The future savings challenge

The implications of Generation Y's attitude to finance and sustainability

In association with

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The implications of Generation Y's attitude to finance and sustainability

by William Andrews Tipper

Green Alliance
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Foreword

Saker Nusseibeh
Chief executive officer
Hermes Fund Managers

In the debate about the future of the financial system and the reforms needed to ensure it is better positioned to serve its proper purpose in society, it is often forgotten that the investment industry is merely an agent for ordinary savers. They are often excluded from the discussion by the 'professionals' and the academics. Such exclusion reflects the disassociation of the ultimate asset owners from the actions undertaken by their agents, which in many ways has contributed to the dysfunctionality of the industry.

This disassociation is especially pertinent when it comes to the views of the young. By definition, they have a vested interest in the longer term outcomes of the decisions we are making in the allocation of capital on their behalf. Moreover, our decisions regarding the way we structure our economy in terms of sustainability and the environment will have a greater impact on their quality of life than on ours.

This work by Green Alliance is, therefore, important in that it is the first serious attempt, to my knowledge, to reach out to the younger generation through focus groups to try to assess their views around their savings and, more importantly, their ability to influence the investment ecosystem of the future through their actions.

In some ways, the findings of the report are not surprising. There is, in that segment of society as in all others, a well deserved sense of distrust when it comes to financial institutions. There is also an understandable focus on short term needs, as this generation seeks to establish its independence following higher education.

However, in some regards, the results are not what the investment industry, or environmental activists, would expect. There seems to be either a lack of awareness among that generation of their power to influence the future shape of the economy with regards to environmental issues collectively, or a reluctance to do so, unless it is seen as part of a societal move. For the asset managers who hope to engage with this generation as potential customers, especially as we move towards a defined contribution model, there is a clear indication that the communication methods used by the industry are neither effective, nor trusted.

For me personally, the study is a welcome reminder that there is much work still to be done on two fronts. First, it is necessary to directly engage with young investors and encourage them to understand and use their collective ability to shape the future allocation of capital by their agents. Second, for those of us who are committed to a more environmentally sustainable future, to advocate to that segment of society that they should consider this more urgently.

Summary

Society needs a strong, resilient savings sector to tackle major social and environmental challenges. The transition to a low carbon economy will require significant capital investment over the course of the next two decades and individuals' savings will be an important source of infrastructure funding. Increased life expectancy and an ageing society will significantly increase the costs of retirement, requiring consumers to have well-funded savings and insurance pots.

Reducing the environmental footprint of economic activity is critically important for the long term prosperity of Generation Y, also known as millennials; this is the population cohort born between 1980 and 2000. Projections show that, without a significant growth in investment in low carbon projects and sectors, they will be retiring into a world seriously affected by dangerous levels of climate change.[1] Their attitude towards saving and investment will help to determine the level of private investment in the low carbon economy over the coming decades.

The results of our research

We undertook qualitative research with 37 young professionals from this cohort to test their attitudes towards financial services, long term saving and sustainable investing. This research has highlighted specific challenges which the savings sector and policy makers will need to respond to.

First, the scale of the disillusion felt by these young adults towards financial institutions is undermining their trust in investing. Generation Y is risk averse and financially cautious. This attitude is underpinned by a lack of trust in financial institutions and chronic financial insecurity. Our research indicates that suspicion of investing is as significant as limited financial resources in determining their preference for cash savings products. This may change as they age and develop greater financial clout and confidence. However, what we heard suggests that these are entrenched attitudes which will be hard to shift.

Second, young adults are largely unaware that the value of their savings is being exposed to climate change-related risks. Stock market holdings in carbon intensive sectors such as fossil fuel extraction are an important component of many pension portfolios.[2] Research suggests that fossil fuel companies may be significantly over valued,[3] creating risks that Generation Y's pension pots could be subject to substantial write downs. High carbon investments face additional long term financial risks from both climate change-related shocks and from the macroeconomic instability that would accompany significant warming of the climate. The young people we worked with were unaware of these risks.

Furthermore, the common assumption that Generation Y will seize the initiative to address sustainability threats was not borne out in the attitudes we found in our focus groups. Many were sceptical about financial approaches focusing on investment opportunities in the low carbon economy. There are signs that this cohort may actually feel less agency and empowerment to influence their environment than previous generations.

The Generation Y savings challenge

The generation which is vital to the future of the savings sector, and will be most affected by its current investment patterns, has very little interest in long term saving or in challenging unsustainable practices.

Auto enrolment, the government programme to enrol UK workers into workplace pension schemes, represents an opportunity to tackle the Generation Y savings challenge. It is already launching many young workers on a long term savings path; early evidence suggests the young have embraced it in far greater numbers than anticipated. It has the potential to be the start of a new conversation between the financial sector and consumers about how finance can help to meet their needs and those of society more broadly. Effective engagement with the financial sector on climate and environmental issues will enable young adults to assume more responsibility for how financial institutions use their savings, encouraging scrutiny and rewarding good practice.

Nevertheless, new approaches will be needed to ensure that auto enrolment delivers for Generation Y. Members of this cohort will need to save sums over and above those mandated by auto enrolment if they are to enjoy adequate incomes in retirement. There is also a need for stronger safeguards to ensure their pension pots are not exposed to unacceptable levels of risk from climate change impacts.

Our recommendations

We make four recommendations, two for the savings sector and two for policy makers:

Savings sector

1. Pension providers should use auto enrolment to form new partnerships that build consumer trust in investing

Auto enrolment represents a 'trigger point' for many in Generation Y, a financial milestone that could lead to the formation of new financial habits. Realising this opportunity will require credible, independent financial education to be available via workplace schemes. Pension providers should explore the potential for this to be delivered through collaboration with credible third parties, such as employers' groups, unions or NGOs. We have demonstrated that sustainable investment approaches can resonate with Generation Y, if such approaches can be seen as credible and safe.

2. The savings sector should actively communicate product level information on climate risks to engage savers on these issues

If consumer choice is to be a driver of change in the savings market, the savings sector will need to adopt approaches that enable savers to differentiate between investment products based on their resilience to climate change. For pensions, this would mean product specific information on carbon emissions (see recommendation three) and strategies for reducing climate risk. To ensure this information can actually influence consumer decision making, the sector should identify communication approaches that make this information comparable and relevant to young savers.

Policy makers

3. The government should require pension providers which benefit from auto enrolment to disclose to customers the carbon impact of their investments

Current investment practices mean that many young workers are being auto enrolled into pensions with excessive exposure to carbon and climate risks. Given the urgency for new safeguards to be introduced, and the benefits of a standardised approach to disclosure, government intervention would be appropriate. There should be mandatory disclosure by pension providers of portfolio carbon emissions, including operational emissions and those embedded in fossil fuel reserves, to scheme members at the point of auto enrolment and in subsequent reporting. A similar requirement already exists for major UK listed companies.

4. The government should explore options for reforming pension tax relief so investments in high carbon assets are no longer subsidised by the state

The government should work with stakeholders to define how new forms of conditionality addressing climate change could be applied to tax relief, such as developing criteria for assessing the appropriateness of pension funds' approaches to climate risk management. It should also consult on appropriate conditions under which this conditionality could be applied; for example, funds where risk management is judged inadequate could ultimately be excluded from the market.

1.

Mapping the Generation Y challenge

There are 14.5 million adults in the UK aged between 18 and 34.[4] This generation is set to bear a heavy financial burden in the years to come. The UK's ageing population will require increasingly significant financial contributions from its workforce over the coming decades to fund incomes for retirees. Between 2012-13 and 2062-63 public spending on the state pension is projected to rise from 6.0 per cent of GDP to 8.4 per cent.[5]

University students are already accumulating substantial debts from higher education tuition fees. The government's commitment to protecting universal benefits for the elderly and funding welfare spending cuts from working age citizens will make even greater financial demands of the current generation of young adults. It is not surprising that they are projected, by the Social Mobility and Child Poverty Commission, to be materially less well off than their parents.[6]

Young adults, often referred to as Generation Y or millennials, those born between 1980 and 2000, will need to accumulate substantial savings if they are to have the financial resilience to manage these challenges. Long term saving through pensions and other products will need to be a particular priority, given the likely decline in the real value of the support they can expect from the state. What's more, these savings will need to address the challenges of climate change effectively if consumers are to enjoy reasonable financial returns. This is for two reasons.

First, because resource scarcity, extreme weather events and other environmental consequences of climate change will create a range of financial risks, both in macroeconomic terms – the Stern Review projected that a five to six degree rise in global temperatures could wipe up to ten per cent off global GDP[7] – and at the level of individual investment strategies, such as real estate investments threatened by rising sea levels. Pension funds will need effective strategies for addressing climate risks if they are to be insulated from climate change-related shocks and enjoy a more stable, predictable investment environment.

Second, because the low carbon economic transition will create a range of investment opportunities that could be particularly suitable for pension funds and other long term investors. Regulation introduced after the financial crisis has reduced the availability of long term and low cost funding from banks, and pension funds are being looked to as alternative providers of long term capital for infrastructure. Green infrastructure, such as low carbon energy generation, sustainable transport and energy efficient buildings, has been recognised by the OECD, among others, as having significant investment potential for pension funds. The characteristics of green bonds – fixed interest debt instruments financing low carbon or environmental projects – make them particularly suitable for pension funds. However, current levels of investment are significantly below the levels required. It has been estimated that meeting global green infrastructure needs will cost in the region of US$2 trillion per year up to 2030, of which only half is currently being delivered.[8]

While consumer returns from cash based savings products are far less exposed to climate and environmental risk factors, the ways in which their savings are loaned or invested by banks will help to determine the pace and nature of climate change. Therefore, savings institutions should be considered when assessing financial sector responses to global environmental challenges.

Understanding the attitudes of young adults to sustainable investing is essential if the savings sector is to develop approaches that are both compatible with climate challenges and appealing to this cohort. We set out to contribute to this understanding by probing the approaches to saving currently being taken by young adults, their attitudes towards climate and environmental investing, and how appealing they found ethical and sustainable financial products. During 2013 we worked with 37 young professionals in their mid-20s. This report describes the attitudes we found and suggests the implications for the consumer savings sector.

Methodology

Focus groups

Four sessions in central London during June 2013.

30 participants aged 21-26, all graduates working in professional jobs in London.

Equal gender split, two all male groups and two all female groups.

Half living independently, half with parents.

Those with very strong positive views about the environment were screened out.

90 minute discussions probed financial status and behaviour, environmental and ethical decision making, and reactions to messages about ethical and sustainable finance.

Workshop

Session in July 2013 for seven young adults (none of whom had participated in the focus groups) and seven professionals from the financial services sector.

The young adults were asked to rate two fictitious 'white label' financial products (equity ISAs); one explicitly sustainable and one not.

The group was sub-divided into three (each including young adults and financial professionals) and were asked to formulate product marketing strategies for the sustainable financial product, aimed at young adults.

The focus groups and workshop were facilitated by Britain Thinks, a leading independent research consultancy.

2.

A problem of trust and understanding

There is a strong savings culture among Generation Y, focused mainly on cash products. However, this is coupled with scepticism about financial institutions and an aversion to investing, associated with risk. The savings industry will need to find ways to address these perceptions if Generation Y's cash saving habit is to develop into an acceptance of investing.

The UK population's savings habits have changed considerably over recent years. Government data shows that levels of consumer savings and investments declined markedly over the course of the financial crisis. In 2007, the average UK household saved or invested £7.10 per week; in 2009, it was £6.50; by 2011, it had declined to only £5.20.[9]

This absolute decline masks a more subtle change in financial habits. UK consumers have been increasingly favouring cash deposits over investment products. Between 2007-08 and 2010-11, annual contributions to cash ISAs (Individual Savings Accounts, a tax exempt consumer savings account) increased from £25.3 billion to £38.2 billion, an increase of over 50 per cent.[10] During the same period annual personal pension contributions in the UK fell from £10.2 billion to £7.7 billion, a decline of 25 per cent.[11]

As growth returns to the UK economy, it is perhaps to be expected that consumers will, over time, choose to place more of their savings in pensions and other long term financial products. The sector's prospects for growth will depend upon this being the case. Hundreds of thousands of people retire and cash in their pensions each year (over 400,000 people with defined contribution pensions buy annuities annually[12]), and they need to be replaced with new savers. The financial sector needs to understand how, as Generation Y accumulates wealth, it is likely to approach saving and investments.

Hardest hit but saving

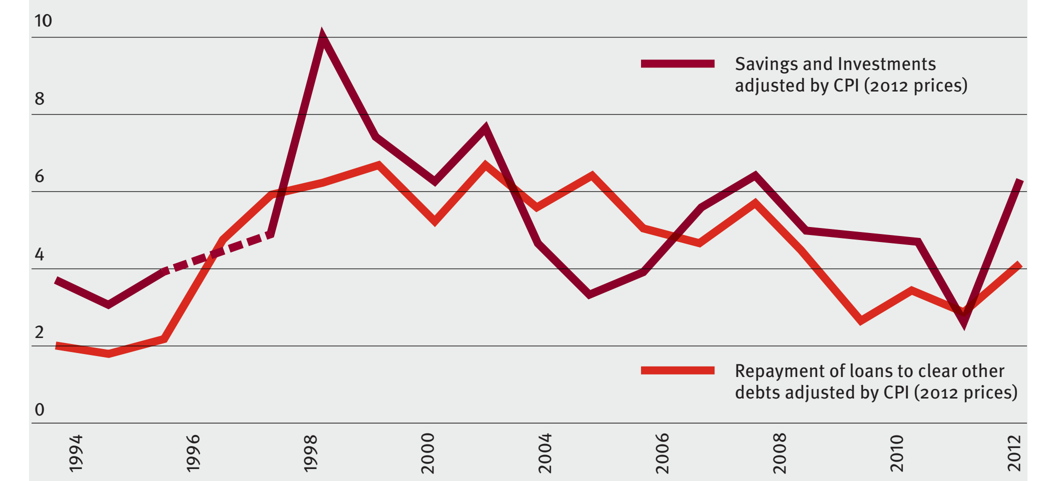
A range of stereotypes are commonly attached to the financial behaviour of young adults. That they are too busy 'living in the moment' to save; that they are too overloaded with debt to be able to afford to save; or that they have too little money for saving to be possible or worthwhile. The results of our research challenged all these views.

Generation Y's economic situation is undoubtedly bleak. Almost half of the UK's recent graduates are working in non-graduate jobs. The most recent class of graduates is earning 12 per cent less than their pre-crash counterparts and owes 60 per cent more student debt.[13] Employment rates for 18-24-year-olds are still eight percentage points lower than before the recession, at 56.7 per cent.[14] A fifth of 18-24 year olds are not in full time education or employment and working age unemployment remains at nearly 2.5 million. As a result many of these young people are no longer willing or able to afford to live independently and have moved back in with their parents. It has been estimated that, in 2011 alone, three million 'boomerang' children went back to live in their family homes after a period of independent living.[15]

The future savings challenge

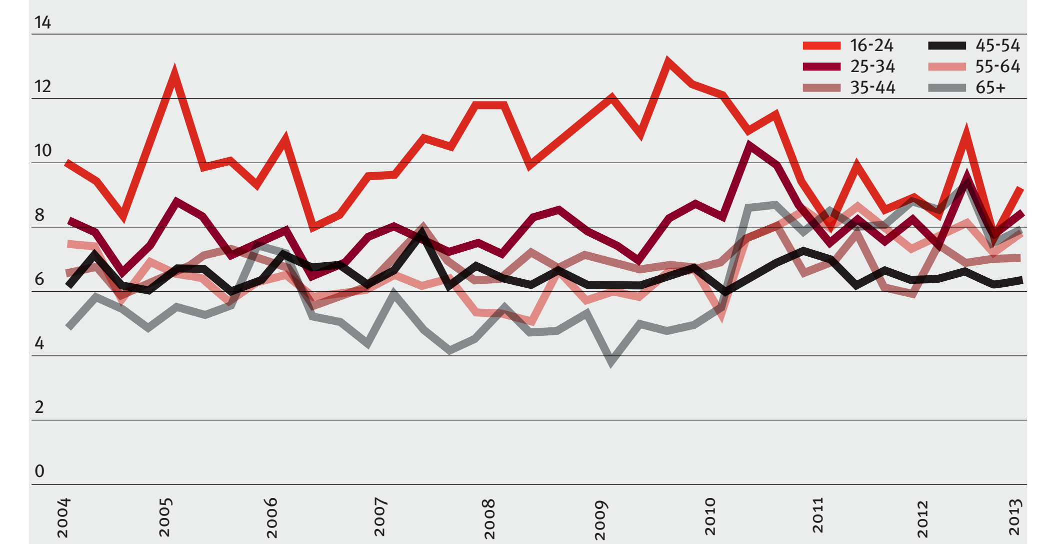
Yet, while young adults may lack the financial resources of older generations, they are nevertheless highly committed to saving. Government data shows that debt is not preventing them from saving. Since 2005, under 30s have on average saved and invested more than they have spent repaying debt every year except in 2011, when debt repayments were marginally higher.[16] While average savings levels have fluctuated considerably over the past decade, the average amount spent by the under 30s repaying debt has seen a downward trend.

Average weekly household expenditure for under 30s 1994-2012 (£, adjusted by 2012 CPI)[17]



While the absolute sums saved by young people are small, as the graph below shows, when calculated as a percentage of income, it is the youngest savers who consistently save the most of any age group.[18 19]

Percentage of income saved by age 2004-13[20]



Simple financial needs and cash products

Young adults mostly have relatively simple finances and often quite specific financial goals. Research has consistently demonstrated that young people are more likely than other age groups to be saving for a specific purpose.[21] A large majority of the young adults we worked with were saving towards defined goals, predominantly a mortgage deposit or to enable a move away from the parental home.

Young adults have a strong preference for keeping savings as cash in the bank. Participants in our focus groups all had a current account and some kind of savings account, while a smaller number had ISAs and credit cards. All were with high street banks, and generally with only one provider.

Our focus groups suggested that the basic offer from the financial sector does not resonate with young adults. Participants exhibited extremely low interest in personal finance, coupled with very low levels of knowledge and understanding about financial services. There was significant uncertainty about how banks make money, what happens to depositors' funds, and how investment funds work. Participants viewed banking as a utility, seeing little value in products or services beyond simple savings accounts.

Research among 16-24 year olds commissioned by the government-established Consumer Financial Education Body (the former name for the Money Advice Service) concluded that "[Young people] have a low interest in finance. They do not believe there are financial benefits to engaging more fully with financial products. They feel that there is little innovation and differentiation between these products, which limits their interest and engagement."[22]

A snapshot of Generation Y's financial product ownership[23]

	Under 25	25-34
Proportion with a current account	85.2%*	91.10%
Proportion with a savings account	54.8%*	70.10%
Number with a cash ISA	1,213,000	1,920,000
Number with a stocks and shares ISA	46,000	184,000
Number with a personal pension	200,000**	920,000

*Age bracket 18-24
**Age bracket 16-24

"Your money in your account – it's sort of there but it's not there."
Female

"There was a rumour in Cyprus that if everyone tried to pull out their money at once they wouldn't be able to. So they must be doing something with it."
Female

A preference for thrift over returns

Recent consumer surveys have concluded that young adults are financially conservative, risk averse and fearful of stock market investing.

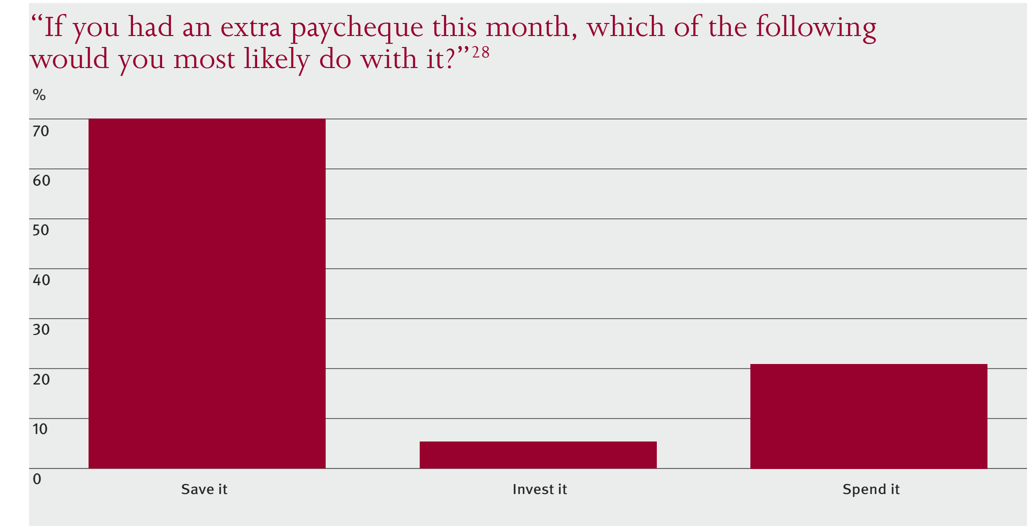
A 2014 study by UBS identified that Generation Y sees working hard and living frugally as the main ways to achieve success in life, with only one in four believing that long term investing has a role to play.[24]

A 2013 study by Mintel found that only six per cent of 18-24 year olds and seven per cent of 25-34 year olds owned a stock market-based product other than an ISA or pension, significantly lower than older age groups.[25]

A 2012 study by MFS found that 37 per cent of Generation Y agreed with the statement "I will never feel comfortable investing in the stock market."[26]

A 2013 FT - Telefónica Global Millennial Survey found that young people in the UK were ten times more likely to save an extra pay cheque than to invest it.[27]

"If you had an extra paycheque this month, which of the following would you most likely do with it?"[28]



Our focus groups confirmed these findings. None of the participants had private pensions. Only a very small number had investments, which were in all cases gifts from family members or an inheritance. Very few, particularly amongst the female groups, would consider stock market investing. While one or two had the impression that good returns would not be possible in the current economic climate, most were simply uncomfortable with having to manage the risks they perceived to be involved.

"You have to know what your talking about with stocks. Otherwise you make some stupid choices."
Male

"I wouldn't take advice from a bank that had to be bailed out – if they can't manage their own affairs, how can they help with mine?"
Female

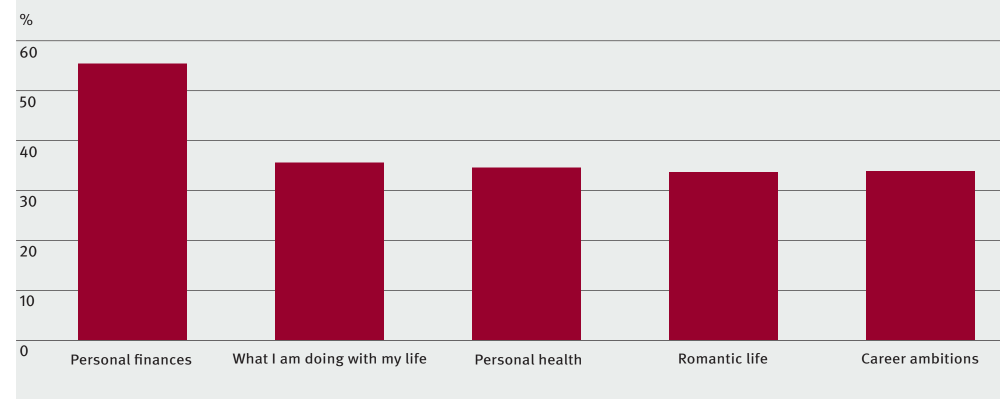
Insecurity, risk and disillusion

Generation Y approaches financial decisions with a high degree of caution. There was a strong association in the minds of those we spoke to between finance and risk. Accordingly, they have a high propensity to seek advice before making major financial decisions. However, only a small proportion use financial advisers to guide their choices. Instead, they turn to those they trust for guidance: their parents, friends and partners.[29]

These attitudes reflect a fundamental lack of trust in banks. None of our focus group participants were warm about their bank, and many were openly hostile. None thought their bank was particularly ethical. Responses were mainly focused on mis-selling stories, bank charges, poor customer service, as well as the banks' role in the financial crisis, taxpayer bail-outs and excessive bonuses. These negative feelings towards the financial sector are common. Only 2.1 per cent of 15-24 year olds and 1.8 per cent of 25-34 year olds believe that banks are very well run. In contrast, over 70 per cent of each age group believe that banks are not well run.[30]

These attitudes feed through into a strong sense of pessimism with regard to money. The FT-Telefónica survey highlighted that personal finances are the issue that most concerns Generation Y in the UK.[31] Nearly two thirds of young adults said that they expected to have to work indefinitely, versus only 37 per cent who expected to be able to retire comfortably.

"Thinking about your future, which of the following are you most concerned about?"[32]



"I'd say it [trust] is on a similar level to energy companies and trains. The cost to the average consumer increases and massive bonuses get paid out, and the benefits don't go to you as a consumer."
Female

"There's too much profit to be made from unethical trading – I don't think banks can really be that ethical if they're going to be successful businesses."
Female

Auto enrolment will not be enough

The UK has suffered for some time from a chronic shortfall in levels of retirement saving. In 2010 Aviva estimated the UK's pensions gap at £318 billion, or £10,300 per adult annually.[33] This is in spite of the government's efforts to incentivise consumers to save by applying tax relief to pension contributions. Not only has this been ineffective, but it is also costly: Michael Johnson has calculated that in the ten years up to 2012 it had a net cost to the Treasury of £17.5 billion.[34]

Since 2012, a new government scheme has applied whereby workers are automatically enrolled into a workplace pension. It is expected to transform the UK pensions market, increasing assets under management in workplace pension schemes more than six-fold by 2030.[35] Auto enrolment has already had significant success at bringing young people into the long term savings market. By 2013 not only had 48 per cent of 25-34 year olds been auto enrolled (more than other age groups), 87 per cent of those approached had chosen to stay in their scheme.[36] In our focus groups, a small number of participants were aware of having been recently enrolled into a workplace pension. No-one who had been offered this option had opted out.

Auto enrolment

This is a UK government initiative to increase the levels of consumer retirement savings. It has applied since October 2012 to larger companies with more than 120,000 employees, with all employers having to act by April 2017. Employees will be automatically enrolled into a workplace pension if they are: (a) over 22 but under state pension age; (b) earn more than £9,440 per year; (c) working or normally work in the UK; (d) not already saving in a qualifying pension scheme with that employer.

Nevertheless, auto enrolment will be highly unlikely to solve the Generation Y challenge. It is a largely passive process over which employees have little input or control and, hence, will do nothing to tackle entrenched negative attitudes towards the financial sector.

The minimal levels of scrutiny that savers entering the auto enrolment process give to their pension plans may also be storing up future reputational challenges for the sector. Many savers will be unaware that their workplace pension plan will not be sufficient to guarantee a decent income in retirement. With minimum contributions set at relatively low levels, the Pensions Policy Institute has projected that the minimum levels of saving set through auto enrolment will not be sufficient to deliver an adequate pension for over half (51 per cent) of people who start saving into the scheme at the age of 22.[37]

What's more, the pensions sector is currently facing a range of reputational challenges with the potential to harm perceptions of pensions among the young. The UK government's focus on charges being levied on pensions is a warning signal to savers, even if proposals to cap charges are not ultimately introduced. The Financial Conduct Authority's competition probe into the annuities market, announced in February 2014, is a further signal to the public that they may not be getting a good deal from their pension. And warnings from influential organisations such as the Institute of Directors about the attractiveness of pensions will influence consumer decisions about retirement saving.[38]

Conclusion

Generation Y's enduring commitment to saving ought to represent an opportunity for the financial sector. However, young adults do not appear to believe that the financial sector offers them value. The spectrum of financial products that has traction appears very narrow, and many young adults are uninterested in exploring new options. The young people we quizzed saw banking as a utility and had little understanding of, or interest in, how banks use their money. This could be a 'situational' effect, which will fade as they age and their financial situation improves. But we identified two ingrained attitudes that suggest this behaviour will endure: profound feelings of financial insecurity, and hence avoidance of risk, and scepticism about the financial sector.

Taking steps to address these attitudes may prove to be essential if this generation is to diversify beyond cash based savings products in greater numbers. Assuming that Generation Y will replicate the savings and investment behaviour of their parents seems unlikely to be an effective strategy, unless accompanied by efforts to rebuild trust and credibility. As the extracts below demonstrate, recent industry studies of the financial sector paint a gloomy picture of its prospects among young savers.

"We are now experiencing a seismic shift in the financial tectonic plates and it has left a landscape populated by individuals who see funds as too risky for their savings. The asset management industry has survived so far by appealing to the wealthy, looking for emerging market exposure and higher returns, and the soon-to-retire baby-boomers looking for sources of income. Some will continue to thrive on this refined diet but the majority will be marginalised if they do not seek ways to re-populate this ever-diminishing universe."
Association of the Luxembourg Fund Industry, 2013[39]

"If Millennials continue to avoid investing their money in the institutional titans of the financial world, those firms that today are most intent on focusing CEOs' attention to the bottom line, may well find themselves with less financial clout to exert that kind of influence in the future. The cultural clash between Millennials' values and beliefs and the priorities of bankers and financiers could signal the death knell for not just Milton Friedman's position that maximizing shareholder value should be management's only priority, but for an entire way of life inside the world of high finance."
Brookings Institution, 2014[40]

3. The long term investment challenge

Climate and environmental risks are material to the quality of life Generation Y will enjoy upon retirement, as well as influencing the value of the pensions they will be paying into through auto enrolment. Pensions providers will need to intensify efforts to address these risks. However, rapid progress is unlikely unless these efforts are matched with interventions to increase demand from savers.

An increasing body of work has highlighted the nature and extent of the risks that climate and environmental factors pose to the financial sector. Carbon bubble analyses, summarised below, indicate that fossil fuel investments may be substantially overvalued, as concerted global action from governments to reduce carbon emissions would leave many such investments as stranded assets.[41] This means investments whose anticipated value is downgraded or cannot be realised. Furthermore, the carbon intensity of many pension portfolios will be a contributing factor in determining the extent and nature of climate change.[42] Any significant levels of climate change will have negative economic impacts, and a material negative impact on the purchasing power of savers' pension pots.[43] The accompanying increase in extreme and unpredictable weather events will create further, potentially value-destroying challenges for investors.

Nevertheless, many pension funds continue to be major investors in carbon intensive stocks. Oil, gas and mining companies represent a sizeable part of the capitalisation of stock markets such as the FTSE, making them integral to the strategies of many pension funds.[44] Although the number of investment strategies that consider environmental, social and governance (ESG) factors has increased significantly in recent years, the market remains small in absolute terms. According to Eurosif, the European socially responsible investment (SRI) association, growth in levels of investment into SRI funds has been primarily due to increased uptake by a small number of large institutional investors (pension funds and insurance companies) rather than evidence of a change in mainstream investor attitudes.[45]

To date, little pressure has been exerted by savers on their pension providers in relation to these issues. A survey to mark the first year of auto enrolment revealed that not a single employee interviewed had taken any steps to investigate the pension they signed up to. Scheme members mostly knew nothing about the charges levied on their pensions, let alone what was being done with their money.[46] With Generation Y set to be auto enrolled en masse into the long term savings market over the next few years, their attitudes to climate risks could play a major role in catalysing new approaches from pension providers.

Carbon bubble

The Cancun Agreement, in December 2010, captured an international commitment to limit global warming to two degrees Celsius (2°C) above pre-industrial levels. The Potsdam Climate Institute has calculated a global carbon budget for 2000-50 of 886 $GtCO_2$ for the world to stay below 2°C of warming. By 2011, the global economy had already used over one third of the 50 year budget, leaving around 565 $GtCO_2$ for the remaining 40 years. The current fossil fuel reserves held by the top 100 listed coal companies and the top 100 listed oil and gas companies represent potential emissions of 745 $GtCO_2$. This means that using just the listed proportion of reserves in the next 40 years would be enough to take us beyond 2°C of global warming. Given that only 20 per cent of the total reserves can be used to stay below 2°C, if this is applied uniformly, then only 149 of the 745 $GtCO_2$ held by listed companies can be used unabated. Investors are thus left exposed to the risk of unburnable carbon. If the 2°C target is rigorously applied, then up to 80 per cent of declared reserves owned by the world's largest listed coal, oil and gas companies and their investors would be subject to impairment as these assets become stranded.

"Look, I'm a smoker, so it's fairly hypocritical for me to suddenly tell my bank I've got a problem with investing in tobacco, even if it would make a difference somehow."
Male

"I'd say child labour [is important] but I still shop at Primark. For holiday stuff it's so cheap, it's like throwaway fashion."
Female

Low knowledge of practices and risks

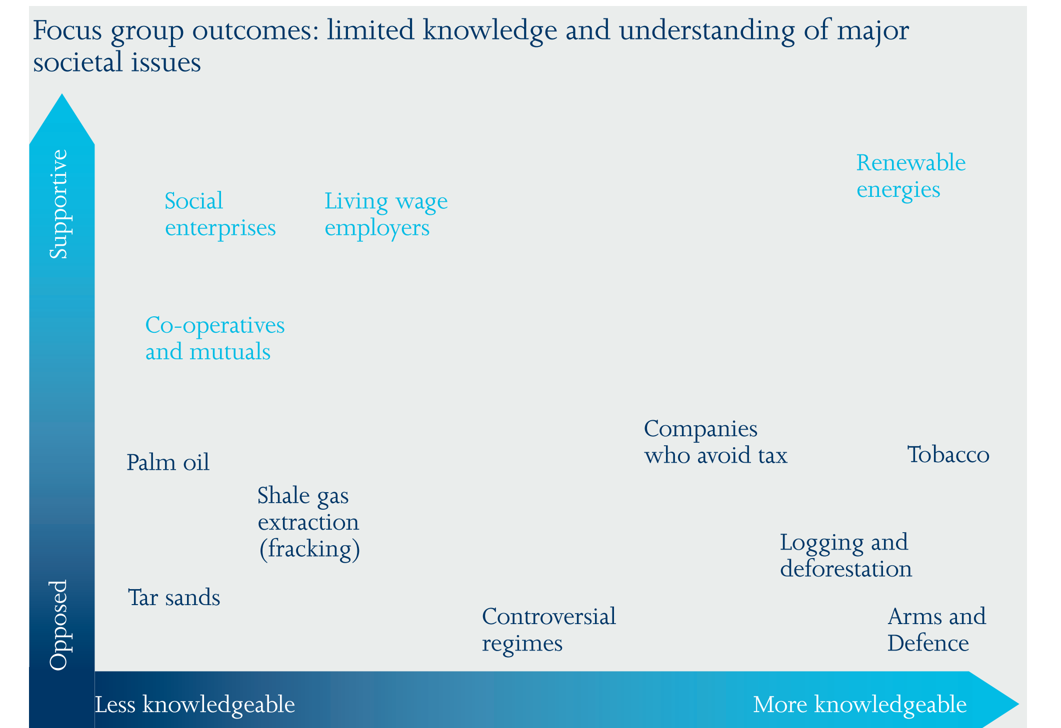
Our focus groups probed the attitudes of young adults to investing in a range of industries with positive and negative environmental and social characteristics. In line with their low understanding of how banks operate, our groups had minimal conception of the role that financial institutions can play in addressing environmental or social issues. On the environmental side, very few participants could identify actions, beyond reducing their carbon footprint or CSR schemes that banks might carry out.

Participants were asked which industries they would support their bank investing in and which they would oppose. Many participants were unfamiliar with the terminology and had extremely poor grasp of the underlying concepts.

While they were open to the idea of making positive investment choices, the appeal of this approach was undermined by the fact that young people simply did not trust banks to 'do good'. Many found the concept of this type of investing counterintuitive. A pervasive attitude was "If I wanted to support a cause, I wouldn't do it through my choice of bank account."

A number of participants were sceptical regarding claims focused on environmental risks. Focus groups revealed a lack of clarity over climate science in particular, with the likely severity of climate change and the speed with which its impacts might be felt commonly underestimated. While environmental issues were important to many, there was a common view that concerted short term action in the name of environmental protection might not be necessary. This echoes survey findings suggesting that young adults in the UK may be less willing to moderate their behaviour in the name of environmental protection than either their global peers or previous UK generations.[47,48,49]

Focus group outcomes: limited knowledge and understanding of major societal issues



Disenfranchisement driving inaction

The young people we worked with demonstrated profound scepticism about their individual ability to achieve change. They did not believe that their personal financial choices could make a difference to complex global issues such as climate change. They also exhibited a striking lack of confidence in their ability to take financial decisions. We encountered a strong sense that finance is inherently risky and that only financial professionals have the expertise necessary to navigate these risks.

We probed these attitudes through a workshop task. Participants were asked to read brief descriptions of two fictitious financial products, described opposite, both equity ISAs. They were asked to assess the appeal of each and identify which they would be more likely to choose. Product descriptions were extremely simple and required participants to make trade-offs between control over how their money is invested, transparency and the return on investment.

All participants selected Account A which gave the better return but less transparency and control. While most did so because of the higher rate of return, there were other important factors guiding their decision making. They thought Account B required customers to have a high level of financial expertise. Transparency over how banks invest their money was appealing but was considered too novel to be a strong motivating factor. Similarly, the investment criteria were not sufficiently motivating to justify the trade-off on the rate of return.

A clear conclusion that emerged was that this cohort finds comfort in being part of the mainstream. Several participants commented that they would need to be persuaded that other people were also making this choice to believe their own actions could make a difference. There was a strong perception that these were niche approaches for people wanting to do good, rather than mainstream financial choices.

"On the one hand, with A, you don't know where your money has been or is going, but on the other hand, it is hassle free. For B, I might need an IFA, it could be expensive, it would definitely be more time consuming."
Male

"I would believe that staff at the bank would have more of an idea about the industries to invest in than myself, but would also feel uneasy not knowing what my money was being invested into."
Female

"I don't know – it's hard to think about banks like this. I've literally never thought about it in this way before – it's always just been the bank I'm with, and if I need a new account, I just get the one that looks best for me."
Female

Product descriptions used in the workshop

Account A: equity ISA

Your bank has full control over how your money is invested. Customers do not receive information about where their money has been invested, or when your bank changes the companies it invests in.

Your bank undertakes to lend responsibly in line with all the applicable regulations.

Your bank states that this freedom to choose how it invests means that this account is likely to generate a level of interest for savers, in line with the best performing ISA on the market.

Account B: equity ISA

Customers have the ability to choose how their money is invested. The ISA account enables customers to select one or more types of industry into which they would like their money invested, including:

- Renewable energy
- Environmental technologies such as water treatment
- Fairtrade companies

Your bank has an online portal with guidlelines setting out your investment options and the characteristics of these industry types. This portal includes the names of all the companies into which it has invested its customers' money which updates when this changes.

Your bank states that these restrictions on how it may invest your money mean that this account is likely to generate a level of interest that is average for an equity ISA.

"It just all feels a bit distant to me – given that I don't have much money to invest at the moment anyway, I feel like this decision wouldn't have as much impact as the rest of my consumer behaviour."
Male

How to increase demand

The young people we encountered questioned the credibility of sustainable and ethical financial propositions. Nevertheless, this exercise suggested that these types of product have an underlying appeal, if the right buttons can be pushed.

Messages

We asked participants to rank the appeal of eight messages (see page 26) describing ethical and sustainable financial products and approaches. There was strong scepticism about messages that they thought were making unsubstantiated claims or that seemed like an obvious 'sell'. Some respondents were suspicious about the motives behind ethical behaviour by banks, suggesting they might be tokenistic, or solely for marketing reasons.

Participants were particularly attracted by messages that conveyed their own ability to do good. Conversely, they were turned off by messages they thought were negative, ie focusing on avoiding harm rather than doing good.

Marketing tools and channels

A clear conclusion was the need for ease; the customer should be able to pick financial products that they know to be ethical but should not be required to make significant choices themselves.

Another finding was the need to demonstrate clearly to customers what positive impact their money could have. Participants wanted to hear the whole story of their investment, with personal stories and case studies, rather than simply seeing figures and statistics.

Social media emerged as an effective way to bring savers and the beneficiaries of the investments more closely together. Twitter could be used to 'socialise' ethical finance choices by showing customers how many others are doing the same thing.

Brand power and collaboration

Our research participants indicated that a financial product would have to come from a trusted, recognised provider. For the most part, they wanted this to be a familiar high street bank, although this was matched with doubt about the credibility of banks offering an ethical product.

Several people suggested partnerships between a bank and a major, trusted charity or NGO. There was some debate about whether high street retailers might be suitable partners. Some found their familiarity appealing, while others believed that these organisations lacked the financial expertise offered by banks. The government was not considered to be an interesting or trusted partner.

Conclusion

Climate and environmental considerations are not significant factors influencing the consumer behaviour of Generation Y. Those we worked with cared about environmental, social and humanitarian causes but had a complex set of attitudes towards them, particularly where, as with climate change, they felt basic facts were contested. While a number were open to investing in products with positive environmental or social impact, the involvement of a bank raised fundamental questions for them about the validity and credibility of the concept.

There was a striking lack of empowerment regarding savings and investment decisions among the group we talked to. They wanted to feel they were making safe choices with their money, which largely translated into placing it with high street banks. They doubted their ability to achieve change with their own individual behaviour. Collective action came across as important. In an environment where they could not see anyone else making these choices, it is less likely that they will do so themselves. Ethical and sustainable finance were considered separate from the mainstream and, therefore, unappealing.

It seems highly unlikely that young adults entering auto enrolment will proactively seek information on the extent to which their pensions are addressing climate and environment risks. Most will simply accept the default options presented to them.

4. Recommendations

This research has highlighted a number of important issues for the savings sector:

There is a strong savings culture among young adults. They are predominantly motivated by specific near term financial goals and, for the majority, long term saving will happen principally through auto enrolment.

Young adults are financially conservative. They feel most comfortable with mainstream savings institutions and approaches, and mostly hold their savings as cash in the bank. Very few have stock market investments and there is a strong association in their minds between investment and risk.

Young adults are profoundly sceptical of financial institutions. But they trust financial professionals with their savings, believing that they possess the expertise to manage the risks they see as inherent to financial services.

Environmental and social factors currently have little traction in Generation Y's financial decision making. Investment approaches with environmental and social impact are appealing to this cohort but are less important than basic 'hygiene factors' such as avoiding financial losses.

The implications of these findings are:

It should not be assumed that young people will automatically gravitate towards investing as they gain experience and greater financial acumen in the future. A strong aversion to risk and lack of trust in financial institutions may mean that Generation Y's strong savings culture does not lead to widespread acceptance of investing. This will have implications for financial sector growth as well as the low carbon economic transition, ie if pension funds and other consumer investments are to play a role in bridging the $1 trillion annual financing gap for climate resilient infrastructure.[44]

New approaches will be needed to ensure that the financial interests of young adults are effectively protected against avoidable climate risks. The financial sector has been slow to adapt its investment strategies to address climate change, while consumers themselves show little interest in pressing for change. The slow pace of progress to date indicates a stronger role for government in accelerating this process.

Investment approaches with environmental and social impact could represent an opportunity for the financial sector to build trust and credibility with Generation Y. However, significant hurdles need to be overcome; specifically, the impact of the sector's negative reputation on the credibility of these approaches, as well as the poor understanding among young consumers of personal finance and environmental issues.

Four recommendations for the industry and policy makers

For the industry:

1. Pension providers should use auto enrolment to form new partnerships that build consumer trust in investing

Auto enrolment will be a major financial milestone in the lives of young workers. For many it will be their first foray into long term saving. They will be considering new financial options that could trigger new financial habits. The point at which they are auto enrolled represents an opportunity for a broader set of discussions on saving and investing. Yet current levels of employee engagement with pensions are low. The experience of auto enrolment thus far has been that young workers are willing to sign up to a pension but do not scrutinise its terms. It appears unlikely that most young adults will invest more than the minimum level required.

A concerted educational push by pension providers in partnership with credible third parties could go some way towards overcoming this lack of engagement. If presented correctly, sustainable investment options could increase levels of engagement with investing among young people. Financial institutions will achieve little working alone; young people do not perceive substantive differences between financial institutions in terms of ethical standards and practice.[51] Employers' representatives and other workplace institutions such as unions will have a major influence on the terms of individual schemes and the decisions of workers to sign up.[52] Civil society organisations such as NGOs are seen to have independence and credibility with young people. Their support or endorsement could help overcome scepticism around sustainable investing.

This is an immediate opportunity. Smaller companies with fewer than 249 employees will be entering the auto enrolment process between 1 April 2014 and 1 April 2017.

2. The savings sector should actively communicate product level information on climate risks to engage savers on these issues

Sustainable investment products should resonate with many in Generation Y, provided certain entrenched barriers can be overcome, such as negative perceptions of the financial sector and the belief that sustainable investing is beyond the financial mainstream. Making climate change part of normal financial decision making will require relevant information on individual financial products to be made available. Disclosure at the level of financial institutions is already extensive. The Carbon Disclosure Project website contains exhaustive information from many major financial institutions on operational impacts and strategic responses to environmental challenges.[53] However, it is not materially influencing the choices being made by savers.

Methodologies already exist to calculate direct carbon emissions for pensions and other retail investment products. These should be universally adopted (see recommendation three) and communicated to savers alongside product specific information on strategies for reducing climate risk.[54] While this approach would not be applicable to cash deposit accounts, which are not allocated by banks to specific loans or investments, it would cover a large and increasingly significant segment of the consumer savings market.

Alternative formats and channels will be needed if this information is to be sufficiently engaging for Generation Y. Our research has demonstrated that building acceptance and support for sustainable investment approaches would be more easily done if young adult savers sensed they were part of a group making similar financial decisions. Online tools may be the easiest way to generate interest and acceptance, with social media offering the opportunity to build communities of young savers. This information should also be made available via more conventional sources for consumers who are seeking independent advice on saving and investing. This would include integrating it into resources on existing financial information websites such as the Money Advice Service and Citizens Advice.

For policy makers:

3. The government should require pension providers which benefit from auto enrolment to disclose to customers the carbon impact of their investments

Current industry practice means that many young workers are being auto enrolled into pensions with significant exposure to carbon and climate risks. Given the urgency for new safeguards to be introduced, and the benefits of a standardised approach to disclosure, government intervention would be appropriate. It should be mandatory that, at the point at which individuals sign up to a pension, they are presented with information about its carbon intensity and its policies on climate risk mitigation. This will allow comparisons to be made across funds and would build awareness among savers of the relevance of climate change to the ultimate value of their pensions.

Major UK listed companies are already required to calculate their direct carbon emissions. This should be extended to pension funds. ShareAction has set out the range of options that exist for calculating the carbon footprint of equity portfolios.[55] At a minimum, this could easily include direct emissions associated with operations (known as scope 1 emissions following the Greenhouse Gas Protocol) and those associated with purchased energy (scope 2 emissions). There are limitations to this approach, as emissions that occur upstream and downstream in their value chains are not covered. This is particularly significant for fossil fuel companies. However, over time, as methodologies evolve, these too could be covered.

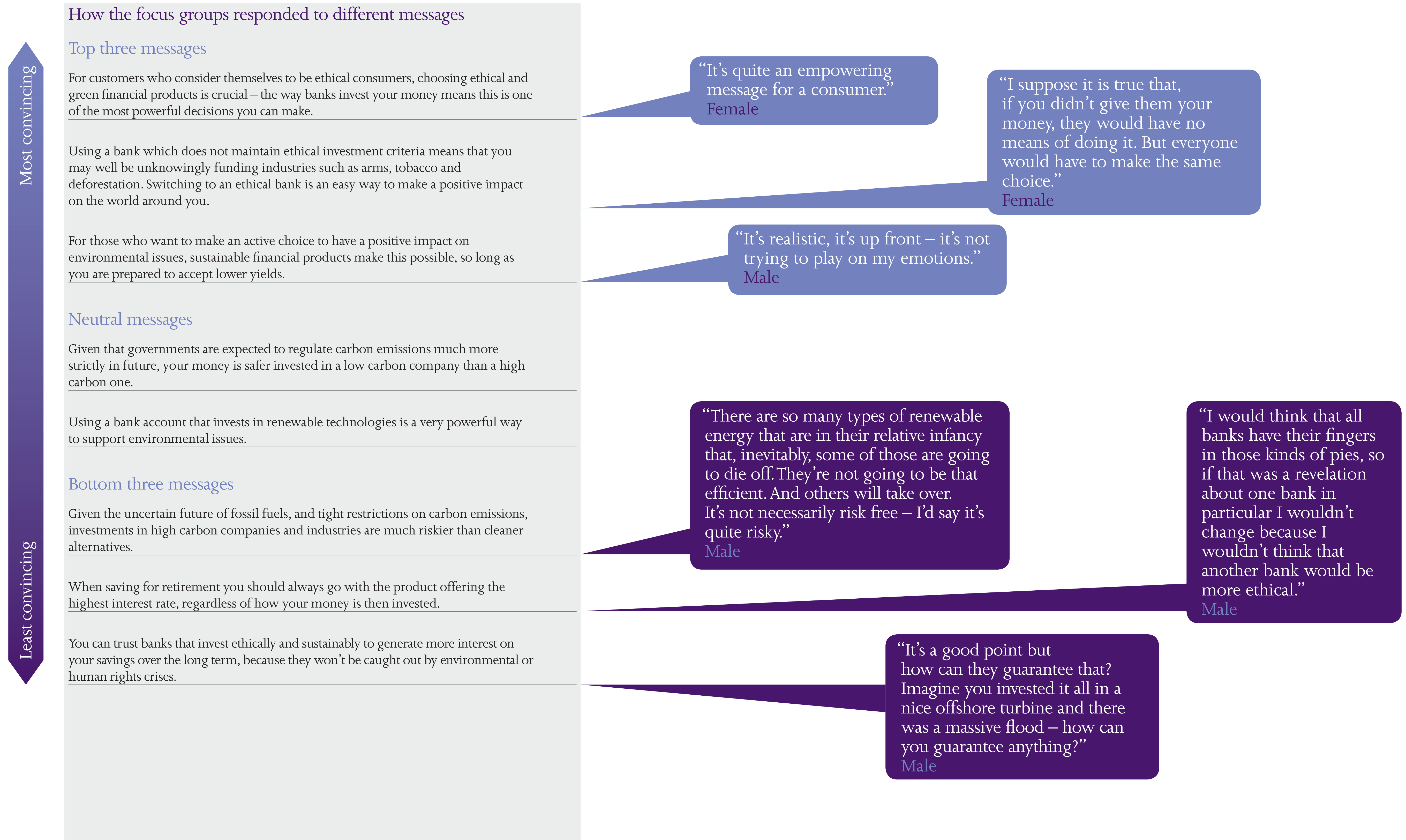
4. The government should explore options for reforming pension tax relief so investments in high carbon assets are no longer subsidised by the state

The principle that tax relief should be contingent on public benefit – which already applies, for example, to the charity sector – should be applied to the pensions sector using a broader set of criteria. Tax relief creates strong financial incentives for consumers to save, and represents significant financial support from the state to pensions providers; net tax relief for pensions totalled £23 billion in 2011-12.[56] Only pensions which effectively address known climate and carbon risks, ie are genuinely acting in the long term interests of young adult savers, should benefit from state support.

New methodologies will be needed to make this principle practically applicable. It will not be sufficient to rely on labels such as 'ethical' or 'sustainable' for funds, or to take the approach that only institutions signed up to existing codes of conduct should benefit. ShareAction has demonstrated that the screening methodologies used by the majority of ethical pensions providers focus on too narrow a range of issues. Nearly half of the ethical funds they examined did not disclose all the investments in their portfolios.[57]

The government should work with stakeholders to explore how new forms of conditionality, addressing climate change, could be applied to tax relief, such as developing criteria for assessing pension funds' approaches to climate risk management. It should also consult on appropriate conditions under which this conditionality could be applied; for example, funds where risk management is judged to be inadequate could be denied pensions tax relief. The government should set a clear timetable for the introduction of any new approach, phased in such a way to give sufficient time for the market to adapt.

The future savings challenge



Endnotes

[1] "Without further commitments and action to reduce greenhouse gas emissions, the world is likely to warm by 3 degrees centigrade above the preindustrial climate... If they [existing mitigation commitments and pledges] are not met, a warming of 4°C could occur as early as the 2060s." World Bank, 2012, *Turn down the heat: why a 4°C warmer world must be avoided*

[2] ShareAction analysis of the FTSE 100 Index demonstrated that 17 per cent of market capitalisation was attributable to just four oil and gas producers and a further nine per cent to mining companies. With UK pension funds holding 39 per cent of their assets in equities (2012 figures), of which 81 per cent were in FTSE 100 companies, the pensions of UK savers are therefore exposed to considerable climate risks. See ShareAction, 2013, *The green light report: resilient portfolios in an uncertain world*

[3] Carbon Tracker, 2013, *Unburnable carbon – are the world's financial markets carrying a carbon bubble?*

[4] Office for National Statistics (ONS), 2013, *Population pyramid for the United Kingdom, mid-2012 compared with mid-2001*

[5] ONS, December 2013, *Pension trends 2013,* Chapter 5

[6] Social Mobility and Child Poverty Commission, *State of the Nation 2013*

[7] HM Treasury, 2006, *The Stern review on the economics of climate change*

[8] OECD, 2013, *Institutional investments and green infrastructure investments: selected case studies*

[9] ONS, *Average weekly household expenditure*

[10] HMRC, September 2013, *Individual Saving Account (ISA) statistics*

[11] HMRC, 22 February 2013 *Personal pension statistics*

[12] Association of British Insurers (ABI), 2013, *UK insurance key facts 2013*

[13] *Financial Times*, 19 November 2013, 'Half of recent graduates are in non-graduate jobs', www.ft.com/cms/s/0/5a6a66a0-5103-11e3-b499-00144feabdc0.html?siteedition=uk#axzz2l73FluXI (accessed 17 February 2014)

[14] Social Mobility and Child Poverty Commission, *State of the Nation 2013*

[15] Mintel, 2011, *Marketing to the boomerang generation*

[16] ONS, *Average weekly household expenditure 2000-12*

[17] Ibid

[18] Data generated by TNS and provided by NS&I based on their *Quarterly savings survey*, see www.nsandi.com/media-centre-nsi-savings-survey

[19] DataMonitor, 2010, *What customers want*

[20] NS&I *Quarterly savings survey*

[21] See, for example, Mintel, 2013, *Consumers, saving and investment*, which found that 32 per cent of 18-24 year olds with a savings and investment product were saving for a specific purpose, against an average for all age groups of 20 per cent.

[22] Consumer Financial Education Body, 2010, *The influence of financial promotions on young people's decision-making*

[23] DataMonitor, 2010, *What customers want;* HMRC, September 2013, *Individual Saving Account (ISA) statistics;* HMRC, February 2013, *Personal pension statistics*

[24] UBS Investor Watch, 2014, *Think you know the next gen investor? Think again*

[25] Mintel, January 2013, *Consumers, saving and investment*

[26] MFS, 2012, *Getting the digital generation to "like" the market*

[27] FT-Telefónica *Global Millennial survey*, 2013

[28] Ibid

[29] UBS Investor Watch, 2014, *Think you know the next gen investor? Think again*

[30] 2012 *British social attitudes survey*

[31] FT-Telefónica *Global Millennial survey*, 2013

[32] Ibid

[33] Aviva, 2010, *Mind the gap: quantifying the pensions gap in the UK*

[34] M Johnson,2012, *Costly and ineffective – why pension tax relief should be reformed*: "Over the last decade [2001-02 to 2011-12], the Treasury has provided tax relief totalling £262 billion (on contributions and investment income), plus another £96.6 billion in NIC relief (ie tax foregone) on employer contributions. This will have been funded through gilts issuance, at a real cost, over the last decade, of 3.9% per annum. Thus, the cost to the Treasury of financing tax relief is 1% more than the average annual real return on all UK pension funds over the same period. This 1% per annum "loss" on its "investment" has accumulated over the last decade to total £17.5 billion."

[35] Assets under management in defined contribution workplace pension schemes are projected to increase from £276 billion in 2012 to about £1.7 trillion in 2030; Pensions Institute, 2014, *VfM: assessing value for money in defined contribution default funds*

[36] National Association of Pension Funds (NAPF), 2013, *National pension survey 2013*

[37] Pensions Policy Institute, 2013, *What level of pension contribution is needed to obtain an adequate retirement income?*

[38] Institute of Directors, 2012, *Roadmap for retirement reform*

[39] Association of the Luxembourg Fund Industry (ALFI), 2013, *Beyond 10% : the case for enlarging the pool of retail investors in Europe's investment funds*

[40] M Winograd and Dr M Hais, May 2014, *How Millennials could upend Wall Street and corporate America* , Brookings Institution

[41] op cit 3

[42] Analysis by Trucost found that UK based equity funds "owned" the equivalent of 134 million tonnes of CO_2 emissions (22 per cent of the UK's total emissions) each year, based on the emissions of the companies in which they invested; Trucost, 2009, *Carbon risks in UK equity funds*

[43] A number of academics have criticised existing economic models for downplaying the potential for climate change to wreak economic havoc; see R Harding, 18 February, 2014, 'A high price for ignoring the risks of catastrophe', www.ft.com/cms/s/0/4fb95100-9882-11e3-8503-00144feab7de.html?siteedition=uk#axzz2txxbcuyd (accessed 25 February 2014)

[44] op cit 2

[45] European Sustainable Investment Forum (Eurosif), 2012, *European socially responsible investment (SRI) study 2012*

[46] NAPF, 2013, *Automatic enrolment one year on*

[47] According to the *British social attitudes survey*, in 1993 32 per cent of 16-24 year olds and 33 per cent of 25-34 year olds were very or fairly willing to accept a cut in their standard of living to protect the environment. By 2010 the numbers were 18 per cent and 19 per cent respectively. Data from British Social Attitudes Information System, www.britsocat.com/

[48] According to the 2013 FT-Telefónica *Global Millennial survey* only 31 per cent of young Britons believe that climate change is "very pressing", well below the global average of 54 per cent and the Western European average of 49 per cent.

[49] A 2012 Carbon Trust global survey found less than a third of UK young people consider the environmental impacts of the products they buy, even though they view this as the most significant carbon impact in their lives; Carbon Trust, 2012, *A global survey of young adults' perceptions of carbon and climate change*

[50] op cit 7

[51] Mintel, 2011, *Consumer attitudes towards green and ethical finance*

[52] Although union membership has seen steady decline over recent decades, the ONS's *Labour force survey* shows that in 2012 ten per cent of employees aged 20-24 and 19 per cent aged 25-29 were members of a union.

[53] Company and city questionnaire responses can be accessed on the Carbon Disclosure Project website at www.cdp.net/en-US/Results/Pages/responses.aspx

[54] ShareAction's *The Green light report* highlights the range of tools that exist to help pension funds understand climate risks and put in place strategies to address them.

[55] op cit 2

[56] op cit 10

[57] ShareAction, 2012, *Ethically engaged? A survey of UK ethical funds*

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