



Choice Architecture and Pension Communication

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Svend E. Hougaard Jensen, Ph.D.

Professor, ECON, CBS
Director, PeRCent, CBS
Non-resident Fellow, Bruegel

Structure

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2. Choice architecture
 - Choices about what?
 - What tools are there?
3. Communication
 - What is it, and who does it?
 - Inspiration from other literature(s): Central bank communication and financial (il)literacy
4. Evidence from selected countries?
 - Australia, Denmark, Iceland and the Netherlands
5. Implications for policy

Motivation: Why we do this...

Increased volume and complexity of pension savings

- Pension savings have increased significantly and constitute in some countries more than twice the size of GDP.
- Pension systems become increasingly more complex – with interaction between the three pillars...
- Use of non-pension wealth, including other financial assets, home equity etc.
- Transition from DB towards greater emphasis on DC plans...

Motivation: Why we do this...

Facilitate better PF-member outcomes

- Choices by PF-members do not only depend on choice architecture – also influenced by pension communication.
- More choice opportunities increase the need for information and the greater influence of pension communication.
- Pension communication can also impact people's trust in the pension system.
- So, should lead to a better overall performance of the pension system...

Project: Netspar International Comparative Research Grant

Joint with Hazel Bateman and Inka Eberhardt

- Describe and compare current regulatory framework and policy changes.
- What is the prescribed goal of pension communication?
- What are the roles of pension funds, regulators and lobby groups?
- What is the effect of pension communication on planning?
- Are there best practices/lessons to be learned?
- Develop an agenda for further research.

- **Choice architecture:**

- “Organizing the context in which people make decisions” (Thaler, Sunstein & Balz, 2013, p. 428)

Choice architecture

What should pension savers be allowed to make choices about?

- **Pension fund:**

- Can people choose their fund? Is there a default fund if people do not choose at the start of employment? Can they even self-manage their savings?

- **Contribution rate:**

- Are there minimum or maximum rates? Can people save additionally? How about the timing of contribution rate? How often can people take a decision? Are there specific circumstances where people can contribute more than a potential maximum rate? (Examples: downsizing of housing, sale of a business, parental leave, buying a house, catchup contributions over a few years...)

- **Investment portfolio:**

- Can people choose their investments? Can they choose a risk profile, investment options, or single stocks/bonds?

- **Time of retirement:**

- Can people choose to retire earlier or later than the "normal" retirement age? Are there (financial) consequences?

- **Retirement income product:**

- Can people choose a lump sum, lifetime/deferred/fixed term annuities, other products? Flexible income?

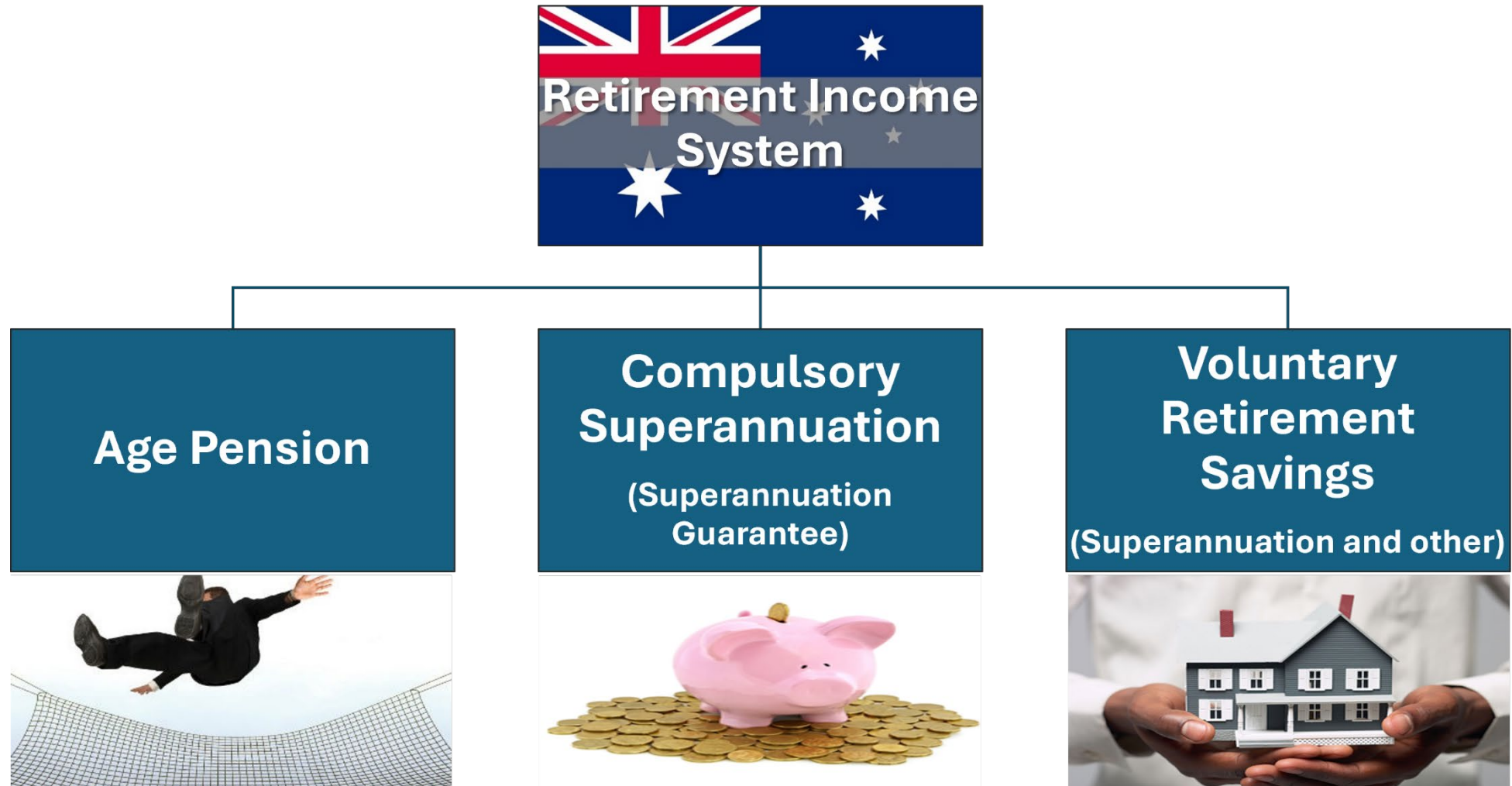
Choice architecture

What tools are there?

- Minimum requirements, e.g., a minimum contribution rate that can be increased.
- Nudges that “steer people”, but give them the freedom to walk another way:
 - Default settings, e.g., having a standard, default investment portfolio for all savers, but offer them a choice to deviate from the default.
 - Labels, e.g., labels of investment products that quickly show savers the products’ purpose/quality.
- Active choice, e.g., asking PF-members at retirement what income product they want, otherwise they do not receive any payments.

Choice architecture

The Australian Retirement System



Choice architecture

The Dutch retirement system



Country studies: AUS, DK and NL

Are there choices: Yes or no? Or “it depends” ...

Choice of ...		AUS	DK	NL
Pension fund		yes (default)	no	no
Contribution rate		yes (minimum)	depends on fund	no
Investment portfolio		yes (default)	depends on fund	only in some DC plans
Retiring after retirement age	<i>Pillar 1</i>	yes	yes	no
	<i>Pillar 2</i>	yes	depends on fund	depends on fund
Payout type	<i>Pillar 1</i>	no	no	no
	<i>Pillar 2</i>	yes	depends on fund	structure depends on fund

The Dutch retirement system

Major reform of 2nd pillar pensions, with transition deadline: Jan 1, 2028

- Aim: individualise pensions, increase transparency, etc.
- Switch previous DB plans to DC plans.
- Employers and employees to agree on new scheme and compensation/transition arrangements.
- Solidarity contribution scheme, with single collective investment policy; gains to be distributed according to predefined allocation rules.
- Flexible contribution scheme, with individual investment schemes (life cycle or personal), converted to variable or fixed pension benefit.
- Funds can keep old DB scheme for current workers or transfer fully to new scheme.

How much do people make use of choice if they are allowed to?

Recent evidence from Australia

- Data from Q2 2024:
 - 626,609 self-managed super funds (SMSF) with 1.15 million accounts:
 - People self-managed their retirement savings, typically high-income or self-employed people not covered by pillar 2.
 - 65% of accounts at pension funds are **default** accounts, with well-regulated, balanced investments.
 - Members actively chose to stay, or did not make a choice.
- Treasury (2020):
 - 25% of pension fund participants contribute extra to their fund.
- 2023 data on pension income products:
 - 5% take a lifetime income product
 - 81% take a phased withdrawal (account-based pension, no inflation, investment or longevity protection).
- Most draw down at minimum rate, leading to an inefficient retirement income system.
- This led policy makers to now require pension funds to have a retirement income strategy that takes into account protection against inflation, investment, and longevity risk (also maximizing retirement outcomes).

How much do people make use of choice if they can?

Recent evidence from the Netherlands

- Early/late retirement:
 - Most people at DB funds can retire earlier/later, 34% did so in 2022.
 - Only 9% at DC funds retired early in 2022.
- Payment structure (constant payments, few years higher and then lower, or few years lower and then higher):
 - In 2022, 99% of retiring members at a DB plan had the possibility to choose their payment structure
 - 21% chose a non-constant structure, and hereof 95% chose the high-low structure
 - 27% of retiring members at DC plans chose a non-constant structure
- Change from a (higher) single pension to a (lower) partner pension)
 - In 2022, 31% of DB and 10% of DC retirees changed their pension, most from a partner to a single pension (by law, 100% of retirees have this choice option)

- **Pension communication:**

- Most pension savers seem to know very little about their pensions...

Inspiration from other literatures: Why communicate?

Financial literacy

- In general, informed decisions lead to the best outcomes, i.e., people need information to take appropriate decisions and maximize (financial) well-being.
- Studies show that:
 - Financial education programs increase financial literacy levels, which then improve financial behaviour (Kaiser, Lusardi, Menkhoff and Urban, 2022, JFE).
 - There is a positive relationship between financial literacy and retirement planning (Lusardi and Mitchell, 2007, 2011, 2017).
 - The financially literate is more likely to plan for retirement and have higher household wealth than less literate (Van Rooij, Lusardi and Alessie, 2012, EJ)
 - The effect of financial education is time-limited and hence calls for “just-in-time” education programmes (Fernandes, Lynch & Netemeyer, 2014).

Inspiration from other literatures: Why and what?

Central bank communication

- Blinder, Ehrmann, De Haan & Jansen (2024, JEL) on reasons to communicate with the public:
 - Accountability:
 - Pension funds are the trustees of participants' funds for retirement
 - Communication helps to explain reasons for their actions and consequences for retirement outcomes
 - Public pressure:
 - Financial crises, documentaries and court cases increase visibility
 - Communication helps to mitigate negative publicity and explains crisis responses
- Haldane, Macaulay & McMahon (2021) describe the "three E's" of central bank communication:
 - Explanation: workings of system and interactions between pillars
 - Engagement: activate and guide members to choose, e.g., investment portfolio, contribution rate etc
 - Education: Help better understand, e.g., consequences for taxation

Pension communication

Goals and tools

Account information

Start & exit letters

Annual statements

Helping with choice options

Comparison websites

Financial product disclosure

Projections & calculators

Unusual market conditions

Letters/ e-mails

Newsletters

Summarising entitlements across pillars

Websites such as
pensionsinfo.dk

Pension communication in practice: What do we know?

Pension funds in AUS, DK and NL are required to communicate

- Before/at the start of contract, including product disclosure statements for DC funds.
- During accumulation and decumulation (annual statements).
- When the contract changes so that benefits change significantly.
- At the end of the contract (death or exiting fund).
- All countries allow for online communication by pension funds – and offline communication can be requested...
- DC funds are required to communicate fees and costs as well as investment strategies and returns.

Recent pension reform in Iceland:

We know that the reform was communicated to the public

- Objective of reform: Equalize pension benefits between the private and the public sector
- Policy: Increase in the contribution rate for private employers by 44 percent
- Communication:
 - Comprehensive search across archives of all major news outlets in Iceland shows that several articles on the pension reform were written, including front page articles of widely circulated newspapers.
 - Articles outlined the timeline of the reform's roll-out, providing delineation of both the adjustments and the levels of employer contributions at each stage.
 - Also, the Icelandic Confederation of Labor initiated a public awareness campaign, including
 - printed information to all union members, and
 - announcements and advertisements regarding the reform across various online and traditional media platforms.

Recent pension reform in Iceland:

Awareness of the reform?

- One survey question tests whether respondents know what the employer contribution is, and another tests whether they know if the employer contribution has changed in past years.
- Only around 26 percent of respondents answered correctly that the employer contribution was between 9 percent and 13 percent of wages.
- When asked about changes in the employer contribution in the past six years,
 - 36 percent of the treatment group responded – correctly - that the employer contribution had increased
 - 25 percent of the control group responded - incorrectly in their case - that the contribution had increased.
 - 34 percent of the control group answered correctly that the employer contribution had not changed.
- This implies that workers are to a large extent uninformed about their pension contribution and future pension income.

Most people seem to know/care very little about their pensions

Evidence from AUS and NL

- AUS: Bateman, Hanewald, Lou & Yan (2024):
 - 47% of survey respondents answered all three questions about interest rate, inflation and investment diversification correctly
 - 17% of respondents answered all four questions about the pension system correctly (taxation, voluntary contributions, relationship between 1st and 2nd pillar, eligibility age for 2nd pillar pension)
 - 27.2% are aware, interested and capable to compare annuities with other products,
 - 57% are unaware of lifetime income products.
- NL: Public Monitor Pension of Q2 2024:
 - 35% have opened and read all mails and e-mails from their pension fund
 - 37% answered that they check their overview of retirement savings online or offline.
 - 60% knew that they can change something in their pension plan.
 - 25% answered that they have ever changed something.

Pension communication in AUS, DK and NL

Differences and challenges

- Australian funds communicate on allocated capital, while income projections are not required by law (assumptions to use when giving projections are regulated, though)
- Online tools to compare funds is offered by SFA in Australia, while done by F&P in DK.
- Tool to increase competition among funds vs for transparency?
 - AUS: funds need to communicate to their members if they've failed the Australian Prudential Regulation Authority (APRA) performance test.
 - No such test required in DK or NL
- Pension dashboards with info on (at least) first two pillars exist in DK & NL, but not in AUS...

Pension communication in AUS, DK and NL

Differences and challenges

- Main current challenge is how to communicate choice for retirement income products in Australia?
- No default products legislated, unlike accumulation products where there is a default.
- Retirement Income Covenant (RIC): funds required to have a retirement income strategy for members that takes into consideration investment, longevity and inflation risks while maximizing retirement income.
- How to do that if funds do not have the license to give personal financial advice?
- Financial advice sector changed a lot after reviews to fight misconduct leading to too high prices and bad advice.
- Now a new change in law is debated due to RIC.

Recent research suggests that there is scope for improvement

Examples from AUS

- Cbus members who received annual Retirement Income Estimates:
 - A 30% increase in member interactions with the fund and a 25% increase in members making concessional contributions (Smyrnis et al., 2019).
- People's perceptions, understanding and (hypothetical) choices of different retirement income products significantly change with different versions of a product disclosure statement (Bateman & Eberhardt, 2024).

Recent research

Examples from NL

- Bauer, Eberhardt & Smeets (2022, RFS):
 - Letters with peer-information statements do not increase the likelihood to check one's pension information online, but lottery-type financial incentives do.
 - Uptake of information does not lead to more pension knowledge/self-reported savings.
- Eberhardt, Brüggem, Post & Hoet (2021, IJRM):
 - Used field, online, and laboratory studies to show that a prevention-oriented assurance frame is twice as effective as a promotion-oriented investment frame in engaging people's information seeking behaviour.

Key take aways from Australia

- Test communication before it is used, especially when designing financial product disclosure
- Do people understand terms used?
 - Do people get the wrong impression from certain framings/words
- How could communication change members' behaviour?
 - Does it affect the target group or other groups?
 - Is the behaviour change wanted?
- Test again after communication is used and potentially change it

Concluding remarks

Q&A

- Importance of choice and communication likely to increase within the pension sector in coming years.
- The role of pension funds is growing – and they act as stewards of other people's money.
- Relatively small group of (higher-educated) “activists” may want more influence.
- Large group who doesn't really care – for such PF-members a good default is important.
- Finally, this is a growing research area, and I hope to be back soon with more insights to you...