Financial Education and Pensions

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Why is financial education particularly important for pensions?

Unique nature of pension issues makes financial education particularly important…

- **Very long-term**
- **Non-recurrent choice (you cannot learn from your own experience)**
- **Environment changed wrt. our parents' (you cannot learn from them either)**
- **Social relevance, political consensus needed for pension reforms**
- **Complex schemes and products**

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Why is financial education particularly important for pensions?

… combined with demographic and systematic trends:

- Increased longevity, health and LTC expenses are set to increase
- Working lives still not adjusting to longevity trend
- Birth rate much lower than in the past
- Stress in public pensions’ finance
- Diffusion of DC schemes and risk shifting to individuals
- Individual choice and responsibility

Yet pensions are poorly understood, probably more than other financial products or issues

Lack of financial knowledge/ understanding/ awareness/ capability relating to pensions:

- **Lack of understanding of the changing retirement environment**
- **Lack of awareness of the need to save**
- **Lack of capability to make sound long-term saving plans**
- **Lack of understanding of pension schemes and products**
- **Lack of awareness of the importance and level of costs**
- **Lack of understanding regarding long-term investment risks**
- **Lack of awareness regarding longevity risks**
- **Lack of trustee and fiduciary capability / governance issues**

Limits of Financial Education

Behavioural economics show serious limits in the capacity/willingness of people to take sensible/ active decisions regarding their pensions

- **Thaler- Bernanrtzi (2001): “save more tomorrow”**
- **Choi et al. (2002): “the path of least resistence”**
- **Mac Farland et al. (2003): “one size does not fit all”**

On the other side, other studies (e.g. Lusardi-Mitchell - 2007) are more optimistic on the impact of financial education

Limits of Financial Education

Financial education therefore needs to be combined with other mechanisms

- **Information, Disclosure**
- **Automatic enrolment**
- **Limit the number of options, keep choice simple**
- **Default options**
  - ⇨ **when wisely designed, default options have an informative and educational value**

OECD Recommendation Good Practices for Financial Education relating to Private Pensions

- Approved by OECD Council on March 28, 2008
- Developed in 2006 by OECD Working Party on Private Pensions, taking stock of the OECD Council recommendation of July 2005

Three parts:

1. General framework and objectives
2. Main stakeholders' roles
3. Methodology: assessment of needs and programmes; mechanisms and tools available

OECD Recommendation Good Practices for Financial Education relating to Private Pensions

1. General framework and objectives

- Financial education for retirement products should be encouraged, either as part of a wider financial education effort, or through specific programmes
- Objectives of financial educaiton include promoting:
  - the understanding of the chnging retirement environment
  - Awareness of the need to save for retirement
  - The understanding of retirement schemes and products
- Financial education should be seen as a tool to enhance
  - Personal well being
  - Social and economic growth through better functioning of competitive markets
  - The performance of pension providers and financial intermediaries
- Financial education should complement financial prudential regulation and consumer protection

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2. Main stakeholders' roles and responsibilities:

- Governments and other public authorities
- Social partners
- Plan sponsors
- Pension funds
- Financial intermediaries

Governments and Other Public Authorities

- Have a significant role to play via public awareness campaigns, providing a strong lead, coordinating other partners
- Should consider the establishment of a specialized structure or agency, and of specific websites
- Need to explain public policy clearly – pension reform, increased individual responsibility, demographic changes etc.
- Should direct campaigns as broadly as possible – in addition specific programmes should be targeted at vulnerable groups
- Should work towards making individuals aware of their limited knowledge, and provide information on where to seek help
- Should organize the regular delivery to individuals of projections of their public pension income
- Should ensure financial education starts as early as possible (e.g. school curricula) and is on-going in an individual's life, in particular at key life points

Social Partners

- Depending on the country context, trade unions, employer, and pension fund associations should contribute to financial education programmes (taking advantage of their networks among employers, employees an pension fund members)
- They should have a role in making sure that members know what pension and/or retirement savings arrangements are available to them.
- Could survey members' levels and requirements of financial education and how they prefer to receive such information
- Could also be direct providers of financial education or training, or should at least inform members where they can receive help.

Employers Sponsoring Pension Plans

- Should inform employees of any pension plan offered to them, its broad structure, a reasonable projection of benefits and any responsibilities
- Should be encouraged to provide financial education information (or at least inform of sources) – particularly via seminars, where costs permit
- Where plan members make investment decisions, should at least ensure that workers are aware of this responsibility and have access to information to help them make informed investment decisions
- Should be encouraged to warn individuals of potential inadequate retirement income if contributions or balances are particularly low
- Where plan members choose investment options, should limit and shape the number of choices and provide a structured default option
- Should consider automatic enrolment into occupational schemes
- Financial education should be encouraged for trustees and fiduciaries

Pension Funds and Other Retirement Income Providers

- Should produce timely and accurate information on the design, operation and performance of products
- Should be encouraged to supply prudent projections of the retirement income to be reasonably expected
- Information should be in as clear and simple a format as possible
- Information should be provided on the choices and responsibilities which individuals are required to take – particularly in relation to DC plans – with particular reference to the types of investment, risk / return profiles, costs etc.

Financial intermediaries

- Should make a clear distinction between financial education and commercial product recommendations. Any advice for commercial purposes should be transparent and disclosed
- Clear and consistent general legal obligations, standards, codes of conduct should be developed. Checking the financial awareness of clients should also be part of financial service providers' good governance
- Those providing any of the above services should be suitably trained, qualified and regulated

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3. Methodology: assessment of needs and programmes; mechanisms and tools available

- Develop methods for the assessment of the level of financial literacy and capability of population and of more vulnerable groups in relation to retirement
- Develop criterias to assess the effectiveness of measures and programmes aimed at enhancing financial literacy related to pensions
- As a complement to financial education, encourage automatic enrolment in pension plans with appropriate deafult mechanisms and opt-out procedures
- Promote various tools –including financial calculators – for estimating retirement income needs and savings requirements
- Make available financial education in relation to pensions through a large variety of sources, including broad media coverage in order to raise awareness of pension issues

Further Work

- Evaluation of programmes of financial education related to pensions
- Case studies of successful projects
- Education on annuity products
- Education for DC plans, member-directed investment options
- Renewed attention on mechanisms to increase coverage
- Long-term risk awareness
  - Pension projections : communicating uncertaninty surrounding expected values
  - More research in the estimation of financial risk in the long-term
  - Favour long-term balanced view; avoid excessive risk aversion and alarmism