Financial Education Programmes for Pension Plan Members: How to Encourage Greater Retirement Saving

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Highlights

- Brief description of OECD's Financial Education Project.
- Context/background: Why are we concerned about retirement saving?
- Overview of studies on behavioural finance—Implications for increasing retirement savings?

OECD's Financial Education Project

- Established in June 2003 to study financial education programmes in OECD countries and selected non-OECD countries, with funding from Prudential plc.

- Purpose: describe existing financial education programmes, analyze effectiveness, and develop methodology to enable comparison of programmes.

- Activities to date: set up website, established a research database, circulated questionnaires and conducted literature review, currently writing report on our findings. First major international report on financial education.

Why are we concerned about retirement saving?

- Changes in pension arrangements—increasing personal responsibility

  - Some countries, such as the U.S. and the U.K., have experienced shifts in employer-provided pension coverage from DB plans to DC plans.

  - Other countries, such as Sweden, Australia, or those in Eastern Europe have introduced mandatory DC plans, either as a component of or a replacement for their state supported system.

  - Still other countries, such as Germany and Ireland, have encouraged voluntary participation in personal pension plans.

Why are we concerned about pension saving?

- Low levels of financial literacy:
  - United States—50% of adults and 66% of high school students fail basic economics test.
  - United Kingdom—fewer than 40% of respondents confident about making financial decisions.
  - Japan—only 1% of consumer education professionals believe that consumers have adequate level of financial knowledge.
  - Australia—37% of those with investments did not understand that investments can fluctuate in value.

Overview of studies in behavioural finance: Implications for increasing savings

- Evaluations of financial education programmes—what has worked

  - Employer-provided financial education seminars

    *Bayer *et al.* (1996): Participation rates of non-highly compensated workers increase 12% points; highly compensated workers increase participation by 6% points.

    *Lusardi (2003): Financial wealth of those at bottom of income distribution increases by 70%; on average, by 18%.

Overview of studies in behavioural finance: Implications for increasing savings

- Evaluations of financial education programmes—what has worked

  - Employer-provided written information

    *Clark and Schieber (1998): Providing generic newsletters on 401(k)s increases participation by 15%; providing specific company 401(k) information increases participation by additional 21%.

    *Bayer *et al.* (1996): Written materials, such as newsletters and summary plan descriptions, have no effect on participation and contribution rates.

Overview of studies in behavioural finance: Implications for increasing savings

- Evaluations of financial education programmes—what has worked

  - Employer-provided one-on-one counselling

    *Ernst and Young (2004): Counselling results in substantial increase in percentage change in participant investing. Less personalised provision of information has little effect.

Overview of studies in behavioural finance: Implications for increasing savings

- Studies of consumer behaviour: Attitudes toward saving

  - MacFarland *et al.* (2003): Link between attitudes toward money and retirement planning.

    *50% of participants are "non-planners": have no strong retirement goals and lack discipline to set and adhere to goals. Find financial matters source of stress or uninterested in future.

    *Suggests need to emphasize simpler decisions, less information, reduced complexity. Emphasize tangible, present-day benefits. Be explicit and direct.

Overview of studies in behavioural finance: Implications for savings

- Studies of consumer behaviour: Too much choice

  - Iyengar *et al.* (2003): Participation is higher when fewer funds are offered.

    *Too many options lead to “choice overload” and less motivation to select funds. Participation rates peak when only two funds are offered.

    *Suggests that employers offer limited number of options. To appeal to more sophisticated investors, one of options might be “many more choices”.

Overview of studies in behavioural finance: Implications for savings

- Studies of consumer behaviour: Role of inertia and lack of will power

  - Choi *et al.* (2003): Identify a key behavioural variable— "following the path of least resistance".

    *Employees often do what is easiest, *i.e.* nothing; few employees opt out of default options. Thus changing the default in 401(k) plans to automatic enrolment can increase participation rates significantly.

Overview of studies in behavioural finance: Implications for savings

- Studies of consumer behaviour: Role of inertia and lack of will power

  - Thaler and Benartzi (2001): Base their approach for increasing savings rates in 401(k) plans on four behavioural factors:

    *Failing to use all available information.
    *Preferring future opportunities to save over current ones.
    *Staying in a programme once enrolled due to inertia.
    *Not wanting to reduce current income (by increasing savings).

Overview of studies in behavioural finance: Implications for savings

- Studies of consumer behaviour: Role of inertia and lack of will power

  - Thaler and Benartzi (2001) designed a programme giving workers the option to commit themselves now to increase savings rate later, each time they got a raise.

    *The workers who joined their plan tripled their saving rates in 28 months from 3.5% to 11.6%.

Overview of studies in behavioural finance: Implications for savings

- Summary
  - Employer-provided financial education programmes increase retirement savings. Method of provision and content of information are important.
  - Different attitudes toward saving need to be considered in design and implementation of financial education programmes.
  - Consumers can be overwhelmed by too much choice.
  - Behavioural characteristics, such as inertia and lack of willpower, can be used to help consumers save more.

Further information

- Financial education website—
  www.oecd.org/daf/financialedcuation

- Contact for specific questions—
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