
Financial Literacy, Financial Education and Pension Investments in the U.S.

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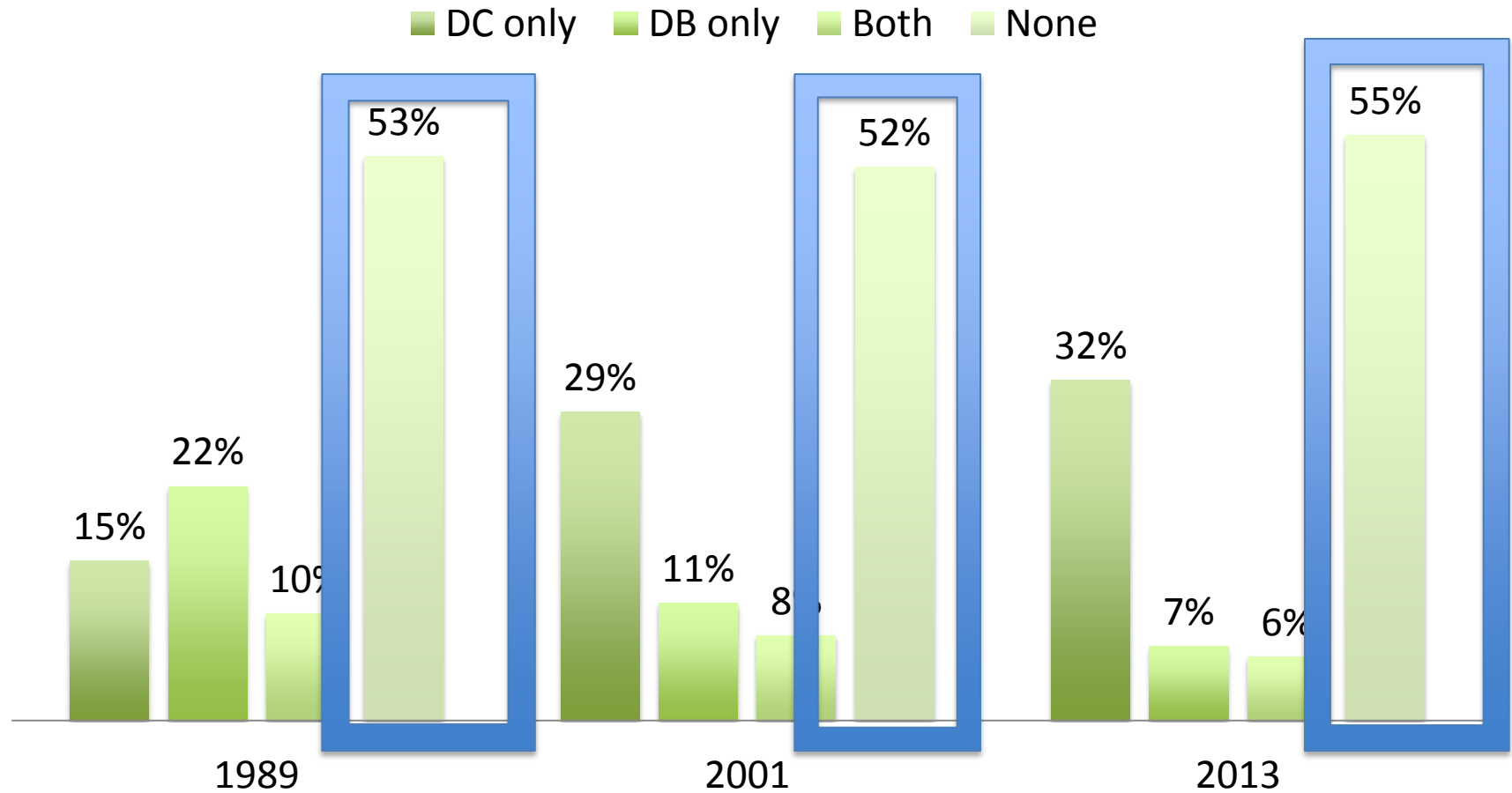
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Pension Coverage of All U.S. Workers (Private and Public), By Type of Plan

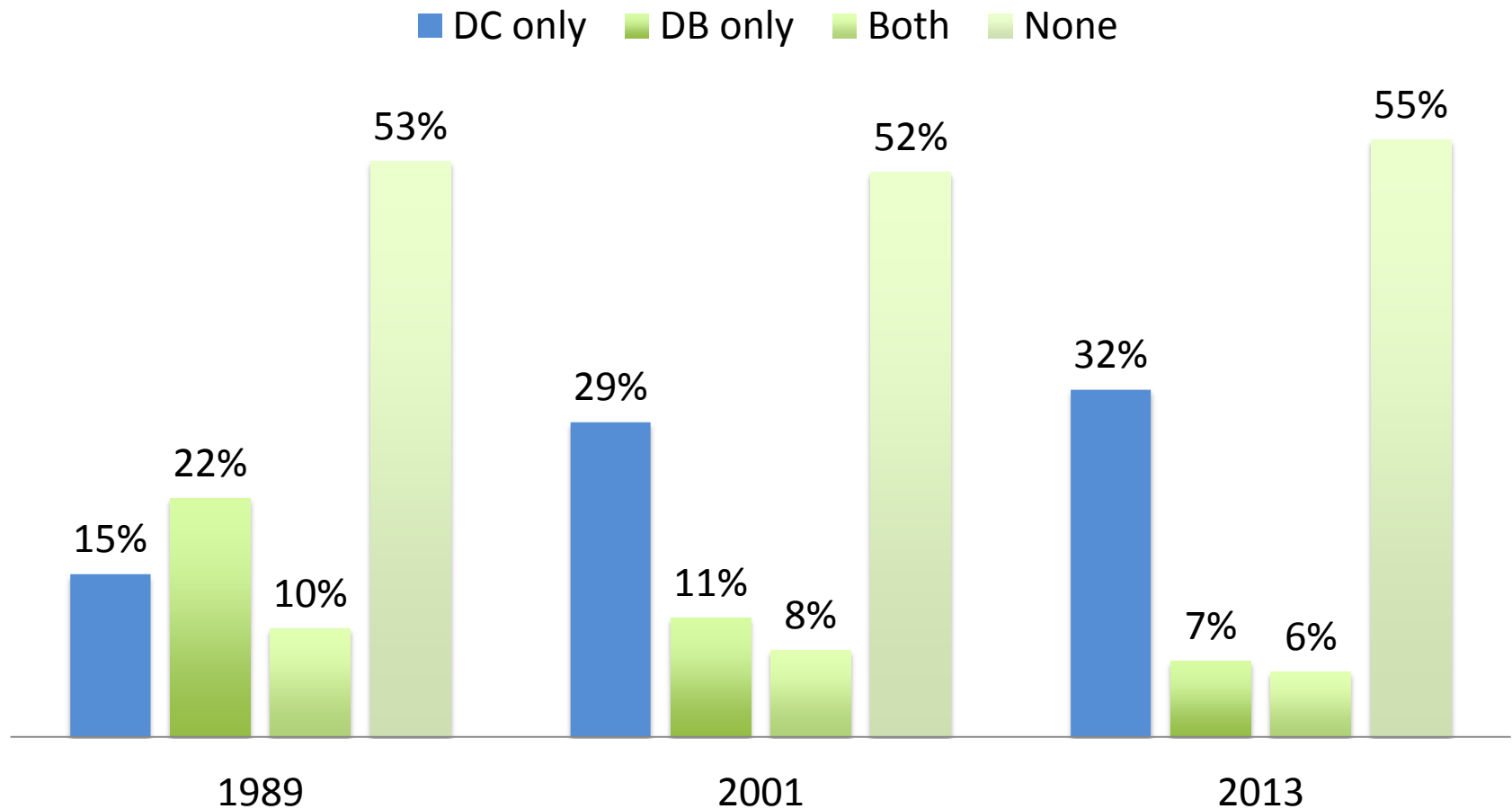


Source: Center for Retirement Research at Boston College Website, Accessed January 13, 2015. CRR staff estimates based on U.S. Board of Governors of the Federal Reserve System, 1989-2013 *Survey of Consumer Finances*



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Percentage in DC Plans Increasing



Source: Center for Retirement Research at Boston College Website, Accessed January 13, 2015. CRR staff estimates based on U.S. Board of Governors of the Federal Reserve System, 1989-2013 Survey of Consumer Finances



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Consequence of U.S. Shift in Pensions

Asset Allocation?

Savings Amount?

Rebalancing?

**Contribution
Level?**

**Plan Type: DC,
Hybrid, DB?**

**Distribution
Decisions: Annuity
vs Lump Sum?**



Financial Literacy AND Pension Plan Knowledge are Issues

- Growing literature documents frequent mistakes made by investors related to low levels of financial literacy
- New study finds that the most financially sophisticated participants earn higher risk-adjusted excess returns in DC plans (Source: Clark, Lusardi and Mitchell 2014)



- We find individuals are less likely to participate when they are unaware of one of their pension plan's benefits (Agnew et al 2012)
- One study finds individuals make sensible decisions based on what they believe is true BUT their beliefs are not always accurate (Brown and Weisbenner 2013)

Another Issue: Feelings about Retirement Decisions

“This is how I felt when the market started to crash. I felt like I had a knife to my throat. I was in the hands of other people and I felt totally powerless.”

(Male, Unaware)

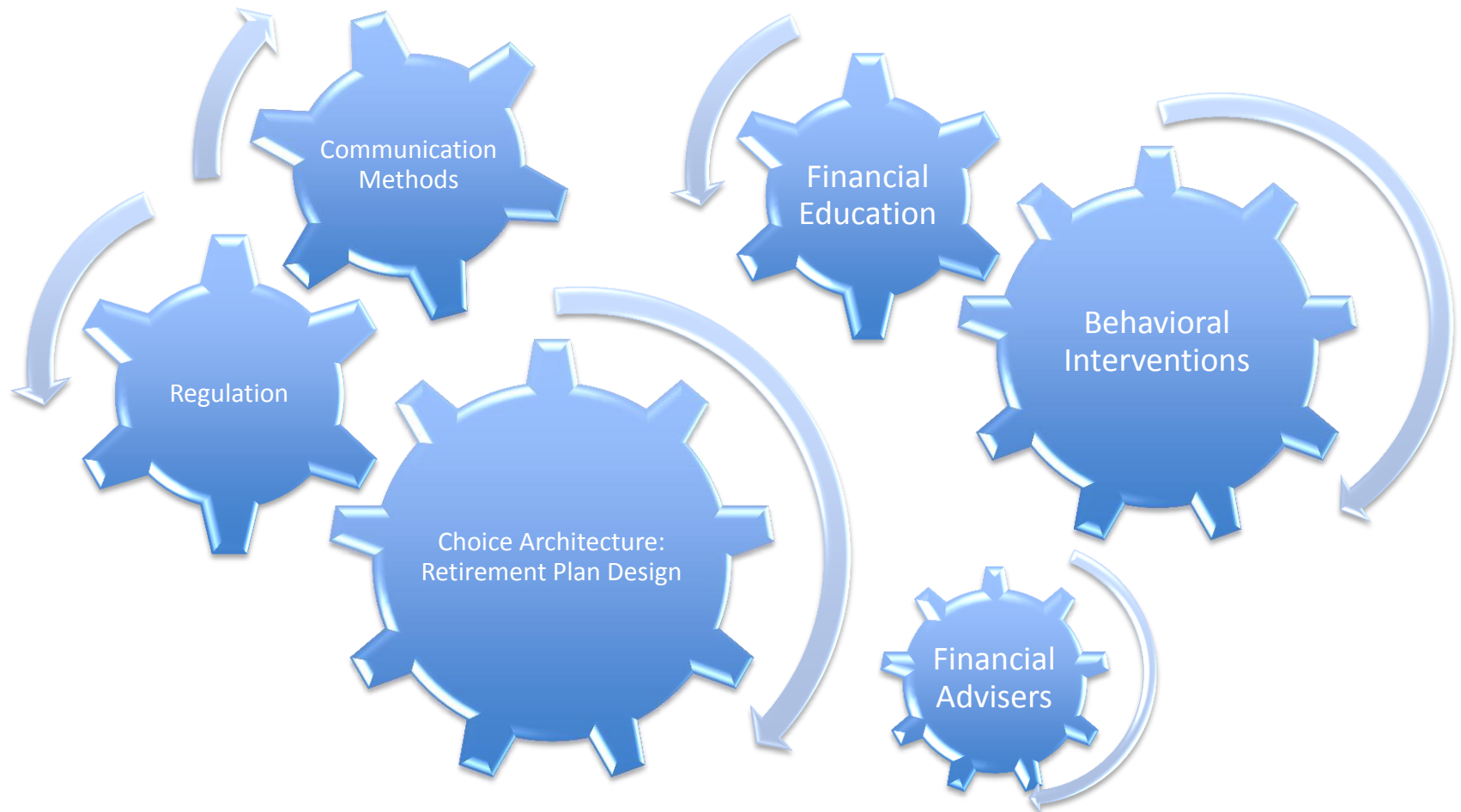
“I think the barber represents the managers who are doing your mutual funds. You are the guy in the seat and that blade is kind of like them managing your money: if he’s good at it, then you will get a good shave. But if he’s not so good, you might have some nicks there. And that makes me feel uneasy – how that shave turns out is completely out of my control.”

(Male, Unaware)






“I feel like him – if I make the wrong choice, I’m going to be hurting myself, cutting myself, losing a lot. But I can’t tell which choices are right and which are wrong. It’s very scary. I’d like to be able to understand what’s going on but I just don’t.” (Female, Unaware)

Possible Ways to Improve Pension Decisions



Example of Choice Architecture

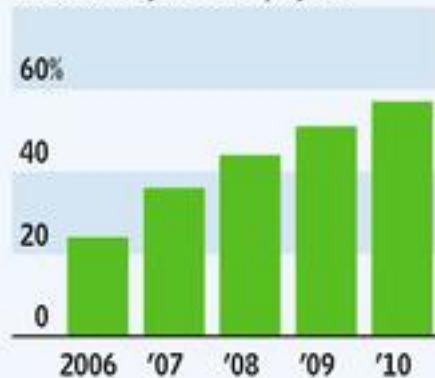
Company	Hire Date Before Automatic Enrollment	Hire Date After Automatic Enrollment	
B	26.4%	93.4%	
C	35.7%	85.9%	
D	42.5%	96.0%	

Is There a Downside?

Unintended Consequences

An increase in automatic 401(k) enrollment ...

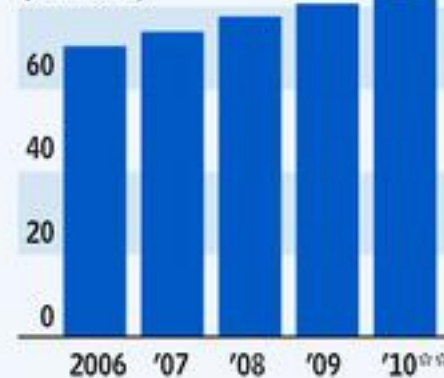
Percentage of large companies that automatically enroll employees



*active, retired, and separated **estimated

...Has boosted the number of savers overall ...

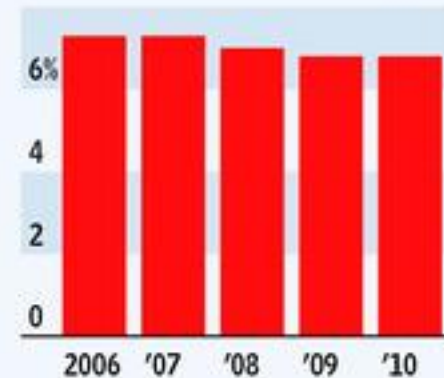
Participants in 401(k) plans (in millions)*



Sources: Aon Hewitt, Cerulli Associates, The Vanguard Group

...But decreased the average savings rate

Average annual contribution rate

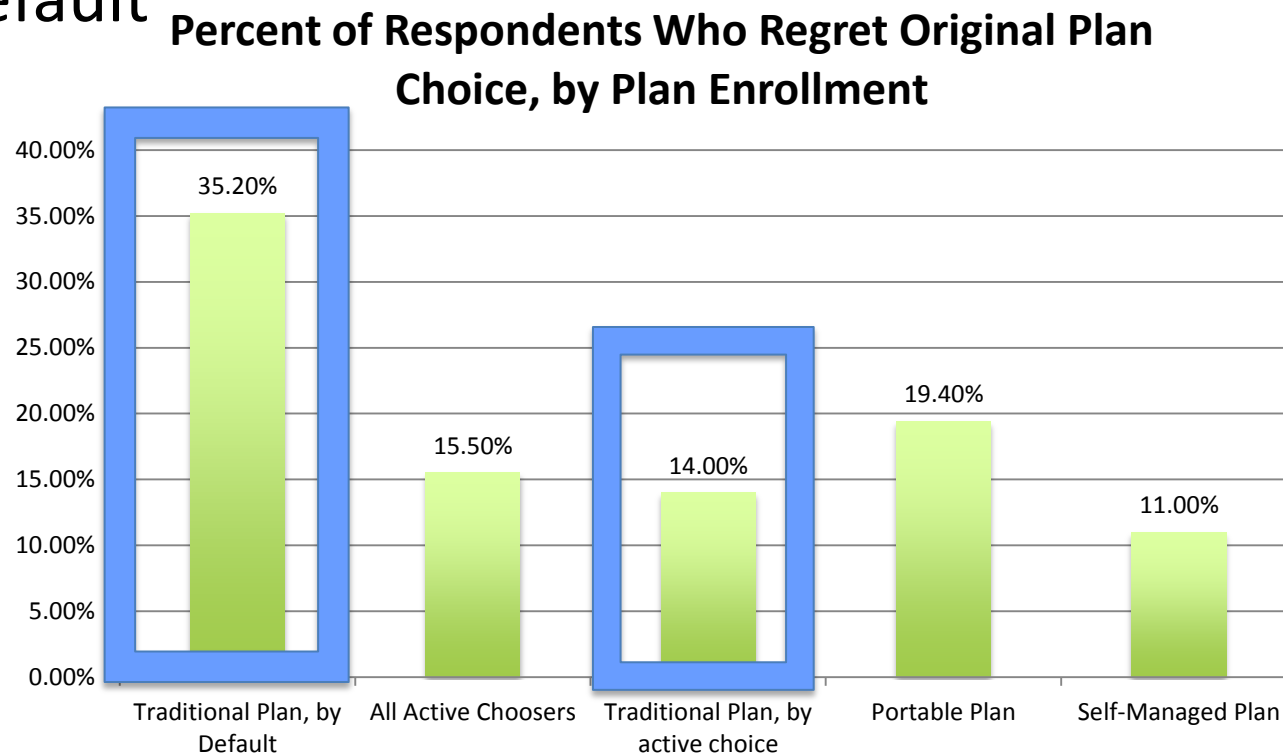


“401(k) Law Suppresses Saving for Retirement” by Anne Tergesen
July 7, 2011 *Wall Street Journal*



Possible Long Run Default Issues

- In the long run, new evidence from a **study of plan choice** suggests greater levels of regret associated with the default

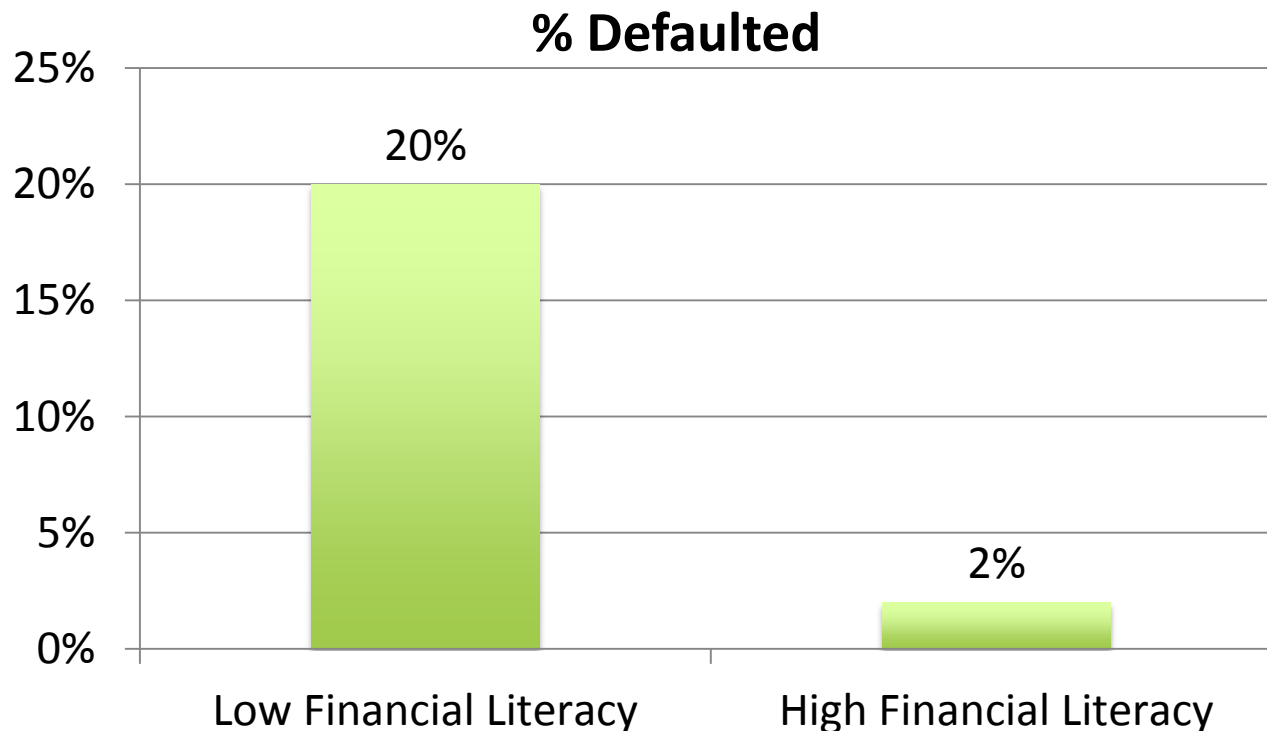


Brown, Farrell and Weisbenner (2011), Figure 2



Who Defaults?

- Experimental study found that those with lower financial literacy were more likely to invest in the **default** asset allocation option than others



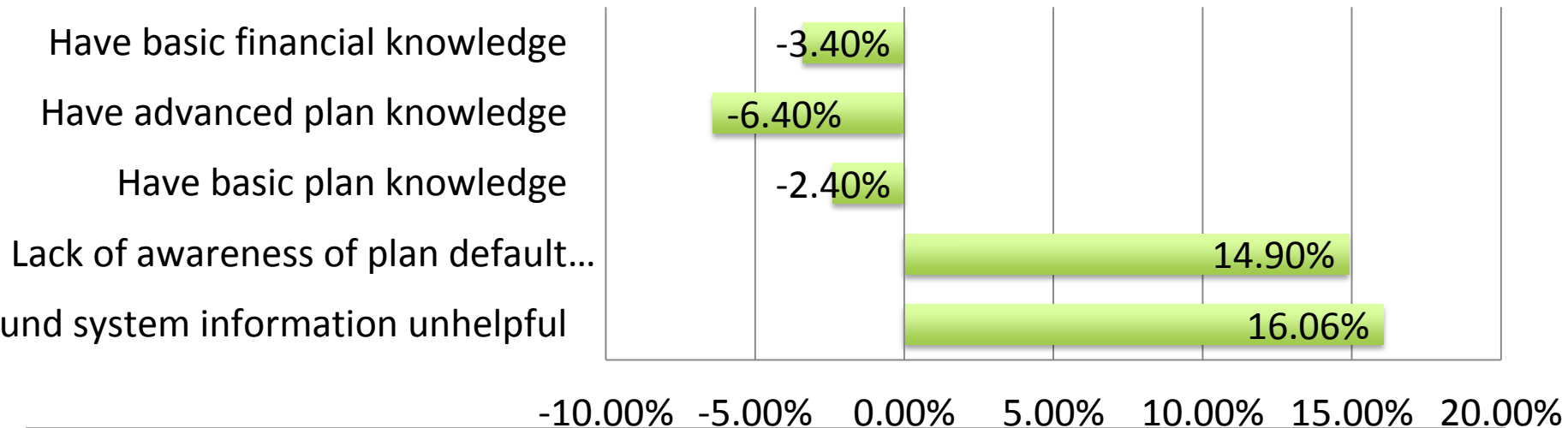
Source: Agnew and Szykman (2005)



Additional Evidence

Returning to the **study of plan choice** (DB, DC, or Hybrid), the likelihood of defaulting into the DB plan is related to basic financial literacy, plan knowledge and information problems.

Probability of Defaulting



Source: Brown, Farrell and Weisbenner (2011)



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What about Communicating More Information?

- In a large scale experiment, we examined the choice between an annuity and a lump sum
- We found that individuals that experienced information overload were **30 percent** less likely to feel confident about their choice



Source: Agnew and Szykman (2011)



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Long-Run Satisfaction

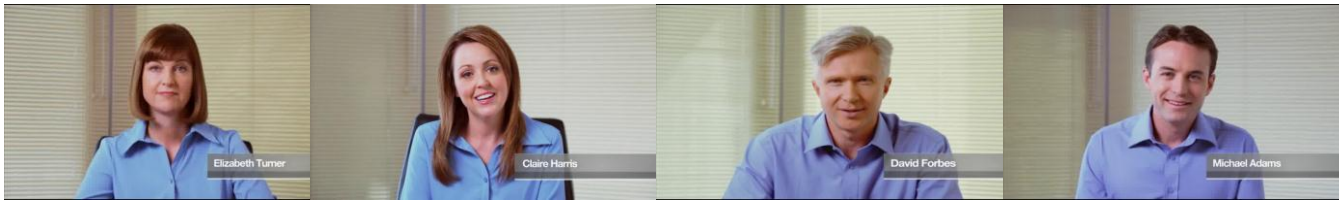
- Controlling for final payouts, those with more information overload were also less likely to be satisfied with their decision when the game was complete



- Those with low financial literacy are more likely to be overwhelmed by the information presented to them
-

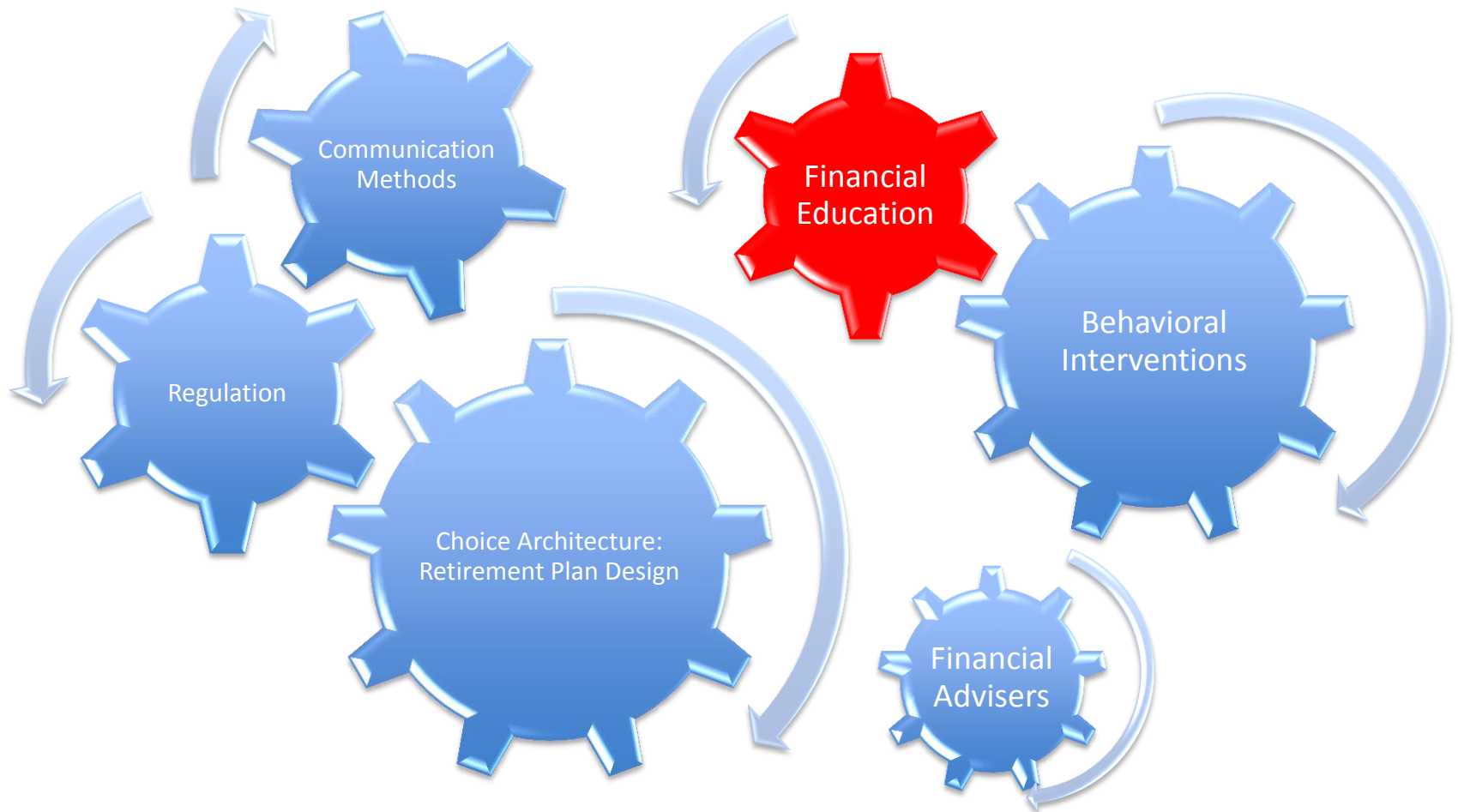
What about Financial Advice?

- In a new experimental study conducted in Australia, we found that individuals were more likely to follow advice from advisers **with credentials**



- Individuals could be **easily** manipulated to follow bad advice on complicated topics
- While credentials might be useful signals, many participants could not accurately tell real credentials from fake ones
 - **2 of the top 3** chosen from a list were **fake**
- **Outstanding question:** Can financial literacy/education make individuals less susceptible to manipulation and more aware of false credentials?

Bottom Line: Financial Education Essential



Financial Education in Sample of US DC Private Plans

Most Common Type of Education Approaches

- ① Enrollment Kit (63.6 %)
- ② E-mail (60.3%)
- ③ Internet/Intranet Sites (57.4%)
- ④ Fund Performance Sheets (43.4%)
- ⑤ Seminars/Workshops (41.2%)

Most Common Primary Reason for Providing Plan Education

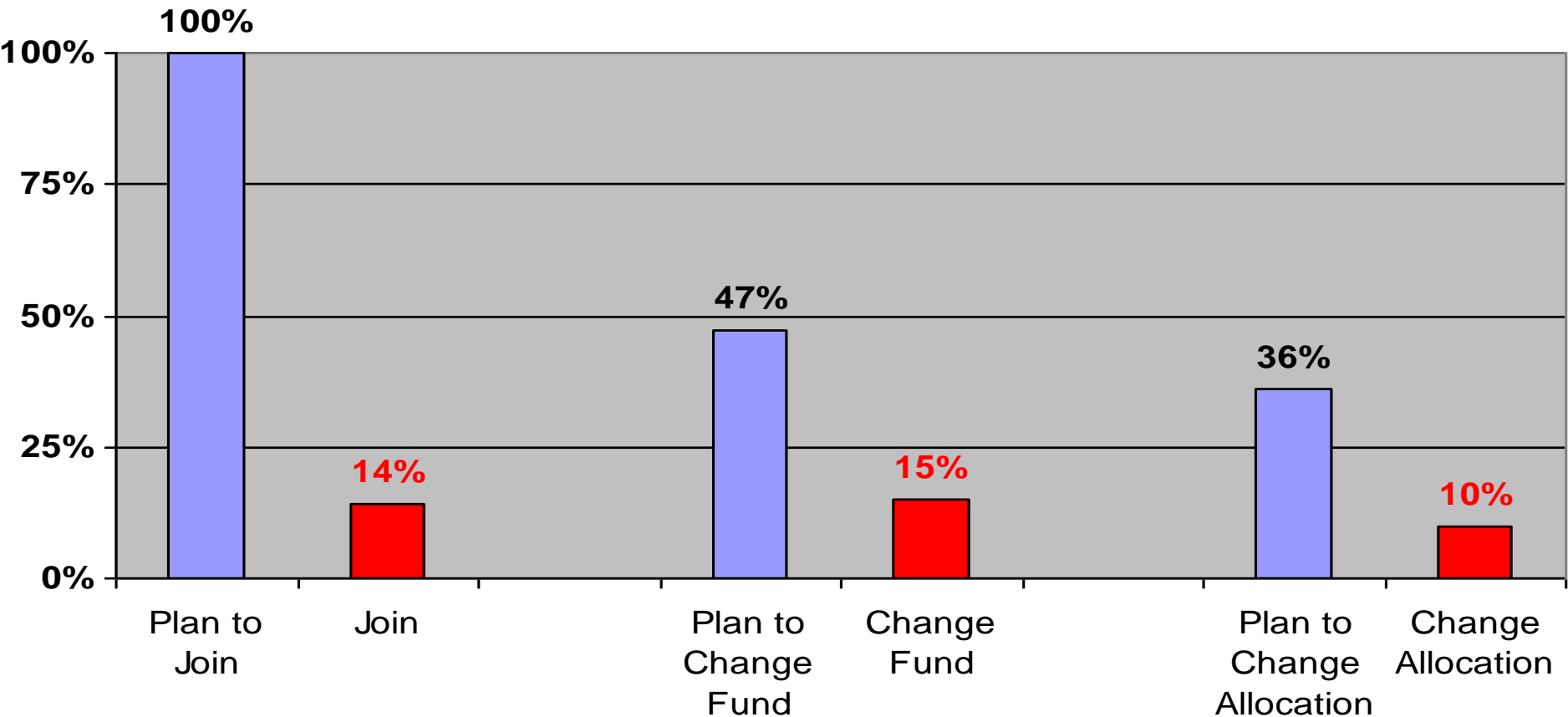
- ① Increase Participation (25.5%)
- ② Retirement Planning (20.2%)
- ③ Increase Deferrals (16.1%)
- ④ Increase Appreciation for the Plan (14.8%)

54% of plans evaluate the success of education programs



How Should Success Be Measured?

Intentions vs Actions



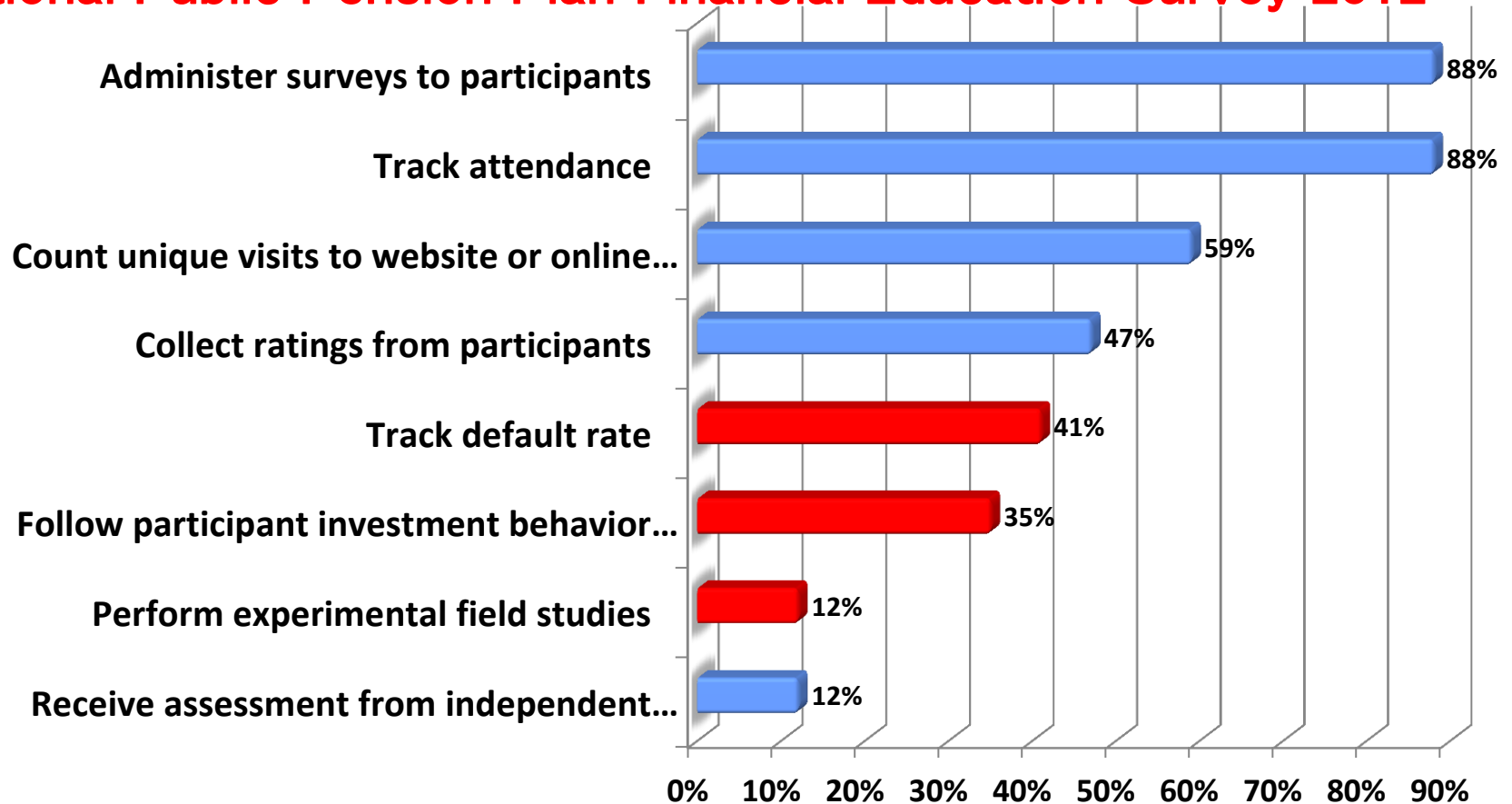
Source : Choi, Laibson, Madrian
and Metrick (2002)



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Some Methods for Measuring Success in US Government Plans

National Public Pension Plan Financial Education Survey 2012



Tips for Pension Education from the U.S. Experience

- **Tip 1:** Broadly define financial literacy to include knowledge of pension features
- **Tip 2:** Recognize that financial literacy and education are needed even in carefully designed pension plans
 - Studies show potential issues related to the use of defaults, communication and financial advisers alone
 - Information overload and financial literacy are related
- **Tip 3:** Carefully evaluate education programs
 - Examine participant actions not intentions
 - Learn from medical research and use randomized controlled experiments to test financial education efficacy

