

Financial Education and Pensions

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Why is financial education particularly important for pensions?

Unique nature of the product makes financial education particularly important...

- **Long-term nature of contract**
- **Wide social coverage**
- **Low risk tolerance**
- **Complex products**
- **Large number of pension schemes**
- **'Social' role**
- **Potential impact on financial markets and economy**

Why is financial education particularly important for pensions?

... combined with demographic and systematic trends:

- **Increased longevity**
- **Shorter working lives**
- **Lower birth rate**
- **Decline in public pensions**
- **Shift to DC schemes**
- **Individual choice**



Yet pensions are as poorly understood as other financial products

Lack of financial knowledge relating to pension:

- **Lack understanding of the changing retirement environment**
- **Lack understanding of the need to save**
- **Lack understanding of investments**
- **Lack of trustee and fiduciary capability**



Understanding the Changing Retirement Environment

Surveys in many countries show people do not understand the pension system in place

Examples

- **China – vast majority of rural workers not claiming benefits**
- **Chile –lack of basic understanding of pension system 25 years after launch**
- **Japanese Consumer Survey on Finance found that 29% respondents had no knowledge of insurance, pensions and tax**



Understanding the Changing Retirement Environment

Financial Education can provide knowledge of system + types and amount of benefit due

Examples

- **China – training for local social security staff to advise on benefits**
- **Chile – receiving statement raises knowledge of system from 28%-44%**
- **Germany – providing annual information on pension entitlements played significant role in additional planning**

Understanding the Need to Save

International surveys show individuals underestimate need to save for retirement

Examples

- **USA – around 50% workers do not participate in occupational pension scheme, even when employers match contributions – blaming lack of information on the scheme or the importance of saving**
- **UK – survey (Barclays) showed people expecting \$32,000 retirement income – savings actually deliver \$11,000**
- **Australian survey found only 37% had determined how much they need to save for retirement**



Understanding the Need to Save

Financial Education can be used to increase coverage and savings rates

Examples

- **USA – participation in 401(k) shown to rise 12% (+ contribution rates increase) after education**
- **Chile – self-employed with above average knowledge of the pension account system 14% more likely to make contributions**



Understanding of Financial Products

Knowledge of financial products consistently low across OECD and other countries

Examples

- **Japan – Consumer Survey on Finance 71% no knowledge of investment in equity and bonds**
- **Chile – 30% claim knowledge of asset allocation less than 10% could identify low risk investment strategy of pension provider (AFP)**
- **Australian survey 32% think a bank account is an appropriate retirement investment vehicle**



Understanding of Financial Products

Financial Education can improve knowledge and change behaviour

Examples

- **USA – investment strategy altered (may involve taking on *more* risk) and financial wealth increased (18% on average) after education**
- **Japan – DC Act requires plan sponsors provide information on investment – e.g. Sanden +10 correct responses on money investment up to 53% from 22% after attending seminar**

Lack of Trustee and Fiduciary Capability

Trustees and other fiduciaries lack capability to perform increasingly complex roles

Examples

- **UK – Myner’s report highlighted ‘amateurism’ amongst pension fund trustees as “the true governance hole at the heart of our investment industry”**



Lack of Trustee and Fiduciary Capability

International trend towards training for fiduciaries

Examples

- **Australia – licensing of trustees introduced (fitness – individual basis / propriety – collective basis) – numbers reduced from 1000 to c300**
- **UK – 2004 Pensions Act greater skill and responsibility required for trustees**
- **Ireland – moving away from voluntary trustee training Pensions Board handbook / guidance / approved training courses / monitor attendance**

Limited Impact of Financial Education

- **Behavioural economics show that some groups will not or cannot save**
- **Financial education therefore needs to be combined with other mechanisms**
 - *Disclosure*
 - *Automatic enrolment*
 - *Number of Choices*
 - *Default options*

Draft Suggestions for Good Practice in Financial Education relating to Retirement Income

General Principles applicable to other financial products also important for pension related programmes

Financial education for retirement products should be encouraged

Should complement prudential regulation and consumer protection frameworks

Initiatives and population needs should be assessed on an on-going basis

Information should be made easily available in as many sources as possible

Information should be provide in simple language (no jargon)

Financial Education should start as early as possible – i.e. at school - + be on-going (e.g. linked to key life events)

Specific roles can also be identified for the different parties involved in retirement income field



Governments and Other Public Authorities

- Should play a significant role via public awareness campaigns and can provide a strong lead, coordinating with a range of other partners
- Need to explain public policy clearly – including any 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 encourage initiatives to provide information on projected pension income both public + private (e.g. online calculators, combined statements)
- Should work towards making individuals aware of their limited knowledge and provide information on where to seek help and advise

Social Partners

- Depending on the country context, social partners and pension fund associations should contribute to financial education programmes – e.g. for example through surveying members to ascertain the level and requirements of financial education and how they prefer to receive such information
- Social partners also be providers of financial information or training, or should inform members where they can receive help. They should also have a role in making sure that members know what pension and/or retirement savings arrangements are available to them.

Plan Sponsors

- Should be encouraged to provide financial education information and training – particularly via seminars, where costs permit
- Financial education should be encouraged for trustees and other fiduciaries
- Where plan members make investment decisions, plan sponsors should at least ensure that workers are aware and have access to information to help them make informed investment decisions
- Where plan members are offered a range of investment options, plan sponsors should consider limiting and shaping the number of investment choices available and provide a suitably structured default option
- Should consider automatic enrolment into occupational schemes



Pension Funds and Retirement Income Providers

- Providers of retirement income products should produce timely and accurate information on the design, operation products
- Information should be in as clear and simple a format as possible
- Information regarding private pension income should be presented within the context of overall retirement income, including public pension
- Information should be provided on the choices and responsibilities which individuals are required to take
- Providers of pension products may wish to alert members if they are aware that contributions to the retirement savings plan are particularly low and could potentially result in inadequate retirement income.



Intermediaries and Advisors

- Clear distinctions should be made between financial education and commercial product recommendations. Any advice for commercial purposes should be transparent and disclosed.
- Clear and consistent general legal obligations and standards should be developed for intermediaries. 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.