Tomorrow's Investor
Interim report

Rowland Manthorpe and Seb Martin

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The RSA is an Enlightenment organisation devoted to finding innovative practical solutions to today's pressing social problems. Through its 27,000-strong Fellowship it pursues its mission: to help people be the people they need to be to see the change they want in the world.

The citizens of the future will need to be self-reliant, engaged and other-regarding if they are to create a principled and prosperous society. This is nowhere more true than in financial matters. The Tomorrow's Investor project, the first stage of a prolonged RSA engagement with these issues, aims to facilitate this goal, both practically and intellectually.

This project would not have been possible without the support of Invesco Perpetual and PricewaterhouseCoopers – many thanks in particular to Sir John Banham, Nick Hamilton, James Rawson, David Phillips and Peter Wyman. Thanks also to Robin Ellison, Paul Myners and John Gray, as well as to all those who participated in the Tomorrow's Investor lecture, expert seminar and deliberative forum. Special thanks to David Pitt-Watson for his support throughout the project.

More information can be found at the RSA website: www.theRSA.org.uk

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About the authors

Rowland Manthorpe joined the RSA in 2007. He read history at St John's College, Cambridge and graduated in 2005 with first class honours. In 2006, while studying for a Masters in Political Theory at the London School of Economics, he was awarded the Ben Pimlott Prize for Political Writing by the *Guardian* and the Fabian Society.

Seb Martin is the founder of Black Box Market Research and has ten years experience in the industry. During this time he has worked on a wide variety of social and political research projects, including work for two of the three main political parties, as well as a wide cross-section of clients from the commercial sector.

1 Executive summary

1.1 Background

Through their pensions and life insurance policies, ordinary investors own large chunks of the UK stock market. Yet, at present, few of them are involved in the management of their investments.

The Tomorrow's Investor project starts with the premise that both business and society would benefit from greater citizen engagement.

For ordinary citizens, there are pressing contingent reasons that make the case for increased involvement: a looming pensions shortfall; the shift from direct benefit to direct contribution, which leaves citizens unwittingly speculating on the stock market; and irrefutable evidence of mismanagement. Recent events in financial markets suggest that issues of ownership and control are critical. Would a crisis have been averted by greater citizen engagement?

The first step in what will be a prolonged engagement with these issues was a research event, intended to contribute to RSA thinking in this direction.

1.2 Methodology

To investigate what relationship ordinary citizens had with their investments, the RSA commissioned Black Box, a market research company, to conduct a deliberative forum with twenty-four ordinary investors. The investors were recruited to be a nationally representative sample and to represent a spread of investment holdings.

The deliberative forum took place in three stages. An initial focus group session explored participants' attitudes towards investments. A group of experts then spoke to the group, presenting a variety of perspectives on engagement and the investment system. The final part of the day assessed what the investors had taken from the presentations.

Before the forum, participants were asked to try and find out where their indirect investments were held. They came to the day with some awareness of the financial system, or at least their place in it.

The investors were placed into one of two descriptive brackets: Active and Passive, based on understanding. At the deliberative forum itself, there were three groups: one made of Active Investors, one made of Passive, and a further mixed group.

1.3 Key findings

Awareness and understanding of finance varies considerably. However, today's investor's are almost universally detached from their pensions.

This leads to what we call "the paradox of control". Pensions are almost universally regarded as the most important financial holding an individual owns, yet conversely are the financial holding consumers feel the most detached from. Investor disengagement is driving distrust in the market. Consumers see pension shortfalls and are worried about their financial future, but don't feel they have any choices or opportunities to give their investment the best possible chance of delivering what they want at retirement.

The greatest concern relating to the pension market is return and security at retirement. Social and ethical issues are starting to become issues for some investors, but for the majority they are secondary concerns.

Changing the current disconnect will be difficult. The deliberative forum highlighted the difficulty of communicating these issues to investors. Overloading them with facts and information, or presenting issues in abstract, intangible terms, does little to aid understanding or move people to action.

However, the experience in other arenas, most notably direct shareholding, suggests that if investors are given simple and easy to make choices regarding their investments, and they can see clear and tangible benefits to those choices, then they can and will exercise choice and enforce change in the markets.

2 Background and overview

2.1 Tomorrow's investor

Tomorrow's Investor is the first project of its kind to look at investor accountability from the perspective of ordinary citizens. It starts from the premise that, if citizens took a more active role in the management of their money, then the entire financial system would function better – for businesses, individuals and society as a whole.

Over two thirds of the adult UK population have some sort of retirement savings: a traditional pension, a defined contribution plan like an ISA, an investment in a mutual fund, or a life insurance policy. These savings are invested in company equities, pooled and ploughed into the stock market by a vast chain of investment professionals.

For the financially literate, this will come as no surprise. But for many ordinary citizens – including a good number of those who participated in the Tomorrow's Investor research event – even the idea that pension contributions are eventually invested in the stock market is a novel one. The notion that indirect shareholdings entail ownership rights is largely alien. Few people engage actively with their investments. Fewer still are conscious of their role as owners.

This is a worrying state of affairs. As recent events have shown, the functioning of a market system of corporate governance depends to a large extent on the participation of investors, particularly in common law countries such as the US and the UK. Regulators, the judiciary and market theory all assume that corporate boards serve as the agents of shareholders. Consensus breaks down on important subsidiary questions, such as which shareowners rule, over what time period, and whether other stakeholders should be included. But modern corporate theory places the investor in a central role.

The first step in the Tomorrow's Investor project was a deliberative forum. We assembled 25 ordinary citizens and asked them what they wanted from the investment system. So far as we are aware, this is the first time an exercise of this sort has been carried out.

This report contains the findings from the RSA's initial research in this area, conducted by the market research company Black Box. Along with the expert seminar and the supplementary papers, this marks the first stage of an extensive RSA engagement with these issues.

2.2 The RSA

From its inception in the coffee houses of the West End, the RSA has had at its core a belief in the power of civic action. Its present set of projects – on education, for example, where the innovative Opening Minds curriculum for Key Stages 3-4 has been taken up by over 200 schools – reflect a belief in the power and importance of change from the ground up. We believe that the challenges we face as a society, from climate change to obesity, require joint and mutual action of a deep and lasting kind. This is nowhere more true than when talking about global finance and capital markets.

The RSA also has a history of successful projects around the theme of ethical capitalism. It has led the policy debate on personal carbon trading. Its Forum on Technology, Citizens and the Market helped companies assess their practices against contemporary shifts in ethics. It also brought together the Tomorrow's Company Inquiry to stimulate greater competitive performance by encouraging sustainable business practices. This initiative spawned a successful independent think-tank, Tomorrow's Company, currently working on a project called Tomorrow's Owners, investigating recent changes in the ownership of companies. This dovetails neatly with the RSA's work in this area, and the outputs of the respective projects are being shared as they develop.

Behind Tomorrow's Investor lies a commitment not just to discovering but to making change happen. Compared with the scale of this ambition, the first stage – which this report describes – may seem modest. Nevertheless, it is an important step. By asking a group of ordinary investors how they would change the system they in part own, we mirror the two-way process of accountability that characterises the very best systems and organisations. It also helps the project proceed most effectively. The RSA is not agnostic on these issues; still, we have a strong commitment to evidence-based policy.

Behind Tomorrow's Investor lies a commitment not just to discovering but to making change happen

The results suggest that the process of change may be a lengthy one. It is one in which we all have a stake. The corporate sector is the wealth generating engine of the country, critical to every member of the population. It is currently malfunctioning. We need it to do better, for the sake of our future well-being.

2.3 Changing ownership

The second half of the twentieth century brought a sea change in the pattern of ownership. In 1963, when the government conducted its first survey of share ownership, over half of UK shares were in private hands. Yet today only an eighth of UK shares are held by individuals.

Between the 1960s and the 1990s shares were transferred from private to public control. Pension funds, mutual funds and insurance funds – public vehicles which invest third parties' money – became the largest shareholders in the market. In 1993, at the high point of their dominance, these institutional investors held over half of all UK shares. They now hold around a quarter. Their place has been taken, however, by foreign investors, often themselves public vehicles. Similarly, British pension funds have moved into overseas equities, which by 2005 accounted for a larger share of assets under management than UK equities.

In sheer money terms, the stakes held by institutional investors remain hugely significant. The largest shareholder in Britain is the BT Pension Scheme, with over £30 billion of assets, a scheme that acts as fiduciary for 350,000 people. When the Personal Accounts system that was proposed under Lord Turner's Review of pensions in the UK comes into place in 2012, it will almost certainly overtake BT, instantly becoming a hugely powerful player in capital markets across the world.

Both these schemes are designed to ensure that British workers, particularly those on lower incomes, directly finance their own retirement. So the power and influence of the Personal Accounts Delivery Authority (PADA) and Hermes Fund Managers, which administers the BT Pension Scheme, is derived from savings held on behalf of millions of ordinary people. This is not unusual. Most large pension funds relate to – or used to relate to – public sector employees in state or local government. The local authority pension scheme, for example, is one of the biggest in the UK. The Royal Mail scheme is of a comparable size.

The history of the last fifty years could be written as a heartening tale of power moving away from elites and towards ordinary people. Some writers have taken to describing this as "democratic capitalism" – a phrase at the centre of one recent campaign in this area, the Investor Suffrage Movement. This ownership relationship is not totally straightforward. Nevertheless, in a very real sense, through their banks, brokers, fund managers, and insurers, ordinary people own the corporate system in much the same way they do public services.

However, as the existence of campaigns suggests, the comparison to representative democracy shows up the failings of the corporate sector. Contemporary political systems are often criticised for being opaque and unaccountable, but the financial system is far harder to fathom. Some attenuation is inevitable, as theorists of the principal agent problem have shown. But many observers feel there is distinct culpability. "The intermediaries have hijacked share ownership, and exploit it for their own benefit", the City journalist Anthony Hilton wrote in March this year. Speaking at the RSA recently, PADA head Paul Myners agreed. Major companies had fallen into the hands of "a self-appointed managerial elite" he said, the result of a "vacuum of ownership". Instead of "democratic capitalism", we have "managerial capitalism". The Tomorrow's Investor project aims to address this issue.

2.4 The case for engagement

There are compelling arguments, familiar from political philosophy, to say that investors have a duty to be active citizens, to involve themselves actively with their holdings. There are also pressing contingent reasons. Three interlocking trends make indirect investment – and pensions in particular – a potent political and social problem. Taken together, they also make a strong case for greater citizen involvement in questions of finance.

2.4.1 Demographics.

When they think about their pension, most people think first of returns, only second – if at all – of investment. Well, returns are under threat. Seismic demographic change has altered the entire basis of pension calculations.

Britain's population is getting older. Like the inhabitants of most rich countries, Britons live longer and have fewer children than they did in the past. By 2050, the number of British citizens aged 65 and over will be 50 per cent higher than it is now. Our "dependency ratio" – the extent to which the working age population supports those not working – will double over the next forty years.

Both public and private sectors have been surprised by the demographic shift. Actuaries have consistently underestimated increases in life expectancy. In 1999 the actuaries' trade body assumed that a British man retiring at 60 would on average live until he was 84. In 2002, they decided he was more likely to live to 86. In 2006, they raised that estimate by 6 months. Not that this is the end of miscalculations. The Pensions Regulator recently advised that pension schemes pick 2040 as the date when mortality reductions will level off. Over 50 per cent of companies, they reported, are still working on the basis that death rate declines will stop in 2020.

While extremely welcome, this development nevertheless poses problems for future pensioners and future taxpayers alike. The pensions Bills following Lord Turner's review have closed some gaps, but, as Prosperity Capital Management's Liam Halligan reported in a recent article for the RSA Journal, they have not solved the problem.[1] The state pension, already tight-fisted – Britain's promise to young workers is the least generous in the developed world – will struggle to cope with the influx of pensioners, particularly as the baby boomers start to retire.

Companies are equally burdened. PricewaterhouseCoopers calculated in 2006 that each increase in life expectancy of one year adds £12 billion to the aggregate pension liabilities of FTSE 100 companies. That is, presuming they have caught up with previous decreases in mortality – which many have not. Corporate pensions, once thought to guarantee a long and anxiety-free retirement, are looking increasingly at risk.

2.4.2 DB to DC

The shift from defined benefit (DB) to defined contribution (DC) schemes is the second reason why ordinary citizens may well be advised to involve themselves more actively in their financial affairs.

Over the last decade, many companies have acted to reduce the risks of providing pensions by closing their final-salary schemes to new members. Three-quarters of FTSE 100 firms have taken this measure. Watson Wyatt reported recently that the amount of money that is saved in money-purchase (or defined contribution) schemes worldwide will overtake the amount of money in final-salary (or defined benefit) schemes by 2014.

1 Liam Halligan, "End of the Line", RSA Journal Summer 2008 (available at http://www.thersa.org/fellowship/journal/features/end-of-the-line)

In defined benefit schemes, employees are promised a retirement income based on their pay and length of service; the employer takes the risk. In defined contribution schemes, the eventual pension depends on the investment performance of the fund that the employee has paid into. He or she takes the risk of poor investment performance – often without their knowledge.

This means that more and more people are speculating on their retirement income, even though they may not know it. We are delegating responsibility for our future well-being to agents we put little effort into supervising – if indeed we are capable of doing so.

2.4.3 Money management

There are good reasons for time-poor individuals to feel apathetic about their investments, not least lack of expertise. They wouldn't tell a surgeon how to bypass a heart, so why tell financial professionals how to manage money? The answer may be that there is strong evidence to suggest that the management is not all it should be.

They wouldn't tell a surgeon how to bypass a heart, so why tell financial professionals how to manage money?

Seasoned observers both inside and outside the industry are asking tough questions. Particularly about directors: their pay, their appointments, their golden goodbyes. But there are also emerging concerns about management's relationship with their auditors, and the practices of fund managers. In a forthcoming RSA pamphlet, Sir John Banham, former Director-General of the Confederation of British Industry, expresses dismay at the way fund managers have adopted indexation so wholeheartedly, and at the general preference for bonds over equities, a policy of risk aversion rather than risk management. Their performance, he says, has been "lamentable".[2]

The credit crisis has thrown this state of affairs into sharp focus. The Carlyle Capital Corporation, Bear Stearns and Thornburgh Mortgage all hit the financial buffers only days after receiving soothing audit reports. Reckless pursuit of short-term profits brought down Northern Rock, whose strategy was once widely admired in the City. Stock market turnover has increased by over 50 per cent in the last ten years; the emphasis on trading speaks to what financial experts see as a misalignment of interests.

2.5 Democratic capitalism

The costs of the financial crisis are being borne by taxpayers, depositors, savers and employers. The law could – and perhaps should – be changed to safeguard these unwitting victims. However, if we think that legislation is sufficient, we are deluding ourselves. New events will always supersede legislation – especially in the City, the very crucible of innovation.

J. S. Mill said that a democracy can only work with an engaged and educated citizenry whose members have what he called "active characters". The financial system is structured like a democracy, but it lacks this crucial

2 Sir John Banham, "Producing Decent Returns: the Failure of the British Fund Management Industry", (RSA, forthcoming)

element. In their 2006 book *The New Capitalists*, David Pitt-Watson, John Lukomnik and Stephen Davis heralded an age of activist investment, where widespread civic involvement would benefit the institutions as well as the investors. Activist investors are indeed more influential, but as yet they are a minority. Outspoken and often self-interested, they do not have democratic legitimacy.

Mill's vision is imperfect. At present, shareholders are often to be most blamed for pushing for short term results at the expense of long term growth. This attitude was reflected in our deliberative forum. Citizens do not yet see themselves as "universal owners", diversified to such an extent that their only rational goal can be steady growth in the economy as a whole. Nor will the general populace ever be likely to approach the level of understanding needed to participate fully in capital markets. There will always be a need for professionals.

None of these considerations obviate the need for citizen involvement. The present economic conditions make democratic capitalism – enhanced by developments in communication technology – a more pressing goal. The aim should be for the rhetoric to match the reality.

2.6 The deliberative forum

The Tomorrow's Investor deliberative event took place on Saturday 19th July at the RSA's headquarters in central London. The inspiration for the deliberative forum was the citizens' juries that have become an increasingly common tool in political consultations. By bringing stakeholders together with the people they represent it is possible to cut through distorted representations and cases of mistaken identity, arriving at a dialogue that is fair and equal on both sides.

By law, and by tradition, companies are accountable to their owners. Yet it is not so often acknowledged that true accountability is a two-way process. It involves not only *being held to account*, but also *giving an account*. This kind of accountability only emerges out of a dialogue – one that acknowledges all points of view. Today that dialogue is based exclusively on discussions between sophisticated market participants. By introducing investors into the conversation, we hoped to hear more clearly from voices that are otherwise silent.

2.6.1 Recruitment

A nationally representative sample of twenty four people attended the event. They were all aged 18 or over; all either in full time employment or retired; all holders of at least one pension; and none of them worked in banking, pensions or insurance. They were paid for their involvement.

A number of additional criteria were applied to ensure that the sample was not overly biased towards one particular demographic or investor type. The group was split evenly between men and women, for example. And at least half the investors were required to be:

* In full time employment
* Aged under 55
* Current or previous holders of an endowment policy
* Holders of one or more of the following investments:
    - Privately owned shares
    - ISA (Individual Savings Account)
    - PEP (Personal Equity Plan)
    - SIP (Systematic Investment Plan)
    - Unit Trust
    - Investment bond
    - OEIC (Open ended investment company)
    - Gilts

2.6.2 Segmentation

Participants were also selected for understanding. As well as participating in the deliberative event, they were set a series of tasks to complete prior to attending the event to help determine what level of engagement and involvement they had with their current financial holdings, particularly their pension.

Two clear sub groups of investors were recruited. We labelled these Active and Passive Investors. One outcome of the process was to show that these names were slightly misleading: even investors defined as Active were by and large passive with regard to their indirect holdings. Nevertheless, they reflected the difference between the two groups:

* The Active Investors were confident in their understanding of financial products and felt they took a strong interest in the day-to-day management of their investments.
* The Passive Investors had little confidence in their understanding of financial products. They tended to agree with these statements (used in FSA questionnaires on financial literacy): "I know I should be doing something with my finances, but don't know where to start"; "I get confused about the various financial products and services on offer these days".

2.6.3 Pre-event task

Participants were asked to complete a task before the event, in order to get them thinking about the issues involved. They were tasked with finding out where their indirect investments were held – and asked to record how they got on.

Few had any success with the task; and, on the day, there were complaints about the customer service and the difficulty of obtaining information.

2.6.4 Methodology

The attendees were split into three groups of eight, each of which was assigned a moderator to conduct two focus group sessions with them over the course of a single day. The groups were split as follows:

- 1 x group of Active investors
- 1 x group of Passive investors
- 1 x mixed group with both Active and Passive investors

There were three stages to the day:

- The first stage involved benchmarking participants' opinions to understand their thinking around investments, pensions and the other key issues.
- The second stage introduced participants to a range of theories from a panel of experts. After the presentations the investors were able to question the speakers in both a formal and informal context. They also had a chance to discuss what they have seen and heard amongst themselves.
- The third stage assessed what impact, if any, exposure to these various theories had on the way the investors thought about investments and pensions.

2.5.5 Panel and perspectives

The panel of experts was comprised of the following speakers, who spoke in the order listed below:

1. **Mark Goyder: "An introduction to the chain of investment".**
   Mark Goyder is Founder Director of Tomorrow's Company, a not-for-profit research and agenda-setting organisation which he formed in 1996. In 2006 he initiated the inquiry on Tomorrow's Global Company. Its findings, published in June 2007, represent the vision of leaders of global businesses from America, Asia and Europe. Mark is now leading a new Tomorrow's Company project entitled "Tomorrow's Owners".

2. **David Pitt-Watson: "The New Capitalists".**
   David Pitt-Watson is the founder and Chair of Hermes Equity Ownership Service, the largest shareholder stewardship programme in the world. He was formerly head of all Hermes shareholder activist activities. In 2006 he co-authored The New Capitalists, which provided the inspiration for the RSA's Tomorrow's Investor project. Between 1997 and 1999 he was Assistant General Secretary of the Labour Party.

3. **Robin Ellison: "On pensions".**
   Robin Ellison is Head of Strategy, Pensions, at Pinsent Masons, a UK law firm. He is Visiting Professor in Pensions Law and Economics at Cass Business School, City University London, and at Birmingham City University. He is immediate past Chairman of the National Association of Pension Funds and remains a trustee of several pension funds, both as independent trustee and as chairman.

4 **Marc Jobling: "Institutional investment".**
Marc Jobling is the Assistant Director of Investment Affairs at the Association of British Insurers. His remit covers Corporate Governance and Engagement, Company Law and Remuneration. Before joining the ABI, Marc worked in management consultancy, and prior to that spent four years at an independent governance and SRI consultancy.

5 **John Gray: "Activist share ownership".**
John Gray is a trade union activist for the public sector union UNISON. He is currently Chair of the UNISON Capital Stewardship Forum; a member nominated representative on the Tower Hamlets Council pension scheme and lay London UNISON Regional Finance Convener.

2.7 Looking forward

Of all the stages, the presentations proved most challenging for investors. It showed how difficult it is for people to find a common language on issues of finance.

Levels of financial literacy in the UK are low. Our research reflected what the Financial Services Authority found in their 2006 survey: people are confused about their financial affairs; they are failing to provide adequately for their retirement; and they are not using the market to best effect.[3] They find it extremely difficult to engage with issues of finance.

People are confused about their financial affairs; they are failing to provide adequately for their retirement; and they are not using the market to best effect

Faced by a bewildering and threatening situation, people often prefer to bury their heads in the sand. This shows most detrimentally in private pension saving – gone into what Lord Turner describes as "significant underlying decline". It is hard to say how much people need to save – partly because the future is unknown; partly because it's hard to say how much is needed for a comfortable old age. While data exist for the US, there are no available measurements here. Nevertheless, the signs are not encouraging. In 1997, we saved 11 per cent of our income (including pension saving). Now, we save less than 6 per cent – a historic low.

Behavioural science gives us two insights into this decline. The first is that decision-making is not a coldly rational, self-conscious act. Rather, it comes at the end of a long chain of processes, most of which happen beneath the level of awareness. We absorb a way of perceiving the world – what sociologists call norms – from our parents and neighbours.

Norms about personal finance have changed. A report by a group of US think-tanks argued recently that a culture of debt has replaced a culture of thrift.[4] While overdebtedness is not a hugely significant problem for the UK, our situation is still perilous. If unemployment starts to rise, reckless borrowing will come home to roost. Effecting change in this landscape is extremely challenging. *Nudge*, Richard Thaler and Cass Sunstein's book on behavioural economics, offers some help for policymakers – although their prescriptions, most notably opt-out state pensions, are not unproblematic.[5] Far too often however, people simply call for more

3 Financial Capability in the UK: Establishing a Baseline, 2006 (http://www.fsa.gov.uk/pubs/other/fincap_baseline.pdf).

4 Institute for American Values, New America Foundation, Demos, Institute for Advanced Studies in Culture, Public Agenda et al, "For a New Thrift: Confronting the Debt Culture" (2008)

5 Richard H. Thaler and Cass R. Sunstein. Nudge: Improving Decisions About Health, Wealth and Happiness (2008)

education – the universal panacea, the black box into which all difficult issues are thrown, from drugs to sex to personal finance.

Financial education is undeniably necessary. But much depends on the method of teaching. If decision-making is indeed governed by sets of subterranean social influences, then simply throwing abstract information at people will produce few positive results, as our research confirms. Every cognitive study we have tells us that people learn by doing just as much as they learn by thinking. Why not instruct people on real life decisions using real life examples – the investments they hold already, but are barely aware of?

The second insight of behavioural science is that, faced with complex and overly challenging decisions, people tend to rely on their most primitive instincts. The present financial system is placing a greater decision-making burden on investors. So perhaps it is understandable that they are finding it difficult to save, to overcome our inbred short-sightedness.

Financial education is a long-term project. In the short term, our research indicates the importance of giving investors clear choices and in terms they can relate to. People want to be able to invest at low cost – ethically if possible – in the knowledge that their pensions will be secure. At present, they are not being given that option. Instead of trying to change people, maybe we should try and change our systems.

3 Consumer research

3.1 Initial understanding and awareness

3.1.1 The priority is the bottom line

The first concern for all groups was financial security. Second to this was rate of return.

> *"At the end of the day, the bottom line is king"* (male investor).

Almost all the investors agreed on this point.

3.1.2 Levels of engagement vary

The level of involvement in personal investments varied considerably between the different investor groups. The Active Investors took a much keener interest in the markets and the types of financial products available to them.

The Active Investors largely said that their primary motivation for becoming actively involved in the day to day management of personal financial holdings and investments, including such activities as voting at an AGM or carrying out research into a company that has been or is going to be invested in is to minimise risk and maximise ROI (Return on Investment).

The Passive Investors tended not to get actively involved or seek out information unless they absolutely had to. They shared the same concerns as the Active Investors, but were much less confident in their ability to secure those goals.

For the Passive Investor groups the general consensus was that:

> *'As long as it pays what I need at the end, I don't need to know the details'* (male investor).

3.1.3 The paradox of control

There is a paradoxical relationship between how important an investment is and the amount of information or control the investor has in relation to that investment.

There was general consensus among the focus groups that pensions are the most important investment an individual owns. They represent future security, they are invested in over a long period of time, and outside of the mortgage they represent the largest single investment made over the course of a lifetime. However this importance is not reflected in how involved or informed people are regarding about their pension.

Most people at the deliberative event claimed to have little or no knowledge of where their money is being invested on their behalf, or even who was meant to be taking care of their investments for them.

3.1.4 The contrast between shares and pensions

Shares are not seen as particularly important and are viewed in many cases a bit of a gamble:

> *"You take a punt on the stock market. It's like putting money on the horses"* (male investor).

Yet they are the financial holding that investors take the keenest interest in on a day-to-day basis. Checking share prices, analysing the markets, buying and selling etc. are all seen as perfectly normal behaviour.

The view that direct shareholding is a gamble seems to free people up to become involved, speculating to make a quick return in a way they wouldn't with more "serious" investments.

> *After all, you wouldn't gamble with your long-term future and security, would you?* (female investor).

However, for many on the day, there was a sense of conflict – what one could call cognitive dissonance – over this issue. Equities supports pensions, yet most investors are stuck in a mindset that the ownership of shares in a company equals short term speculation.

3.1.5 Psychologically, pensions in a different place

Typically, people place pension in a different mental place to other investments. Most people don't seem to take nearly as much interest in them as they do in their other lower value financial holdings. A number of key reasons emerged at the deliberative forum to explain this:

* The customer journey and perceived lack of free will in the market, particularly around company pension schemes. An individual is given the opportunity to join their company pension scheme and have money paid in by their employer as well as by themselves, but they have little or no say over what pension they join or how this is managed. It's not something they have made a conscious decision about.
* Pensions lack urgency as an investment; for many it's too far away to be worried about. Consumers only start to think and worry about their pension when it starts getting close to retirement (five years or so), but by then it's too late if something has gone wrong or it's not going to deliver on expectations.
* The market and the institutions responsible for managing pensions do not encourage active participation in the decision making process. This was evidenced by the reaction many respondents got when they tried to complete their pre-attendance task by contacting their pension providers to ask for details and information and were met with barriers and resistance.
* An investor's pension might be spread across hundreds of different companies and it seems impossible to take an interest in them all.

3.1.6 Variation over pensions

There is of course variation in how people regard their pensions. Influencing factors include:

* Type of pension scheme, particularly if it is a final salary scheme.
* Age and proximity to retirement.
* Purchase channel and degree of free will in choosing the pension. Did the investor make the decision? Was it put forward by someone else like an IFA, or did they join the company pension scheme without thinking about alternatives?
* Number of pensions held: those who had several private pensions were less interested than those who had paid into one scheme their whole life.

3.1.7 Level of engagement makes a difference

There is also variation between investor groups. Level of engagement affects how people regard their pension:

* Few people in the Passive Investor group expected to have a say in the management of their pension; and, in many cases, they didn't want one. The perception here was that the 'rules' of the pension game meant that it was managed for you. This is taken as read.
* The Active Investor group are less fatalistic or resigned about the management of their investments. They are still predominantly detached from their pensions however, particularly if they are company run schemes. Private pensions are a slightly different issue. If it's something they have consciously chosen in the marketplace they are more likely to take an active interest, monitor it and even try and have some say over how it is being run. However they are typically far less involved with their pension than they are with their other financial holdings.

3.1.8 But attitudes are broadly consistent

Overall, with few exceptions, participants tended to have the following attitudes towards pensions:

* A disconnected mindset: you hand over all responsibility to another when you take out a pension. It stops being your money and becomes their money until it's time to reclaim it when you retire.
* An element of blind faith: you sign up, you hand it over to someone who 'knows what they are doing with it' and you trust them to do a good job for you.
* A sense of powerlessness: What are the alternatives? What can I do?
* A sense of intangibility. This stemmed both from the lack of immediacy around pensions, and from the fact that they are not selected as a conscious decision.
* A frustration at having to be involved. While they see the necessity of engagement in other areas, investors are typically looking for a fairly passive model of investment around pensions.

Some of these attitudes are contradictory. Investors complained at the lack of choice, but frequently said that they would prefer not to be involved.

The core principle for the investors was always financial security. They wanted to know that their money was going to grow and that the companies they invest in are going to do well in the long term, but they had lingering doubts that this would be the case. What then, they wondered, were their options?

3.1.9 Consumer concerns relating to pensions

There is a growing sense of cynicism and distrust where pensions are concerned. Many of the participants in the deliberative forum felt that a pension shortfall at retirement was a very real danger. There was also a strong sense of powerlessness around this, with most people feeling there was little or nothing they could do about it.

Many of the participants in the deliberative forum felt that a pension shortfall at retirement was a very real danger

This broad feeling was frequently combined with a contradictory one: a faith, or a hope, that pensions would pay out. For people who felt this way there was an element of 'see no evil, hear no evil' in relation to pensions. It is easier to put your trust in the organisation you are investing through, they seemed to feel, than it is to start to question the investment decisions you have made relating to your long term future. This attitude was more common amongst Passive Investors.

Key concerns regarding the pension market include:

Return on Investment (ROI)
Getting the best possible return on their investment is the number one priority for most investors. Investors want to know that the money they invest is being given the best possible chance of growth. Bottom line is king and in a number of cases supersedes ethical issues.

> *"If it came down to it and it was a choice between investing ethically and getting the best possible return for my money, I'd go for whatever would make the most money"* (female investor).

Long term security
Whilst ROI is important the real issue is whether or not an individual's pension is going to give them enough money to live comfortably on when they retire. This was not such an issue for those on final salary schemes but was a major concern for those investing through other forms of company pension scheme or private pensions.

> *"You want to know that what you put in is going to afford you the kind of lifestyle that you've come to expect. Your biggest worry about your pension is that you're going to get a nasty surprise at the end of it"* (female investor).

Asset management
Is my pension being managed well? Is the fund manager 'performing well'? This tended to be judged in the way that most investments are judged; in the short term.

How did my shares do this month? How did the fund manager perform last year? It could be argued that this view encourages the pursuit of short-term gain through trading rather than the careful management of investment over the long term. This is not an easy cycle or mindset to break. Given the choice most people would like to think they are more focused on long-term growth and careful management of funds companies. In reality, they judge the performance of the fund on short-term measures.

Social/ethical issues
These are starting to become more important and feature in people's decision making around their investments although ROI is still regarded as the most important issue across all groups

Engagement on the issue of ethical investment is not particularly clear or focused in the minds of many investors. Participants typically said things like *'I don't want my money spent on arms'* but didn't tend to go much beyond this, and in many cases there is the perception that social and ethical means more expensive or less profitable, which significantly undermines how investors see this as an issue. In any case, investors have very little awareness of where their money is actually being invested, so social and ethical considerations are limited to a fairly narrow frame of reference.

Cost
This is a consideration, but not one that features heavily on the list of priorities until it is explained in detail, particularly the impact cost can have on the final ROI.

> *"I can't believe the amount of my pension I lose through charges… I knew charges were high but I didn't think they were that high"* (male investor).
>
> *"We're getting charged a lot for not very much work"* (female investor).

The unifying concern around pensions is return on investment. All other concerns are secondary to this issue. However, given the rise in ethical and social considerations and only fairly limited access to information around pensions, one can clearly see a need for a new system that gives citizens greater control of their pension, even if that is just by giving them greater access to information and allowing them to make more considered choices.

3.2 Ethical considerations

3.2.1 Corporate Social Responsibility
The term Corporate Social Responsibility (CSR) is not a straightforward for investors either in terms of how it can be defined or how individuals can relate to it. There were two clear schools of thought on the subject of CSR among the participants. One that says that this is an entirely subjective viewpoint and therefore almost completely unmanageable; another that there is a baseline of what

we as a society deem socially acceptable behaviour and/or business practices that we can all recognise and abide by – you work from this point upwards.

> *'What's ethical to me isn't likely to be ethical to him now is it?'* (male investor).

The fact that there is no clear consensus about the meaning of the term CSR highlights just what a difficult and emotive issue this is to deal with. To then be asked to exercise choice as a consumer around the issue is even more difficult, although on the day the Co-Op was frequently cited as an example of how simple consumer choices can be made despite lack of clarity on the definition of the term.

There is a clear knowledge gap between the different types of investor on this issue. The phrase ethical investments seemed to work better for the more Passive Investor. For them that term seemed to mean generally making good and positive investment choices.

Behaving at all times responsibly and with integrity is what CSR really boiled down to for this group, and once they agreed on this way of thinking in relation to ethical investments the idea started to resonate with them. This research affirms the importance when trying to engage the public at large on this issue of using language that does not detract from the issue or worse still act as a barrier to engagement.

3.2.2 Does CSR equate to less efficient and profitable?

A key concern to stem from the discussions around CSR is that in the minds of many consumers and investors the terms CSR or ethical trading equates to less efficient and therefore less profitable companies.

The notion that a company with a good track record on CSR can be more profitable or can benefit society as a whole is not typically the current mode of thinking. In many people's minds it is as if you have a choice of ethical and lower return, or invest at will and chase maximum ROI.

On the day, the issue of ethical trading and how it impacts on profitability leads into the discussion of externalities – how, if a company damages our society or the environment in order to make a quick profit, the gains made in the short term from that profit are wiped out in the long run as we pay to clear up the mess.

This concept was not one that most people had thought of, and one many struggled to understand or engage with, particularly when trying to relate it back to their own investments. Many people have a hard time reconciling the notion of externalities with their personal finances. There is an underlying feeling that they will be personally losing out somewhere along the line if they invest in ethical products. There is also an expectation that government should be the one responsible for regulating industry and ensuring that companies operate within the law or in a way that we deem socially acceptable rather than it being primarily the individual's responsibility.

When trying to explain some of Tomorrow's Investor underlying principles it was easier and more impactful if the frame of reference was personal financial gain or loss on the most basic and personal level. More complex economic theories failed to resonate with our consumers.

3.2.3 Engaging with Corporate Social Responsibility

The idea of engaging with CSR or applying some of the principles of CSR or ethical behaviour to their day-to-day lives or even their investments is not an easy one for most people to grasp.

The current mode of thinking is that it is much easier to demonstrate your views on the issue of CSR or ethical trading via your purchase behaviour than it is through your investments, particularly indirect investments such as pensions. This is just a case of mindset though: the fact that consumers are making clear choices via their purchases on ethical issues shows that there is appetite for choice around ethical issues.

Investors, like consumers, need clear, simple and easy choices. It is a relatively simple and easy decision to take money out of your pocket and hand it over in a retail environment. Trying to gain more control over how the money you have entrusted to an organisation to invest on your behalf is harder and more complex. If a choice framework can be provided and investors can see personal as well as social benefits from their investment choices then it is possible to change behaviour around investments such as pensions.

3.3 Response to expert opinion

3.3.1 Key messages

The format for the panel allowed respondents to hear experts argue that the pension system in its current format is fundamentally flawed. David Pitt-Watson in particular was clear that unless we as citizen investors start to have a greater input into how the companies we indirectly own are run, the interests of these companies and the pension funds that invest in them will never be aligned with our own.

Participants also heard Robin Ellison argue that citizen investors should not expect to have to get involved, and that it's better for all concerned that these matters are left to the professionals in charge.

Despite the use of a number of key speakers at the event, the arguments put forward were seen as falling into these two distinct camps. The other speakers' arguments tended to be used by participants to supplement one of these opposing standpoints. The key point that the majority of attendees took away with them from the event was the issue of charges in relation to their pension. There was a massive reaction to the news that they could lose up to 40 per cent (roughly equating to ten years worth of contributions) of the value of their pension over the course of its lifetime.

This came as a huge shock to most people, strong enough to really get them to think about their investments and the people they have entrusted to look after them.

Charges in relation to pensions are not something most investors have fully grasped or feel they have been given enough information about from their pension provider. In many cases investors do not even know what they are being charged. There is also little or no awareness of any differences in the market on this issue, although a pension scheme that could offer real value in terms of its charges would have a clear point of differentiation in the marketplace. However with most investors unaware of what they are being charged and how this impacts on their investment a process of investor education is as important as offering greater choice and better value.

3.3.2 Investor understanding

Finance is not an easy subject for a lot of people to grasp, as was evidenced by the discussions at the deliberative event. Pensions in particular are remote and mostly detached from people's everyday awareness, and trying to get them even to think of their pension as a portfolio of shares is quite difficult. Trying to get them to then think of those shares as small stakes in a multitude of different companies is even more difficult. Trying to get them to think that they can somehow exercise rights over those shares in order to influence the behaviour or direction of a company is a further barrier still.

The arguments for increased engagement – like those put forward by David Pitt Watson – require a major shift in the established consumer mindset around pensions. To many people his theories represent an almost entirely new and largely abstract way of thinking about their pension. On the day, not everyone agreed with what he said. Even if they did, they found the thinking inaccessible and alien; for some it was almost completely detached from their perception of reality around pensions.

The opposing viewpoint presented by Robin Ellison proved less of a problem. Key to this was the message that it's OK not to be too concerned about these issues. In an environment where established thinking was being quite rigorously challenged and some people felt they were a little out of their depth, this was the lifejacket that many people clung to. Others picked up on it but chose to interpret it in a different way. They could see how appealing it was to hear this message but felt they had to resist the lure of the easy cop out.

3.3.3. Investor responses

Overall the majority of attendees found the presentations engaging and stimulating. The theories put forward by David Pitt Watson in particular were not something most consumers had been thinking about.
Some of the Active Investors found that the information presented on the day made them review their relationship with their investments, particularly the faith they had in their pension provider and/or fund manager. The more Passive Investors struggled to grasp some of the concepts being put forward
For both groups however, the information raised as many questions as it answered.

Central to this was how you take these theories on to the next step and deliver practical solutions or choices. How do you go about empowering citizen investors? What are the practical solutions? This was a stumbling block for many at the event and served to highlight the need for clear, simple and easy choices in this field. People could see the merit in the arguments being put forward but could not then reconcile these with practical application.

People could see the merit in the arguments being put forward but could not then reconcile these with practical application

What the more Passive/Occasional investors took from the event was:

* It is okay to talk about pensions and investments
* Some of it is more understandable and accessible than you might think
* Companies haven't been sharing as much information as they could with customers in relation to pensions
* It is possible that companies associated with pensions may not always be working in the best interests of their customers
* Someone (maybe the government but definitely not me) needs to keep an eye on what's going on 'just in case'

3.3.3 Regulation and the state

Other issues raised included those put forward by Mark Goyder from Tomorrow's Company who claimed that we (as citizens) effectively abdicate our responsibilities if we don't take a more active interest in the way the companies we are investing in operate. This notion was generally rejected, the consensus being that it is not the responsibility of ordinary citizens to ensure companies operate within the law; it's the responsibility of government. If companies are acting illegally, or operating in an irresponsible manner that is within the boundaries of current laws then we need tighter regulation, not a more devolved power structure that encompasses citizen investors.

There was also a general sense that citizens are too time poor and it is neither practical nor realistic to expect them to be actively involved in the running of all the different companies they might have invested in. This was a common theme that ran through discussions in all of the groups. They might not like the current situation but they didn't feel in a position to do anything about it. It all seems too remote, too inaccessible and too complex for them to get seriously involved. Engagement and the sense that it is easy to make choices around this issue are as important as the choices themselves.

Marc Jobling's presentation also led to discussion of regulation. A common reaction here was that the ABI is funded by the major FTSE 100 listed companies, and as a consequence is compromised by the very nature of its funding.

> *"How can they as an organisation monitor and exercise any real power over the very people they need to keep their own organisation afloat?"* (female investor).

Citizens are typically looking to the state to take the lead through regulation and enforcement.

When really pushed respondents admitted that although in theory individuals are an important link in the chain, in practice, it is a bit unrealistic to expect them to play an active role. There was a strong sense that no-one is likely to care what the individual investor thought or felt. There were also some fears that individuals are potentially the weakest link in the chain; and that collective action – conceived as "interference" – could actually be detrimental to the system.

Several respondents latched onto John Gray's presentation. His ideas resonated with their situations and the set up of their pensions. Those respondents who were teachers and had pensions through their local authority were particularly interested in what he had to say about making changes to where pension funds are invested. They were encouraged to find that when individuals took a stand they could have an impact.

A key theme to emerge was the level of faith investors placed in the organisations managing their pension schemes. Listening to the five speakers and effectively going through a process of education had the effect of stopping some people from being so trusting and so passive in relation to their investments. However without practical choices or solutions to the issues being addressed there was still a gap between what people wanted to do with their investments and what they could practically undertake. This was particularly an issue for those nearing the end of the pension or those who were already drawing their pension.

3.3.4 Impact on future behaviour

A key finding to come out of the event across all three groups was the sense that they as investors would like more information and more transparency from the companies in charge of their pensions. A threefold approach would probably be required in order to deliver a practical solution to this issue: more information per se, but also greater access to the information and a change in the dynamic of the relationship between investor and investment agent. This would need to be driven by a more proactive approach from the pensions company looking to engage investors and bring them into the decision making process and turn them from passive to active investors.

On the whole most investors are loathe to get too involved in moving existing products/services, particularly their pension which is universally regarded as difficult to negotiate or navigate. They want most of this done for them. They also don't feel they have the time or expertise to become closely involved in the decisions around their pension, such as where and how the money is invested on their behalf. That is not to say that given some practical and easy to make choices they would not exercise them. Determining exactly what those choices are and the impact they would have on the different investor groups and their pensions is something for another project however.

There is a fairly strong belief that the state will ensure that companies are being run within the boundaries of acceptable behaviour and that additional legislation will be brought in if required. The idea that it could be the responsibility of a collective of individuals has some appeal but they don't currently envisage a way in which it could be either manageable or effective.

The notion that individuals are powerless was a recurring theme throughout the discussions, a view based on what the participants saw as a lack of clear alternatives. The most common questions throughout the discussions were around what the alternatives were; what could they do as an individual; and what engagement would look like in practice.

The most common interpretation of how a more empowered citizen investor might exercise their rights and help to shape and drive corporate behaviour that best serves the interests of the citizen investor and society as a whole is through voting. However, the idea that they as a share holder would be expected to cast votes and help make decisions regarding the companies they collectively own is generally regarded as completely impractical: as individuals would have neither the time, expertise or inclination to educate themselves about the multitude of different companies they hold indirect shares in via their pension.

3.4 Alternative financial models

With our citizen investors struggling to find practical ways to implement some of the ideas they heard on the day, we decided to present them with two possible alternative financial models related to the pensions market.

3.4.1 Option A – a new type of pension or savings vehicle:

* Profitable and sustainable in its own right
* Offering low cost/high return savings
* Actively participating in ensuring capital markets and companies are run in the best interest of citizen investors

Reaction to this was universally positive. After the discussions about pension companies and high charges, lack of value, poor returns and lack of investor involvement this model was seen as the perfect antidote. The main appeal of a product such as this though was the rate of return rather than anything around empowering the investor. These aspects of this option were regarded merely as nice-to-haves. Although this was just testing of a proposition at its most embryonic level a number of issues were raised that could have a significant impact on the take up of a product such as this, were it available:

* What is the customer journey? How much free will do consumers have in the market when choosing their pension? In short, do you need to target consumers directly with an offering such as this or do you really need to be appealing to agents acting on their behalf?
* How easy is the product to understand? Most people don't want to have to think about it too hard, and although the concept of an empowered investor

has some appeal it mustn't come across as complicated or an imposition on their time.

* How easy is it to switch from my existing pension?

Participants were in general very enthusiastic about this option. Some voiced doubts, however:

> *"That's the Holy Grail isn't it, that's what every investor hopes to find, but my initial reaction would be that if something looks too good to be true then it probably is"* (male investor).

3.4.2 Option B – Proxy voting

We tested how investors reacted to being given the option to transfer their voting rights as indirect shareholders to organisations that they might trust or believe to share their values such as trade unions or charities.

Participants found the idea of proxy voting interesting, but were on the whole suspicious.

> *"How can I be sure that the people I give my voting rights to share my views, even if they're from a charity I personally support?"* (female investor).

However, several people expressed an interest in this and said they would be happy to give their voting rights to a third party if they trusted that organisation. This was also seen as the only practical solution to the problem of how to exercise your voting rights for the numerous companies that you indirectly hold shares in through your pension.

4 Key findings

4.1 Today's investor

Investor awareness and understanding of the pensions market varies considerably, and there are a significant number who have only very limited knowledge regarding the details or mechanics of their personal holdings, particularly their pension.

Pensions are almost universally regarded as the most important financial holding an individual owns, yet conversely are the financial holding consumers feel the most detached from. There is currently a wide gap between the perceived importance of pensions and the amount of knowledge, understanding and engagement the average consumer has in relation to their pension.

Consumers typically intend to engage with their pension only on a superficial level and do not exercise any real say over how or where their money is invested. This in turn drives distrust in the market.

Trust in the pension market is in increasingly short supply. Consumers see pension shortfalls and are worried about their financial future, but don't feel they have any choices or opportunities to give their investment the best possible chance of delivering what they want at retirement.

A number of factors are responsible for consumer disconnect from the pension market

- A customer journey which disempowers consumers
- Lack of tangibility – pensions seem too distant, too far in the future
- Lack of inclusiveness – pension companies discourage consumer awareness or participation
- A sense of powerlessness and a lack of clear alternatives

The greatest concern relating to the pension market is a pension shortfall at retirement. Social and ethical issues are starting to become issues for some investors, but for the majority they are secondary concerns.

There is an established view that ethics come at a cost. The notion that a company with a good track record on CSR can be more profitable is a relatively new one to most people.

Privately owned shares show that consumers can be more involved and active in their financial holdings. However, the primary goal among those who do hold shares in this way is typically short term financial gain.

The concept of shared ownership is an alien one to most investors. Shares are typically seen as a commodity to be traded for short-term financial gain. They are not seen as a small stake in a company to be nurtured for long-term growth.

There is a disconnect between private share ownership and indirect share ownership through a pension scheme. Investors do not think of themselves as shareholders through their pensions, they merely think of themselves as pension holders. They find it difficult to reconcile their short term view of sharedealing with their more long-term view of their pension.

Citizens currently prefer to exercise choice through their purchases rather than through their investments.

4.2 Tomorrow's investor

Quite a lot of the people who attended the deliberative event struggled to grasp the concepts presented to them. The main barrier to understanding was the somewhat abstract or theoretical nature of what they were being told. They struggled to reconcile what they had heard with their own experience. This highlights the need for clear, simple and easy choices as well as straightforward language and communication. Only by engaging with investors on their terms and in a way they can understand can you hope to drive a change in behaviour.

Despite the undoubted importance of pensions there is quite a lot of resistance from individual investors to becoming more involved in the way individual investment schemes are being run on their behalf. Investors want security, good returns, and ethical investment where possible but are not as a rule prepared to get personally involved to ensure that this takes place. There is a sense that the state rather than the individual investor should be responsible for monitoring the behaviour and conduct of big business. If citizens are to be more engaged then it must be accessible and manageable for them to do so.

Consumers react positively to the idea of a new type of pension fund but their primary motivation is personal financial gain rather than notions of a more empowered citizen investor. If you can offer consumers an attractive financial proposition that also adheres to principles of inclusiveness and CSR you are on to a winning formula, but it's important to bear in mind that for many the primary appeal of any such a product is the rate of return.

The single piece of information that generated the most discussion throughout the whole day was the news that in many cases the charges related to an individual's pension could account for up to 40 per cent of the value of that pension over the course of its lifetime.

The investments market and the pensions market in particular are not easy waters to navigate for most consumers. Typically investors do not want to get heavily involved in the day-to-day running of their investments and do not generally feel qualified to do so. At the same time there is an underlying sense that they are being excluded by the very nature and structure of the markets. If they can be presented with simple and easy to make choices regarding their investments and they can see clear and tangible benefits to those choices then they can exercise choice and enforce change in the markets.

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