has been falling for decades and there are ample reasons to be concerned about the financial health of households.

Interest rates remain low and are likely to rise only gradually, while the crisis has left consumers hyper-aware of the risks involved in investing. Personalised advice about investment and ways of earning higher returns has become more difficult to access. And even when households do overcome the barriers to investment, returns have fallen as a result of new macroprudential regulations. We're living in a 'new normal', where returns are lower, but we are living for longer and need to save more.

We analyse why, when and how households choose to save, the factors that prompt them to begin investing and the type of advice they seek. In this report we offer new policy recommendations to boost household savings rates and unlock investment.

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