Greening Pensions: A Behavioural Perspective

A report by the
Behavioural Insights Team

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Foreword from
Make My Money Matter

Across the world, we're seeing an explosion of activism on key issues of social and environmental justice – from #MeToo on gender, to Black Lives Matter on race, to Fridays for the Future on the climate crisis. As these movements grow, people are increasingly seeking opportunities for impact, asking 'what can I do to make a difference through my everyday actions?' And they're finding that answer in unexpected places. They're finding it in the clothes they wear, the food they eat, and how they travel. They're finding it in the products they buy, the brands they support, and the companies they work for.

The next big revelation is that they're also finding it in the places they put their money. Unbeknownst to most of us, our pensions have made many of us accidental investors in practices we avoid and causes we fight against.

Why is it that the UK's 3.5 million vegans are funding factory farming? How can it be that the pensions of scientists researching cancer treatments fuel the tobacco industry? And why is it that our most sustainable businesses and greenest activists have pensions which contribute to coal mining, oil extraction and deforestation? In the short term, our money is likely contradicting our values. But more worryingly, in the long term it's undermining the viability of the very futures we're saving for.

It doesn't have to be this way. There's £2.6 trillion invested in UK pensions alone, and that's money owned by all of us – money which could be directed toward clean energy, affordable housing, medical research, and green infrastructure. Money which could help build a world we actually want to retire in.

This powerful report highlights the growing need from citizens across the UK to make their money matter, to help realise the economic and environmental opportunities presented by cleaner, greener pensions. But it doesn't stop there. Its greatest contribution is to adopt a unique behavioural perspective, to identify critical barriers limiting individuals and institutions from investing more sustainably - and presenting clear, actionable solutions to these hurdles - that help to ensure green pensions become the default, not the exception.

In following the recommendations of this report, we can harness the hidden superpower of our pensions to help drive a net zero transition across our economy, and ensure everyone, everywhere has a pension they can be proud of.

David Hayman
Campaign Director, Make My Money Matter

Foreword from **the Behavioural Insights Team**

Tackling climate change is about behaviour change. According to the Climate Change Committee, the majority of future emissions reduction will come from changes in our behaviour - in how we heat our homes, how we travel, what we eat, and what we buy. Some of this will be about us taking up new habits - such as wasting less food and eating less meat - but the majority will come from adoption of new technologies, such as electric vehicles and heat pumps.

Behavioural science has a lot to say about how we can achieve societal-level uptake of these green actions. It teaches us about the primacy of environmental factors and cognitive biases underpinning human decision-making; the need to address barriers for people's capability, opportunity and motivation to act; and to make the desirable behaviour easy, attractive, social and timely, following BIT's own EAST framework.

But as individuals we're also part of a system - a society and an economy which all too often promotes high-carbon lifestyles, and which we can often feel powerless to change. How can we all be expected to decarbonise our travel habits when our cities are built around cars not bikes, when flights are so much cheaper and quicker than trains, or when petrol cars are still superior to electric for driving around the charge-point-sparse British countryside? These issues need major investment and technological advancement before individuals can easily change their behaviour. If only we could all do something about that...

It turns out that we can - our investment choices can accelerate green innovation and investment. And the best part is that relatively small shifts in behaviour could cascade through the system and trigger seismic benefits. For example, by deshrouding the pensions market so that consumers are informed of their environmental impacts, even a minority of engaged switchers could drive environmental improvements among providers and competition among the businesses they invest in, creating a virtuous loop through which other savers get pulled along too.

We've seen time and again that a single timely nudge can help to unlock these complex problems. In fact, pensions were the target of some of the first, and most successful nudges - encouraging people to 'save more tomorrow', and in the UK harnessing the power of defaults to help millions more save for retirement.

It's time to apply these techniques to the most pressing challenge of our time.

Professor David Halpern
CEO, Behavioural Insights Team

1. Executive summary

Through their pensions, the vast majority of people in the UK are investors, with pension pots collectively amounting to over £2.6 trillion.[1] Investing a greater portion of this money sustainably - i.e. in businesses who have positive or neutral impacts on the environment and green technologies – could significantly accelerate our transition to a low-carbon society.

While 68% of people say they would like their investments to be responsible and impactful,[2] just £1 in every £10 is invested this way.[3] Many pension holders who are concerned about climate change unknowingly invest in activities which are harmful to the environment.[4]

So what's stopping people from investing in environmentally-friendly pensions? Evidence shows that, to switch to a greener pension, pension holders must overcome a myriad of behavioural barriers. These include: choice overload given the huge range, diversity, and opacity of pension options; risk-aversion due to the perceived threat of worse financial returns from green pensions; frictions and hassle in identifying the green options and making the switch; inattention and lack of urgency; disinterest or discomfort in financial matters; and status-quo bias which draws people strongly towards the pension fund which their provider or workplace has allocated them to by default.

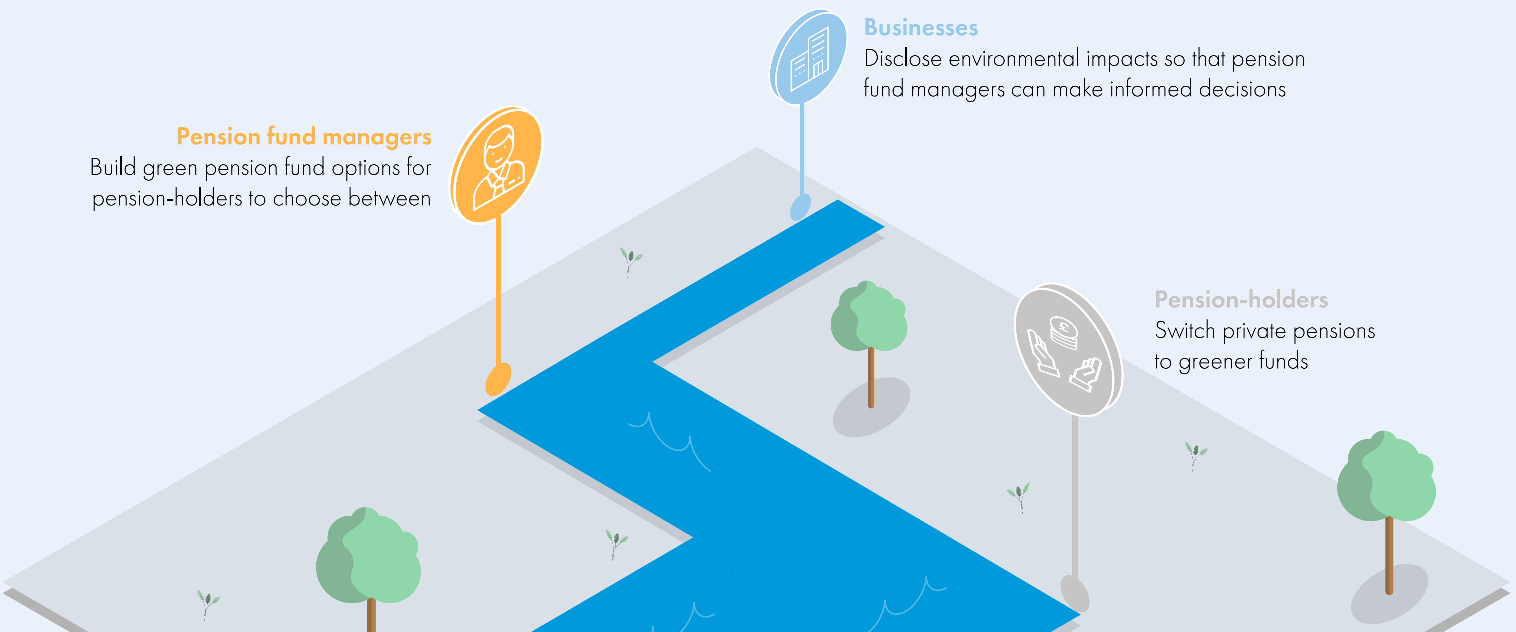
Behavioural science tells us that, to green our pensions, we need to act both downstream and upstream. Downstream, at the individual level, we all have the agency to move our pensions into greener funds. But upstream, fund managers must develop high-quality green pension investment options, based on quality environmental disclosure from individual businesses. The two sides of this coin are mutually reinforcing - increased demand for greener pensions from savers drives change among providers, which in turn makes it easier for more savers to choose a greener pension. Therefore, to achieve a wide-spread and meaningful greening of pensions, we need to not only empower and motivate consumers to act, but also ensure that regulatory and market functioning supports, encourages, or even automates greener choices.

In this report, we set out seven recommendations, each targeted at one of three key stakeholders:

- Individual pension holders
- Pension fund managers
- Businesses

These seven ideas are organised along two levels and two aims:

- **Downstream: Nudging individual pension holders to switch to greener funds.**
- **Upstream: Shaping the pensions market.** This involves ensuring that pension funds managers provide credible green options for pension holders, which in turn depends on asset holders (such as businesses) measuring and disclosing their environmental impacts to inform pension fund managers' decision-making.



1.1 Nudging individuals: Supporting pension holders to make greener choices

While 68% of pension holders want their savings to help fight climate change,[5] they are subject to practical and psychological barriers which make it extremely difficult to act on this preference. We can apply behavioural science to support individual pension holders to overcome the behavioural barriers they face in switching to a greener pension fund, helping them to translate their desire to invest more ethically into concrete changes to their pension.

Provide pension holders with timely information about environmental impacts

57% of pension holders are interested in knowing about the impact their pension has on people and the planet,[6] yet most don't know whether their pension is invested in line with their values.[7] When people do try to learn about the environmental impacts of their pension, the relevant information is often unavailable or difficult to interpret. We can support more informed decision-making by giving pension holders clear and timely information about their pensions' impacts on the planet.

- **Idea 1: Label pension funds to communicate environmental performance.** The environmental impact of pension funds (not just individual assets within) should be given in a salient, consistent, and easy-to-interpret format. Evidence suggests that one-to-five star ratings could be most effective.[8]

- **Idea 2: Provide regular feedback on the environmental performance of pension pots, with the opportunity to switch to a greener option.** Pension holders should be given regular updates on their pensions' environmental impacts, with prompts to switch to a greener fund if relevant. This information should be communicated at timely moments (e.g. during their annual benefits windows or when they receive their annual statement), when they might be more open to switching to a greener fund.

Change the choice architecture to support green pensions

Given better information, some pension holders will be motivated to explore greener options. However, motivation alone may not be enough to overcome the hassle, uncertainty, and perceived risks of switching one's investments. Adapting the systems and context within which people make decisions about their pension (i.e. the choice architecture) can reduce these frictions.

- **Idea 3: Easy switching through the Pensions Dashboard.** Many pension holders don't know where their old pension pots are, let alone whether they are invested sustainably.[9] The government is currently developing a 'Pensions Dashboard' where individuals can easily view the value and location of all of their pension pots.[10] This should be augmented with i) information about each pot's environmental impact; and ii) functionality to easily consolidate pots and switch to more sustainable options.

- **Idea 4: Force a periodic active choice.** Pension providers and / or employers could be asked to periodically engage individuals to make an active choice about their pension fund selection to ensure it aligns with their values over time. These choices should be presented during moments of change (e.g. at the point of leaving or starting a new job, receiving a pay rise, or when making a mortgage application), as evidence shows people are more open to making changes in their lives when old habits are disrupted.[11]

- **Idea 5: Make green pensions the default.** Building on the huge success of pension auto-enrolment,[12] workplace pension providers should be mandated to select a sustainable option as the default pension fund. Individual workplaces would retain the option to choose a different default fund for their employees, and individual pension holders would still be able to switch to a different fund if they wish.

1.2 Shaping the pensions market: Improving the availability and integrity of green pensions

The choices made by individual pension holders are constrained and influenced by the options made available by pension providers. For pension holders to make environmentally-friendly choices, high-quality green pension options need to exist, be easily accessible, and be credible in their environmental claims.

However, for this to be the case, several things need to happen. First, pension providers must create pension funds which are truly environmentally-friendly; this requires accurately assessing the environmental impacts of different assets which they might invest in and making decisions accordingly. Second, asset holders must measure and disclose their environmental impacts so that pension fund managers can take these into account when making investment decisions. Third, the regulatory environment needs to facilitate the development and marketing of greener investment options. Fourth, there needs to be a strong feedback loop between consumer demand for high-quality green investment options, and the incentives on pension providers.

Support pension fund managers to identify green businesses to invest in

- **Idea 6: Provide clear and timely information on businesses' environmental impact.** Difficulties understanding the environmental impact of different investment opportunities is a key barrier to greener investing.[13] Pension fund managers should be given standardised, clear, and timely information about assets' environmental impacts so that they can easily take it into account when making investment decisions.

Support high-quality disclosure of environmental impacts by businesses

For pension fund managers to make meaningful decisions based on environmental considerations, they must be able to evaluate the impact of different types of assets (e.g. stocks, bonds, private equity, real estate). In this report, we focus specifically on how we might encourage businesses to disclose good-quality data on their environmental impacts, helping pension fund managers to choose between different stocks. Although a substantial number of British businesses are already mandated to disclose their environmental impacts (and many more will be by 2025), evidence suggests that non-voluntary disclosures tend to be of lower quality.[14] With this in mind, the following strategy might be used to encourage businesses to deliver high-quality and meaningful disclosure:

- **Idea 7: Highlight the short- and medium-term disclosure benefits to business leaders.** Business leaders are often motivated by short-term, quarterly, and financial outcomes,[15 16] rather than longer-term environmental wins. This may make them less likely to take forward environmental disclosure initiatives. To address this, business leaders should be presented with nearer-term incentives to pursue disclosure schemes. Reputational and legitimacy benefits to the business should be highlighted, and individual business leaders could be given prizes or official accreditation for successfully implementing a disclosure system.

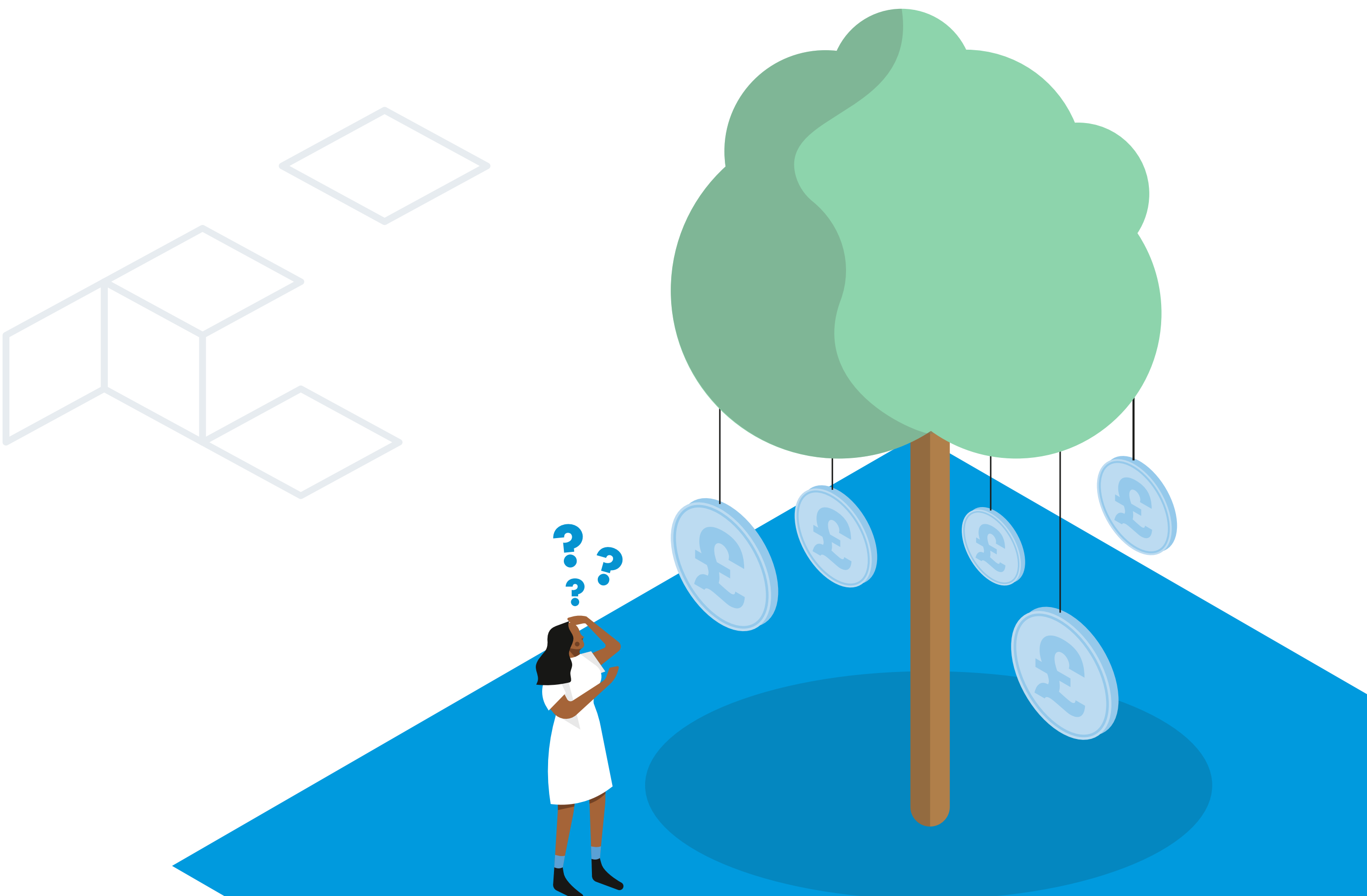
Table 1 below gives a high-level assessment of the likely impact and feasibility of each of our recommendations.[17]

Table 1. Summary of solution ideas, including impact and feasibility assessment

No.	Idea	Impact	Feasibility
1	Label pension funds to communicate environmental performance	Medium	High
2	Provide regular feedback on the environmental performance of pension pots, with the opportunity to switch to a greener option.	Low	High
3	Easy switching through the Pensions Dashboard	Medium	Medium
4	Force a periodic active pension choice	High	Medium
5	Make green pensions the default	High	Low
6	Provide pension fund managers with clear and timely information on businesses' environmental impact	Medium	Medium
7	Highlight the short- and medium-term disclosure benefits to business leaders	Low	Medium

We hope that the ideas in this report will inspire governments, investors, and pension providers to take forward a behavioural science approach to supporting greener pensions.

If you'd like to explore these ideas further, or test them in your organisation, please get in touch at **info@bi.team.**



2. Introduction

To achieve Net Zero, we must transform our economy. Currently, we are heavily reliant on businesses whose assets and practices produce an unsustainable quantity of greenhouse gas emissions, and which partake in practices which cause long-lasting damage to our environment (e.g. fossil fuel extraction, deforestation, and plastic waste). To move towards a more sustainable economy, climate risks and impacts must be taken into account when making business or investing decisions. Ultimately, we want to move to a world where increasing investment is flowing to businesses which have positive or neutral impacts on the environment. This will help us to reach Net Zero emissions by:

- Incentivising businesses to prioritise corporate social responsibility and the environment in their decision-making;[18 19]
- Ensuring that green projects are sufficiently funded, while carbon-intensive assets or practices become less financially viable;[20 21] and
- Pragmatically guiding business and investment strategy by revealing companies' physical climate risks (like floods and fires) or 'transition' risks (such as risks to a business from climate policy, legislation, or technology changes).

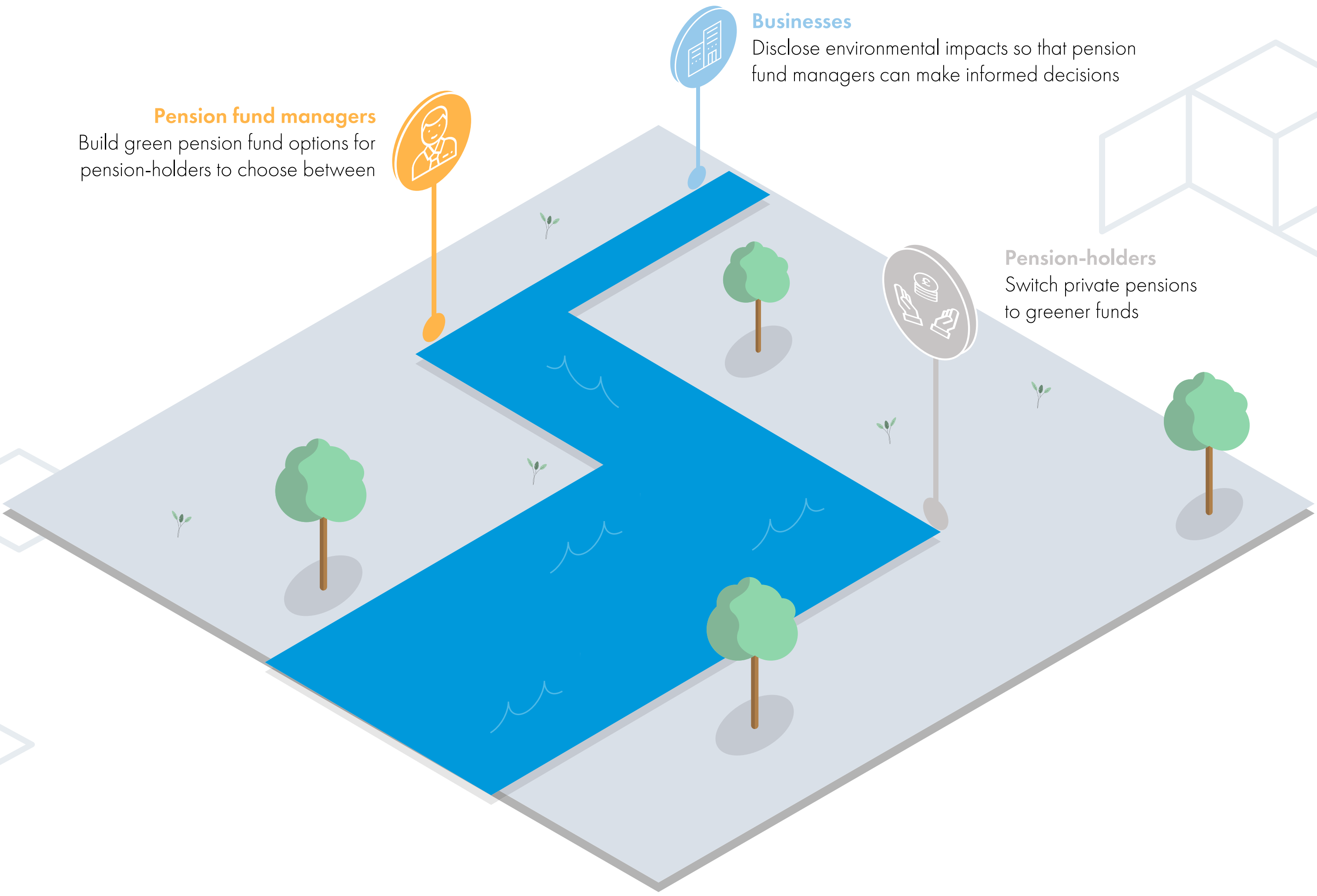
Although the need for green financing is pressing, the resources are lagging. As much as US$90 trillion in sustainable investments would be needed by 2030 to achieve current 1.5°C goals,[22] and investments in green technologies and energy efficiency need to increase six-fold by 2050 (compared to 2015) to achieve the same targets.[23 24]

The majority of people in the UK currently invest in the finance system through their workplace pension. Collectively, these pension investments amount to a huge amount of money: over £2.6 trillion.[25] Although nearly 70% of people say they would like their investments to be responsible and impactful,[26] only £1 out of every £10 is invested this way.[27] If more people switched their pensions to greener funds, this money could become a force for good.

In this report, we apply a behavioural science lens to offer seven ideas to increase the number of people who invest their pension in a sustainable fashion. We start downstream, considering how we might influence the behaviour of individual pension holders, and then move upstream to address the system they operate within. We have taken this approach because pension holders' ability to affect meaningful change depends on the investment options available to them and we cannot, realistically, expect each individual pension-holder to navigate a system loaded with frictions and confusion.

The choice environment pension holders face is shaped (and often constrained) by the behaviours of other actors further upstream. At the mid-stream level, pension funds are managed by professional investors, who must build truly environmentally-friendly pension portfolio options for pension holders to choose from. For investors to build these portfolios, they must have access to accurate information about the environmental impacts of the assets they might choose to invest in. This takes us even further upstream: asset holders, such as businesses, must accurately measure and disclose their impacts, and those of their suppliers yet further upstream, so that relevant information is available to investors. With this in mind, the second section of this report considers how behavioural science can be used to encourage the following positive behaviours:

- Pension fund managers to identify and develop greener funds to invest in; and
- Asset holders, such as businesses, to publish accurate and detailed accounts of their environmental impacts.



We have conducted a high-level impact and feasibility assessment for each of our ideas. We have estimated impact based on the likely target population size and magnitude of behaviour change, while weighting upstream interventions higher due to their greater ability to improve outcomes for disengaged individuals. We have established feasibility based on criteria such as the current regulatory setting (i.e. whether substantial policy changes are needed), the likely cost of implementation, and availability of necessary data.

Box 1. Green finance - definitions and critiques

Green finance refers to any structured financial activity - product or service - that aims to deliver a better environmental outcome. Greening finance is about trying to channel more funds into sustainable practices that should benefit our planet (e.g. renewable energy) - and vice versa, encourage divestment from harmful activities (e.g. fossil fuel distribution). In practice, this could include anything from investing into renewable energy, waste management, boosting biodiversity, fighting deforestation, reducing pollution and carbon emissions. 'Environmental considerations' of green finance can include different angles: ethical exclusion (i.e. harm to people or the planet), responsible practices, or climate-related (i.e. exposure to climate risk or focused on fighting climate change). It can involve various practices, such as 'green lending' to projects with sustainable focus or 'green equity investment' which means buying shares in pro-environmental companies. In this report, 'green finance' will denote the amalgamation of these definitions, unless stated otherwise.

Since markets are not perfectly efficient or liquid, by encouraging investment reallocation, green finance may help accelerate decarbonisation. This could be further strengthened by triggering virtuous feedback loops and multiplicator effects. For instance:

- An initial green investment for a business trickles through the industry and its supply chains, spurs competition among businesses for more funding driven by uptake of sustainable practices;
- A pioneering green product or service reaches the critical amount of consumers, disturbing the market equilibrium by boosting demand for more 'green' products and services;
- A 'green' business benefits not only from reallocation of capital, but also from labour, as it attracts more (environmentally-conscious) talent.

Potential criticisms of green finance

- ***If* markets work well, green finance is redundant:** Believers in market efficiency claim 'green finance' has little *additional* impact since climate risks and opportunities should be priced into company valuation, and if environmentally unsustainable companies are profitable, divestment on environmental grounds will not be sustained in the long term.

- **Complexity enables greenwashing:** Identifying truly 'green' investments is hard, leaving room for greenwashing. Given the variety of products, services and practices, as well as the complex supply chains, evaluating whether a company is truly 'green' is difficult - and the angles to take are multiple. For instance, the 'green' stamp could be simultaneously given to a renewable power company, a petrochemical company committed to reducing its environmental impact by some future date, and a clothes retailer using durable materials but generating a lot of carbon emissions via international shipping.

- **Equity concerns:** An overt focus on greening finance may disadvantage businesses from the Global South, in countries where environmental standards may be less well embedded, climate-related risks may be higher, and focus on sustainability and climate change-beating technologies is lower.

3. Nudging individuals: Supporting pension holders to make greener choices

A recent survey by Make My Money Matter found that 80% of pension holders have never considered that their monthly contributions might be accelerating global warming. However, when asked, 68% of respondents want their savings to help fight climate change.[28] This shows a gaping mismatch between how consumers would like to invest their pensions and how they are invested in reality - whereby environmentally-conscious individuals might be unknowingly investing in companies which drive deforestation, fund fossil fuels, and pollute the natural environment.[29]

What are the behavioural barriers to switching to a greener pension?

Even people who are passionate about doing what's best for the planet can be thwarted by psychological and practical barriers:

- **Lack of engagement with pensions:** Few people actively engage with their pension at all, let alone evaluate whether it is being invested sustainably or not. Previous work by BIT found that, when asked what's stopping them from saving more for retirement, 15% of people say they don't know how to increase their contributions, and 20% simply haven't thought about it.[30]

- **Lack of awareness of pensions' environmental impacts:** Few pension holders know that their investments could impact the environment. Only 29% of pension holders feel they know what their pension scheme does with their contributions,[31] and 53% don't know whether their pension is invested in line with their values.[32]

- **Choice overload:** Even an engaged pension-holder might have a hard time deciding which fund to invest in. The behavioural science literature shows that the more options people have, the more overwhelmed they become and the less likely they are to choose well, or to make an active choice at all (thus sticking with the default).[33]

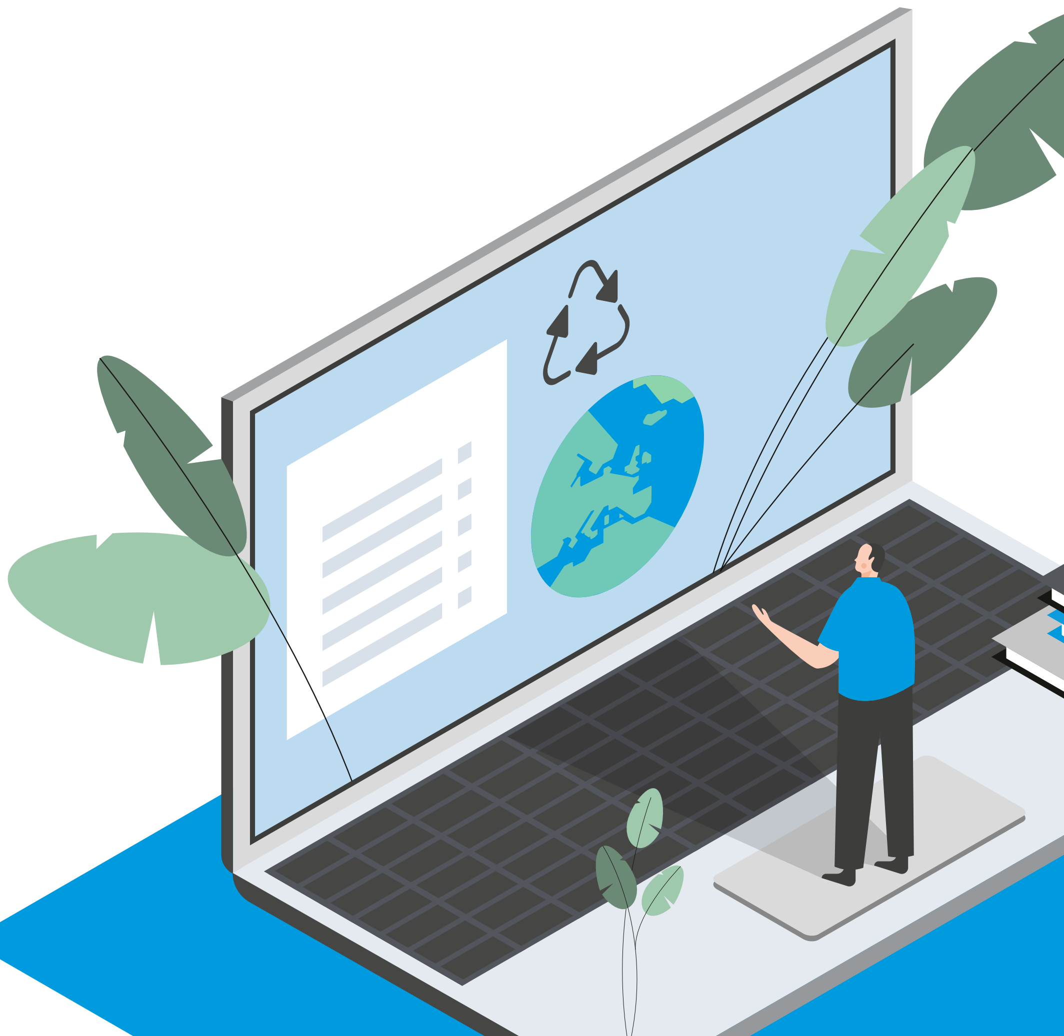
- **Status quo bias:** People tend to stick to pre-selected options.[34] A recent trial conducted by BIT found that it had only occured to 79% of people to so much as consider switching their pension. In practice, this means that pension holders are overwhelmingly likely to keep their pension in the default fund selected for them by their employer or pension provider.

- **Frictions:** Even individuals who are engaged and willing to switch would still need to overcome various small frictions to be able to move their pensions. These include remembering where their different pension pots are, and navigating pension portals to find and understand green options.[35]

- **Lack of agency:** Pensions are generally managed by a third party and invested somewhere on an individual's behalf.[36] As a result, individuals are a step removed, restricting their agency to select green pension funds.

- **Concerns about financial performance of greener funds:** There is widespread concern within the green finance space that people may assume that there is a trade-off between what is good for the environment and what is profitable. Indeed, a recent survey by BIT found that just 41% of pension holders think that an environmental fund would perform at least as well as the other funds financially.[37] Even where there is no overt concern about under-performance of green investments, any lingering doubt may be inflated by our inherent risk aversion, leading us to stick with the default option just to be safe. This may be exacerbated by green investments being presented as a 'different' choice against a norm of non-green defaults.

In the next section, we set out a range of strategies to help pension holders overcome these barriers and switch to a greener pension.



Behavioural strategies to help pension holders green their pension

Provide pension holders with better information about environmental impacts

Impact: Medium
Feasibility: High

Idea 1:
Label pension funds to communicate environmental performance

Behavioural barrier: Pension holders tend to have very **low awareness** that their savings may be harming the environment. This is partially due to lack of engagement with their pension more generally, but is also due to the widespread dearth of accurate and accessible information about environmental impacts. Where such information is available, it is often complex, qualitative, and difficult to compare between pension funds.

Solution: Evidence shows that clear and simple labels to communicate the environmental impacts of different products can influence consumer behaviours.[38 39] This is because they simplify information about climate impacts and make it easier to find, reducing the amount of effort required for consumers to take it into account when making purchasing decisions. A labelling approach should be used to communicate the environmental credentials of different pension options.

A recent survey by BIT found evidence that there is appetite for such an approach: 68% of respondents thought pension providers should provide environmental ratings on all funds.[40] To maximise efficacy, label format and content should be standardised so that it's easy for pension holders to compare across different pension funds. Findings from a recent online experiment by BIT suggests that star ratings are a promising and effective labelling system to encourage people to switch to a green pension scheme (see box 2).

Box 2: An online experiment to test the impact of behavioural science framings on green pension choices

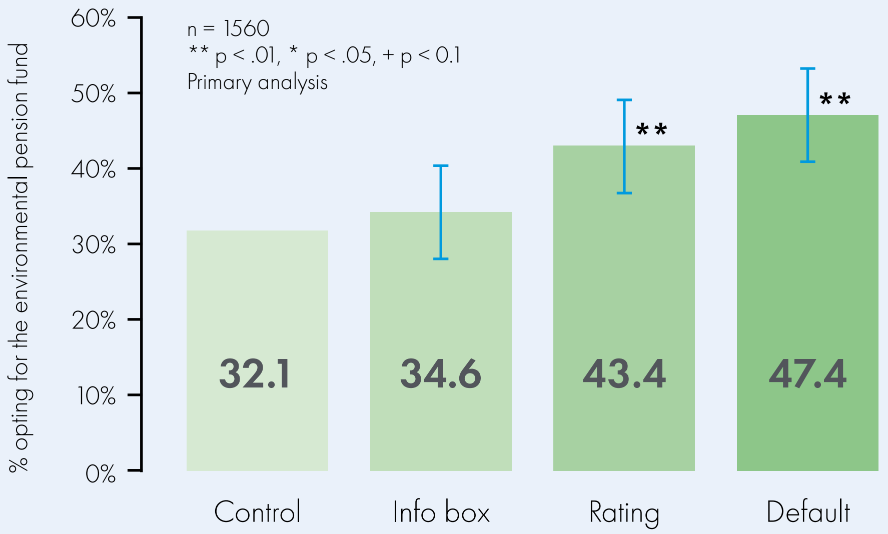
We wanted to gather some initial evidence on the potential impact of our recommendations - would they actually change pension holders' behaviour? To learn more, we conducted an online experiment using our in-house platform Predictiv to test which framings work best to encourage people to switch to a greener pension.

Methodology
We ran an online experiment with 1,560 pension holders. Respondents were given a hypothetical scenario where they received an email from their HR team. The email asked if they'd like to switch from their (default) current pension fund to a different fund (they were given two alternative fund options). They were randomised into one of four groups: a control group, and three treatment groups. These are summarised in the table overleaf.

Figure 1. Participant choice set in the experiment

	Default option	Alternative 1	Alternative 2
1. Red flag	Multi-asset fund	Diversity equity fund	Environmental fund
2. Star ratings	3. Green default	Diversity equity fund	Environmental fund
3. Green default	Environmental fund	Multi-asset fund	Diversity equity fund

Results
Both the 'star rating' and 'green default' conditions led to a statistically significant increase in the number of respondents who indicated they would switch to (or keep) the green pension option. The 'green default' led to a slightly greater increase (47.7%) than the 'star rating' (35.2%). However, the 'red flag' condition had no significant impact on the number of respondents who said they would switch to an environmental fund.



Key takeaways
Our results provide promising evidence that green pension defaults and star ratings can increase the number of pension holders who ultimately choose to switch to a greener option.

In practice, defaults are likely to have an even stronger effect, given not all real-world employees would engage with an email on this topic, and switching would incur more hassle than it did within the experiment. This would reduce the number choosing the green fund within the control, info box and rating conditions, and increase the number within the green default condition. Nonetheless, the relative impacts of these interventions is still informative.

Finally, our results show that a relatively high percentage of people (32.1%) in the control condition would switch to an environmental pension fund following a straightforward email from their workplace. This gives us some (albeit weak) evidence that transparent communications about pension options can be effective in prompting pension holders to consider greener options, providing the act of switching is very easy, even in the absence of any targeted framing which nudges people towards an environmentally-friendly fund.

Idea 2:

Provide regular feedback on the environmental performance of pension pots, with the opportunity to switch to a greener option.

Impact: Low
Feasibility: High

Behavioural barrier: People tend to have very **low engagement** with their pension: they rarely access their online pension portal and take little interest in how it's being invested. Even if accurate and easy-to-understand information exists about the environmental impacts of various pension funds, few will make the effort to seek it out.

Solution: Pension providers and employers should work together to send their members regular updates on the environmental impact of their pensions. Proactively offering this information (rather than expecting pension holders to seek it out themselves), will likely increase the likelihood that pension holders read and engage with it. Any updates should come with clear instructions on how to switch to a greener option, making it as easy as possible for people to act on the information they're given. To maximise efficacy, the following should be taken into account:

- **Timely delivery:** The environmental impacts of pensions should be communicated to people during timely moments when they might already be considering their personal finances. These could include: at the point of receiving a pay rise, when receiving a tax return, and upon retirement.

- **Effective framing.** We react to the same information in different ways depending on how it's framed. For example, people are more likely to buy the same ground beef product when it's labelled as '75% lean' compared to when it's labelled '25% fat'.[41] Different approaches could be tested to determine the most powerful way to communicate the potential environmental impact of pension options. Approaches might include: providing the amount of C02kg saved, equivalent number of trees planted, or number of cars taken off the road.

- **Highlighting social norms:** People are more likely to engage in a behaviour when they believe it is in line with the behaviour of the majority, i.e. the social norm.[42] For example, research shows that people reduce their energy consumption when they receive feedback that they are consuming more than their neighbours.[43] While green pensions are not yet the norm, using 'dynamic social norms' (communicating that others are increasingly switching to green pensions) could be effective in encouraging action.

- **Salience.** We are more likely to act on information which attracts our attention.[44] Environmental information could be made more salient by making use of bright colours and positioning in the page. For example, if included on a pension statement, environmental impacts could be included in a bright green pop-out box at the top of the page.

Change the choice architecture to promote green pensions

In the previous section, we discussed how behavioural science approaches might be used to provide pension holders with better and more timely information about the environmental impacts of different pension funds. We anticipate that this will go some way to increasing pension holders' motivation to switch to a greener fund. However, we know from the behavioural science literature that our actions are profoundly shaped by the choice environment, which may make certain choices easy or hard.

Currently, the choice architecture (i.e., the environment within which people make decisions about their pensions) does little to support green pensions. The 'path of least resistance' typically leads pension holders towards non-green funds, and if they do want to switch, it can be an effortful and time-consuming process. In this section, we set out how the choice architecture might be adapted to better support green pensions.

Idea 3:

Easy switching through the Pensions Dashboard

Impact: Medium
Feasibility: Medium

Behavioural barrier: Small details which make switching pensions more effortful (i.e. friction costs) can make people disportionately less likely to follow through with their intentions to switch. A key friction is remembering and locating old pension pots, as people often lose track of them when they move jobs or house.[45] More than 1.6 million pension pots, altogether worth £19.4 billion, are currently 'lost'.[46] Once they are located, people often struggle to access their account; research by BIT found that 10% of pension holders report not knowing how to access their pension account as a barrier to switching their pension.

Solution: The government is currently working with industry to support the development of a pensions dashboard, which will allow individuals to access all of their pensions on a single secure online portal.[47] This will remove a key friction in the pensions switching process: locating old pension pots. To make it even easier for pension holders to switch to greener funds, the dashboard should be augmented with the following features:

- **Clear information on each pot's current environmental impact:** The dashboard should implement effective labelling (see idea 1) to communicate each pot's environmental impact. This will make it easier for pension holders to evaluate the current impacts of their various pots and make any switching decisions accordingly.

- **Green switching service:** A one-click switching service should be included within the pensions dashboard so that people can easily move their pension pots to a different fund. This would benefit pension holders more generally by increasing their agency over their pensions, while also specifically making it easier for them to switch to a greener option. Similar initiatives have previously proven successful: the Current Account Switch Service, launched in 2013, provides a 'one click' switch service: a customer can simply select a new current account and preferred switching date, and during a seven day process all the hard work is done behind the scenes such as automatically transferring all direct debits to the new account and closing the existing account.[48] Since its launch it has successfully switched over 6.7 million current accounts and has achieved high customer satisfaction rates.[49]

Impact: High
Feasibility: Medium

Idea 4:
Force a periodic active pension choice

Behavioural barrier: There is widespread **lack of engagement** with pensions: only one in ten people use their online pensions platform,[50] and pension providers report that engagement from their members is limited despite it being actively sought.[51] People are often passive when it comes to pensions: rather than making active choices about their pension contributions and where they are invested, people tend to stick to whatever options are chosen for them by their workplace.

While this has worked to the advantage of policies such as automatic pension enrolment, it also means that most people have very low engagement with their pension. A recent YouGov survey found that 63% of pension holders have no idea where their money is currently invested, and 80% have never considered whether their contributions could be accelerating global warming.[52]

Solution: The behavioural science literature shows that, when left to their own devices, people tend to stick with the default option.[53] However, further studies have found that when people are forced to make an active choice, they tend to have better engagement further down the line: for example, people are more likely to request an appointment reminder when they have to actively choose whether to have a flu shot or not, compared to when they are signed up for one by default (implying that they had a greater intention to attend the appointment).[54] With this in mind, pension holders should be periodically engaged (either by their employers or by their pension provider) to make an active choice: to either keep their pension in their current fund, or move it to a new, greener one. To maximise efficacy:

- **Choices should be prompted at timely moments.** Evidence shows that people are most open to making changes when old habits are disrupted or not yet formed.[55] With this in mind, pension holders should be prompted to make an active choice about their pension at moments such as these. Examples might include: at the point of receiving a pay rise; when making a mortgage application; when moving on from a job (after which the pension pot risks being ignored in perpetuity as a new pension is created at a new job); or at the end of the financial year (when employees are often asked to make other decisions about their benefits package).

Impact: High
Feasibility: Low

Idea 5:
Make green pensions the default

Behavioural barrier: Pension holders are subject to status-quo bias, which means they tend to stick to whichever default pension fund their employer assigns them to: 90% of people who are automatically enrolled in a pension stay in the fund they're first assigned.[56] Previous policy changes have shown that defaults are powerful drivers in how people make decisions about their pensions: the introduction of automatic pension enrollment in the UK caused the number of people enrolled in a workplace pension to increase from 47% in 2012 to 76% in 2018.[57]

Solution: Make the default pension fund green. The behavioural science literature shows that people are vastly more likely to opt for something if it is the default option:[58] it is easier to do nothing than decide between other options, and the default option is often assumed to be the safest, most popular, and recommended choice. The results of a recent online experiment by BIT suggest that a green default could increase the number of pension holders choosing a green option by 47.7% (see box 2). With this in mind, making the default pension fund green is likely to hugely increase the number of people who invest their pension in an environmentally-friendly fund.

Research suggests that default green pensions could be a popular change: a recent survey by BIT found that 58% of English pension holders think pension providers should provide environmentally-friendly funds as a default.[59]
In practice, there are different levels at which this idea could be applied, with varied likely impacts on behaviour change:

- **Pension providers to set green workplace pension defaults.** This would mean that individual workplaces would be able to choose a non-green default fund for their employees if they wished, but if they did nothing, the default would be green. Further down the line, employees would also have the flexibility to switch to a non-sustainable pension fund.

- **Workplaces mandated to default employees into a green pension fund.** Rather than pension providers changing their default pension fund, workplaces could be asked to select a green default instead (which would apply to all future employees). This is likely to be more impactful than acting on pension providers, because workplaces wouldn't be able to opt out, so ultimately more pension holders would have a green fund as their default.

4. Shaping the pensions market: Improving the availability and integrity of green pensions

For people to be able to invest their pensions more sustainably, high-quality green pension options must exist in the first place. Ethical or green options are increasingly a standard part of any pension provider's offer, but exceptions remain. There is also room for improvement among pension providers that only offer one 'ethical' option, exacerbating the perception that it is a non-standard choice. Ideally, consumers would have a range of green pension options to choose from, so that they are able to make a decision which suits their specific needs (e.g. risk-tolerance, age, other social objectives). Non-green options should eventually become a novelty.

Furthermore, for behaviour change amongst pension holders to truly make a difference to the planet, green funds must live up to their claims of sustainability. 'Greenwashing' - where companies or products make misleading claims about environmental impacts to improve their appeal and palatability - is of increasing concern within the pensions sector, and has the potential to undermine the impact of customers making the switch to 'green' pension funds.

In this section, we set out how behavioural science might be applied to pension fund managers and businesses to improve the availability and integrity of green pensions.

Solution ideas

Support pension fund managers to identify green businesses to invest in

Pension funds are curated by pension fund managers: they decide what each fund should invest in. These decisions are made based on available information on assets' performance, risk level, and (sometimes) environmental impact. When information about environmental impact is unavailable, inaccurate, or difficult to interpret, pension fund managers are less able to make informed investment decisions. This can mean that (1) it's harder for them to create new environmentally-friendly funds; and (2) existing 'green' funds may inadvertently invest in environmentally-harmful assets, as investment decisions have been made based on inaccurate or incomplete information.

Impact: Medium
Feasibility: Medium

Idea 6:

Provide pension fund managers with clear and timely information on businesses' environmental impact

Behavioural barriers: Difficulties understanding complex and often confusing sustainability-related investment information is one of the key barriers to green investment amongst professional investors.[60] From a behavioural perspective, **informational scarcity and complexity** is likely to result in decision fatigue, making it more likely that pension fund managers rely on their existing mental shortcuts and priors. For instance, as a result of decision fatigue, they could be more likely to go with the flow and opt for their usual 'go-to' investments or if 'going green', picking investment options with the most salient sustainability focus, rather than meaningful green credentials.

Solution: Pension fund managers should be supplied with timely and easy-to-digest environmental impact information about potential investment options. Evidence suggests that giving investors better information about climate impacts increases the likelihood that investors redirect their investment from environmentally-harmful to green assets. For example, in 2016, a leading investment research website introduced a simple rating system for funds' environmental impact. This led to a $24 billion increase in net investment for those with the highest environmental ratings, and a $12 billion reduction in fund flows for those with the lowest rating.[61] In practice, this could involve the following changes:

- **Distilling environmental performance into a simple label.** The environmental impact of potential investment options is often communicated via qualitative rather than quantitative metrics, making it challenging to interpret or to use to compare between different funds.[62 63 64 65] Instead, this information should be given via a simple, standardised, and quantitative labelling system. This would make environmental impact information easier to digest and to act on. Emerging research suggests star ratings are the most promising labelling system for increasing the weighting given to environmental impact by investors.[66]

Support high-quality disclosure of environmental impacts by businesses

For pension fund managers to make informed decisions about which businesses to invest in, companies need to be transparent about exactly how green their current operations and strategies really are.[67] This will ensure that pension fund managers can make informed decisions based on the true environmental impacts of different potential investments.

Across the world, companies are increasingly mandated to disclose their environmental impacts by government legislation. Within the G20, 74% of countries already have some form of mandatory scheme related to climate reporting.[68] Within the UK, all premium-listed companies are already required to report their climate-related risks, and by 2025 this requirement will be extended further to include listed companies, large private companies, pension schemes, insurance companies and banks (although firms with less than £5bn in assets will be exempt).[69] These changes are promising given that previous disclosure mandates have led to substantial improvements in various outcomes: gender pay gaps closed by 20% in the UK after mandated reporting was introduced[70] and the UK's 2013 greenhouse gas (GHG) disclosure mandate reduced emissions by 14-18% relative to a control.[71]

However, disclosure mandates have drawbacks: evidence indicates that non-voluntary disclosures are of a significantly lower quality, and therefore don't always provide accurate or complete information about environmental impacts.[72 73] This is perhaps unsurprising, given that businesses that disclose voluntarily tend to be either highly motivated or pro-environmental already (so stand to gain from such disclosures). For climate disclosure mandates to have a meaningful impact, businesses must be motivated to produce information which is accurate, detailed, and complete.

Impact: Low
Feasibility: Medium

Idea 7:
Highlight the short- and medium-term environmental disclosure benefits to business leaders

Behavioural barriers: Business leaders are subject to present bias; they tend to be incentivised by short-term, quarterly, and financial outcomes, rather than longer-term wins.[74 75] High-quality environmental disclosure projects can lead to some negative impacts in the short- and medium-term: it can be time-consuming, resource-intensive, and (if the findings are very damning) generate bad PR. To reduce these short-term negative impacts, business leaders may be tempted to opt for a less rigorous assessment of environmental impacts (to bring down costs), or even obscure negative findings from their public-facing reporting (to avoid bad PR). This can mean that pension fund managers have to make investment decisions based on low-quality information about environmental impacts.

Solution: We need to draw attention away from the short-term disadvantages of disclosure. Instead, we should help business leaders to focus on the short-term benefits (of which there are many), and potentially generate new ones.

- **Emphasise the short-term financial benefits of disclosure:** Surprisingly, the environmental disclosure process can lead to financial savings for businesses. This is because it entails auditing a company's operations, which normally involves assessing energy and water expenditure and identifying any waste in the system. For example, Walmart's environmental disclosure project identified a huge amount of waste in their operations. They used insights from the audit to make improvements to their product design and waste diversion and recovery,[76 77] which led to over $12.4 billion in savings.[78]

- **Emphasise the immediate reputational and legitimacy benefits of disclosure:** A further short-term benefit of disclosure is that it can enhance brand / company reputation. Disclosing companies are seen as positive, moral actors, and working in line with society's values, which can generate immediate positive outcomes for consumer retention, talent acquisition, some investment, and relationships with social movement groups.[79]

- **Reward the business leader:** Senior business leaders typically work for a given company for five - seven years.[80] This can disincentivise them from actioning longer term sustainability strategies, as they may not be part of the business once these benefits become apparent.[81 82] To address this, business leaders could be given direct short-term rewards to motivate immediate disclosure to a high quality standard. This might take the form of government-sponsored awards; for example, the Queen's award for enterprise might be expanded to include recognition for individuals who make remarkable contributions towards their company's sustainability efforts. Alternatively, the government could develop official accreditation for business leaders who have initiated a company's disclosure. This latter option especially addresses the behavioural barrier associated with CEO tenure not being long enough to reap the benefits of sustainable action, because this accreditation could be harnessed to enable a transition to a new role. However it could of course also apply to all board members to motivate them to identify as sustainability champions within their organisations.[83]

5. Conclusion

In the year of the UK hosting COP26, climate change is on the top of the agenda. While many are starting to accept the urgent need to change how we heat our homes, how we travel, and what we consume, few are aware of the potentially transformative role of our pension savings in driving the investment that will make these very behaviours more prevalent.

Applying a behavioural lens can help us to green the pension system. Ultimately, this ambitious goal of harnessing trillions sitting in pension funds to transform the UK's economy - and save our planet - will come down to individual choices, decisions, and behaviours of different actors throughout the system. Starting upstream, with asset holders complying with environmental disclosure, through to pension funds using this information to create high quality credible green options, to individual pension holders choosing funds which will help us to achieve what's best for our planet.

In this report, we contribute to the emerging conversation on green pensions by highlighting the benefits of using a behavioural approach. We outline seven initial ideas on how insights from behavioural sciences can help green our pensions, and invite further discussion on how these and other similar approaches could be implemented and rigorously tested in the field. When it comes to green pensions, we're still at the beginning of the journey, with many doubts to overcome and questions left to answer. How can we maximise the impact of green pensions in fighting climate change? How can we redesign our complex pension system to support green investment every step of the way? Which solutions will be truly effective on the ground? While we recognise that much more research is needed, this report aims to provide initial steers, based on existing research and drawing on key tenets of behavioural science.

If you are a pension holder, pension fund manager or business leader, think about how you can green your pension or facilitate that switch for others. And if you are a business which provides a workplace pension, policy-maker, or pension provider, and would be interested in helping us to develop and test these ideas, please do get in touch.

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Greening Pensions: A Behavioural Perspective

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