

RESEARCH FROM SEI INVESTMENTS

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DC Pension Plan Members: Psychographic Profiles

EXECUTIVE SUMMARY

SEI remains committed to identifying the issues facing pension plans today. Further analysis of information gathered in SEI's Defined Contribution (DC) Pension Plan Member Study conducted in the spring of 2004, reveals distinct mindsets exhibited by Canadian employees regarding retirement planning.

Through cluster analysis, five distinguishable psychographic profiles of DC members towards education, advice, and confidence showed up in consistent patterns. Their level of comfort regarding the ability of their pension plan to provide sufficient income at retirement, and their investment decision-making abilities also vary.

Taking into account these differences in communication programs offered to DC plan members, more effective education can be delivered whereby both member and sponsor will benefit.

This paper explores the five psychographic profiles and the impact on improving retirement prospects for members, as well as the reduction of litigation risk for sponsors.

INTRODUCTION

The defined contribution (DC) pension benefit is important to employees, making them feel valued by their employer. Employers are justified in offering this benefit, given the derived value, whether it be real or perceived. SEI Investments has talked to a wide range of industry participants (service providers, plan sponsors and plan members) to gain a better understanding of the future of the DC pension benefit in the Canadian marketplace. SEI commissioned a set of studies in the winter of 2004 investigating the mindset of the Canadian plan sponsor and member.

Problems identified in SEI's earlier studies included pessimism expressed by both parties on the ability of employees to retire with enough money. Employers, aware of their fiduciary responsibility and concerned about the threat of litigation, believe that educating their plan members is the most important and effective way to protect themselves from a lawsuit. Nevertheless, the majority of employers admit to providing ineffective education programs. Ramifications of this were evident when SEI tested employees on their knowledge level regarding retirement planning. Employees demonstrated, and admitted to, a low level of knowledge.

Further investigation by SEI has been in the emerging field of behavioural finance. Probing into the mindset of DC plan members, two very interesting discoveries were made. First, there is the fact that members are overconfident, believing they know more than they actually do. Second, SEI found members exhibited clear distinctions in their psychographic profiles towards education, advice, confidence and comfort in their pension plans and investment decision-making abilities. These psychographic profiles showed up in consistent patterns, uncovering five distinct clusters of member mindsets.

Such clusters may be helpful in the implementation of DC education programs. To date, industry practice has been to structure education to cater to a homogenous group. These communication programs are failing. The solution could lie in the recognition that DC members do not think and behave as a homogenous group, but demonstrate different psychographic profiles towards retirement planning.

In this research report, SEI explores the five different psychographic profiles and their role in delivering effective education programs and communication strategies for DC plan members.

WHAT WE ALREADY KNOW

The DC Pension Benefit is Important

Earlier research by SEI has revealed that the DC pension benefit is important to employees. SEI's DC Member Study, conducted in March and April of 2004, surveyed over 2000 employees, with 67% agreeing that having a pension plan makes them feel valued by their employer. In addition, 39% believe the pension plan is so important they would leave the organization if a pension plan were no longer offered.

Based on this satisfaction rate, one could conclude that employers are doing the right thing in offering the DC benefit to employees. It's a win-win situation, it would seem. The employee receives investment education and help in planning for a secure retirement, while the employer benefits from increased employee satisfaction, productivity, and loyalty.

Members' thoughts on their plan:

- The pension plan makes 67% feel valued by their employer.
- The pension plan is so important, 39% would leave if it were no longer offered.

Fear of Litigation

Unfortunately, the situation is not quite so simple. SEI's research revealed that Canadian employers fear a lawsuit launched by unsatisfied DC plan members who, upon retirement, discover the retirement programs did not provide the benefits they envisioned.

SEI interviewed 120 plan sponsors in the DC Sponsor Study (conducted in November and December 2003) and discovered that a deficiency in the education programs they provide is a key area of concern for them, particularly with respect to potential litigation. Overall, 53% of sponsors interviewed believe that educating plan members is the most important and effective way to protect against litigation. However, only 11% thought that they were performing extremely well in this area. Our research shows that sponsors are correct. They are not performing well in their educational offerings and they should be concerned.

Sponsors' thoughts on litigation:

- 24% feel their organization will face litigation within the next 2 years
- 40% think judgement will favour members
- 53% believe educating members is the most important and best way to protect their firm
- 11% think they are doing a good job educating their employees

Members Lack Knowledge

The DC Member Study revealed that employees have a low level of knowledge. Only 15% of employees declared themselves to be very knowledgeable about retirement planning. Thus it was no surprise when 79% expressed a desire for sound, trustworthy advice, rather than more education from their employer.

Employees are unclear on the basic features of their pension plan regardless of whether or not they participated in employer sponsored education programs.

Members don't understand their plan:

- 42% don't know if their plan is compulsory
- 55% don't know if they can make their own contribution to the plan
- 31% don't know if their employer is matching their contribution
- 28% don't know if their employer is contributing to the plan

Employees don't understand investments either. Again, participation in employer sponsored education programs did little to improve their knowledge. In a question testing their understanding of the concept of asset allocation, 82% demonstrated a lack of knowledge in this area. Survey participants were asked to allocate pension savings into stocks and bonds across two different scenarios. Regardless of their risk preference, one would expect the allocation between stocks and bonds to be at least roughly consistent across both scenarios. However, even allowing for some variance, 82% were inconsistent in their stock-bond mix.

In another question, survey participants demonstrated a tendency to chase 'hot stocks'. Participants were asked to allocate pension savings between 2 stocks. Both stocks were forecast to earn the same return over the next 5 years, but one had a significantly better historical performance. One would expect an investor to diversify roughly equal amounts of their pension savings into each stock. However, this was not the case. Signs of momentum chasing were exhibited as 62% of participants put more than half their savings into the 'hot stock' and 21% put 100% into the 'hot stock'.

Members don't understand investing:

- 82% don't understand asset allocation
- 62% are momentum chasers

Dangerous Overconfidence

Based on the information gathered from surveying Canadian DC members, behavioural finance research was conducted in conjunction with an expert in this emerging field. Richard Deaves, Professor of Finance at the Michael G. DeGroot School of Business at McMaster University, discovered that DC members are overconfident in their investment knowledge. Their certainty level of answering investment questions was high relative to their ability to provide the correct answer.

“While lack of knowledge is undesirable, thinking you know more than you in fact do know, or being overconfident, is dangerous for plan members. The former leads to indecision and the desire for education and advice, the latter can lead to misinformed decision-making.”

Richard Deaves
Professor of Finance
Michael G. DeGroot School of Business
McMaster University

The danger in such a scenario is that overconfidence leads to misinformed decision-making. What's worse? Clearly a lack of knowledge, which leads to indecision, is undesirable. However, overestimating your investment knowledge is equally undesirable, if not potentially worse.

Overconfident investors have the tendency to trade excessively. Without a clear understanding of the pitfalls of market timing and momentum chasing, nor the benefits of asset allocation and long-term strategic investing, excessive trading by the member is costly for both parties, the sponsor and the member.

The danger of overconfidence also applies to members subject to inertia. These members are highly unlikely to revisit their original asset allocation decision, trusting themselves to have made the right decision at the outset. The danger is making the wrong decision and not doing anything about it.

Problems Await

Given sponsor fears of litigation, as a result of providing inadequate education programs, and member overconfidence in what little knowledge they have, there is a real cause for concern. Sponsors are justified to fear litigation. Both parties are justified to fear the member will not have enough at retirement because she/he is not making the proper retirement planning decisions.

Is Advice the Solution?

The most likely solution would appear to be the delivery of sound licensed investment advice to members. With the exception of those members with a high level of retirement planning knowledge (who might override the advice), as well as those members who are disengaged (who may not show up to receive the advice), the majority of members would benefit from the value of advice.

However, at this juncture in the Canadian marketplace, one must question if advice is the solution when there are no clear guidelines for the employer in providing such a service. There may be legal implications to providing advice involving; the sponsor's responsibility to select and approve licensed advisors; the onus of fiduciary responsibility when the sponsor delegates to the advisor; and the responsibilities to members who choose not to use the advisor's services.

Further, due to the relatively high degree of customization along with high compliance and administrative requirements, advice programs can be costly. Sponsors must ensure the benefits outweigh the costs.

Effective Education

For those unwilling to bear the fiduciary and cost responsibilities associated with advice, a fresh approach to education is the solution.

Utilizing the insights of behavioural finance, sponsors can examine member mindsets and better address their abilities and needs. An overhaul of the design and structure of education programs incorporating psychographic behaviours may offer strong benefits over the present approach.

Psychographic Profiles

Probing into the mindset of employees, a number of questions from the DC Member Study were utilized to investigate whether or not DC plan members differ in their psychographic types towards education, advice, confidence and comfort in their pension plans and investment decision-making abilities, as well as their knowledge level.

Using these questions, cluster analysis was performed to ascertain whether certain typical mindsets emerged. Consistent patterns revealing five such mindsets were uncovered.

See the Methodology Appendix at the end of this report for a brief discussion on how these clusters were formed.

Smart Guys (Overconfident & Actively Involved)

These individuals feel the most knowledgeable and exhibit the highest level of overconfidence. They are very comfortable regarding their pension plan.

Participants (Education-Driven & Overconfident)

These individuals are slightly less knowledgeable but just about as overconfident as the Smart Guys. Their differentiating point from the Smart Guys is their desire for education.

Seekers (Worried & Want Support)

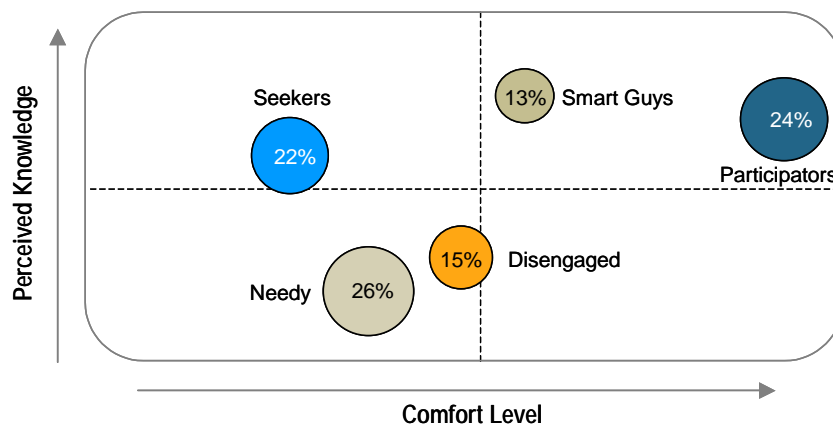
These individuals are the least comfortable that their plan will be sufficient at retirement. Willing to learn, they have an insatiable appetite for advice and education. They are slightly less knowledgeable than the Smart Guys and Participants.

Needy (Confused & Inactive)

These individuals are struggling and are very uncomfortable managing their plan. They have the least amount of knowledge, and are most desirous of advice.

Disengaged (Inactive & Avoid Support)

These individuals are starved for time and are not taking advantage of educational support provided by the employer. For a group such as this, default investment options are crucial.



PSYCHOGRAPHIC PROFILES

The first two groups described below are closely related. They are both reasonably knowledgeable and actively involved in the pension decision-making process. In addition, they are comfortable and confident that they are doing the right thing.

Smart Guys

(Overconfident & Actively Involved)

The smallest group, 13% of survey participants fall into this mindset. When asked, the Smart Guys are quite comfortable managing their plan and feel confident in their knowledge. They are most in agreement with the statement “I am more knowledgeable about my pension plan than most other plan members I know” and “I am knowledgeable about financial planning for retirement”. They are least in agreement with the statement “I find it very difficult to manage my pension plan.”

The weakness in this group is their overconfidence. Smart Guys are the most actively involved in making financial decisions surrounding retirement and the least likely to use a default investment option, but they may not be doing the right thing. Overestimating their level of knowledge, Smart Guys tend to believe they have made the right decisions when they are in fact wrong. Related to their overconfidence, Smart Guys may be subject to the costly habit of frequent trading.

These individuals receive retirement planning recommendations and advice from others and do not want more education or advice from their employer. They feel their needs are being addressed.

Dominated by the male population, Smart Guys are well educated and the wealthiest within the five segments.

Participators

(Education-Driven & Overconfident)

Roughly 24% of participants fit this psychographic profile. Along with the Smart Guys, the Participators are quite comfortable managing their pension plan and are confident. However, these feelings derive from having taken advantage of educational offerings provided by the employer. When asked, they are the most likely to agree with the statements “I take advantage of extra seminars or information available to plan members” and “I have used support for the plan provided through call centres or websites.” Based on this high participation rate, it is no surprise that the Participators are also most in agreement with the statement “the education provided about the plan has given me the confidence to make my own decisions”.

The Participators have a moderate level of knowledge and are overconfident. They are too comfortable about the future and lack focus on long-term needs and risks. This group is a primary target for education as they want more of it and need it.

Roughly two-thirds of this educated group are males (vs. 61% for the entire survey sample).

The next two groups described move us to the other side of the spectrum in terms of knowledge level and involvement in pension decision-making. They are less comfortable, less confident, and do not take advantage of education programs offered.

Disengaged

(Inactive & Avoid Support)

Being the next to smallest group, 15% of participants are classified as Disengaged. These individuals are struggling and do not have time for or interest in their pension plan. They are the most likely to say, “I do not have time to learn more about my retirement needs”. They are also the least likely to take advantage of any extra educational seminars, or to use call centres or websites for support.

Not surprisingly, with no time or willingness to learn, the Disengaged have a low level of knowledge when it comes to their pension plan. They are not involved in financial decisions regarding retirement and tend to use the default investment option more so than do other groups.

Having no desire for advice, the Disengaged need to be told what to do to help them take action. Intelligent defaults are particularly appropriate for such groups.

Equally split between males and females, the Disengaged are among the least wealthy in the group.

Needy

(Confused & Inactive)

Twenty-six percent of participants fall into the Needy category. This is the largest group (by a small margin). These people struggle like the Disengaged but have a significant difference. While the Needy are also inactive, it is due to the fact that they are confused. They are least likely to say “I am actively involved in all of my financial decisions around retirement.” Moreover, they are the least likely to agree that “the education provided about the plan has given me confidence to make my own decisions.”

They strongly yearn for advice (more so than education) being the most likely to answer that “I would like to receive advice about my pension plan to help me make decisions.” They are also the most desirous of receiving “a review of your individual company pension by a professional” and “a review of your entire household’s savings, investments and loans by a professional.”

On self-declared knowledge questions, they come in last and are the least comfortable in managing their pension plan.

The Needy population is equally split between males and females. These individuals are the least educated and the least wealthy relative to the other five segments.

The last group falls between the overconfident first two groups (Smart Guys and Participators) and the inactive latter two groups (Disengaged and Needy).

Seekers

(Worried & Want Support)

Approximately 22% of participants were found to be Seekers, with an insatiable appetite for education, and an even larger appetite for advice in their quest to seek comfort. While they are willing to spend the most amount of time to learn more about their retirement needs, they ultimately want to be nudged in the right direction. Seekers receive the most amount of retirement planning

recommendations and advice from sources other than their employer-sponsored programs.

Seekers are least comfortable with the ability of the pension plan to provide for retirement. In terms of self-declared knowledge and difficulty in managing their plan, they fall in the middle.

Males comprise two-thirds of this group. Their income, wealth and education levels are comparable to the two more confident groups.

	Smart Guys	Participators	Seekers	Needy	Disengaged
Comfort Level	High	High	Low	Low	Moderate
Knowledge Level	High	Moderate	Moderate	Low	Low
Overconfidence Level	High	High	Moderate	Low	Low
Use of Education & Advice	High	High	High	Low	Low
Confidence Gained from Education	High	High	Low	Low	Moderate
Time to Learn	High	Moderate	High	Moderate	Low
Desire for Advice	Low	Moderate	High	High	Low
Desire for Education	Low	High	High	High	Low
Involved in Decision-Making	High	High	Moderate	Low	Low
Receive Outside Help & Advice	Moderate	Moderate	High	Low	Low
Gender	Mostly males	Mostly males	Mostly males	Equal split	Equal split
Male	70%	65%	63%	47%	49%
Female	30%	35%	37%	53%	51%
Mean Age	44	42	43	41	41
Married	83%	78%	78%	69%	70%
Education	Well educated	Well educated	Well educated	Somewhat educ.	Well educated
Completed high school or less	11%	11%	9%	16%	16%
Completed some college/university	20%	23%	22%	31%	24%
Graduated college/university	69%	66%	69%	53%	60%
Mean Employment Income (\$000)	\$72.2	\$67.1	\$71.8	\$57.0	\$58.5
Mean Household Assets (\$000)	\$299	\$232	\$276	\$154	\$178

Value of Incorporating Psychographic Profiles to Improve Education

As a plan sponsor, you may be asking yourself “How does this information help me?” Given the diversity in psychographic types towards education, advice, confidence, comfort, knowledge and investment decision-making abilities, plan sponsors should be aware that a “one size fits all” approach to education is not optimal.

Value #1

Allows for mass customization that addresses distinct mindsets and desires more effectively.

Segmenting members according to their mindset enables sponsors to offer targeted education and address distinct mindsets and desires more directly. Determining the psychographic profile of each member, by way of questionnaire before delivering an education program, allows for mass customization. This translates into a more effective approach that is likely still manageable in terms of cost and delivery for the sponsor.

Value #2

More effective education helps members to gain a better understanding of how to plan for retirement and/or investment related matters.

With more targeted education, the member can relate better to the communicator as he/she receives help in a “language” at a more appropriate sophistication level. For instance, education topics and vocabulary geared towards the Smart Guys versus the Needy would differ given the extreme range in levels of knowledge, and degree of involvement in making financial

decisions around retirement. This aids the member in gaining a better understanding of how to plan for retirement and/or investment related matters.

Value #3

Enhanced education programs increases employee satisfaction, leading to improved productivity and loyalty to the employer.

Enhanced education programs should have the impact of improving the financial benefit to employees. In turn, this should result in increased employee satisfaction, another benefit for the sponsor. We know that the DC pension benefit is important to employees, making them feel valued by their employer. It is reasonable to expect that improving the member’s experience related to pension matters will increase their level of satisfaction, and thus the level of productivity and loyalty to the employer.

Value #4

Improved education reduces the Sponsor’s likelihood of facing litigation.

Reducing litigation risk is of concern to sponsors. Based on SEI’s DC Sponsor Study findings, we know that 24% of sponsors think they might face litigation within the next 2 years, and 40% think judgement would favour members. Sponsors believe that educating members is the first priority in protecting their organizations against potential litigation since better education should result in better member decisions and stronger financial results. When only 11% of sponsors think they are doing a good job at assisting members to prepare for retirement, incorporating their psychographic profiles into education programs to address their needs and abilities may be the key to improvement.

CONCLUSION

Many Canadians fear finding themselves with insufficient income at retirement. DC plan sponsors fear they will be blamed and have to face litigation. Sponsors believe one of the most effective methods to prevent such a scenario is by offering effective education programs that help employees plan for retirement and make the right investment decisions. Presently, most sponsors are failing in this effort.

The emerging field of behavioural finance tells us that DC members do not think and behave as a homogenous group. Their attitudes towards education and advice differ, as do their levels in comfort, confidence, and knowledge regarding pension plan management and investment decision-making. Behavioural finance also tells us that members are overconfident, believing they know more than they actually do.

Recognizing these differences could be the key to providing more effective education and reducing the risk of litigation. Incorporating the five psychographic segments into education programs, communication strategies, and investment options, sponsors can more closely offer what members are looking for using language that the member will better understand, and more effectively prepare the member to retire with the benefits they envisioned.

METHODOLOGY APPENDIX

The DC research conducted by SEI has been a multi-stage process with the goal to identify and illuminate issues of relevance to the DC pension industry.

Phase I, which focused on “Theme Discovery”, involved interviews with key industry players, while Phase II involved research with a cross-section of plan sponsors across the country to understand their most pressing concerns.

DC plan sponsor data were gathered through telephone interviews conducted with 120 sponsors with assets under management of \$3 million or more. While this figure may seem small, it actually represents larger plans in the scope of the Canadian DC market. Interviews were conducted from November 19 to December 2, 2003, in the sponsor’s preferred language (English or French).

Phase III focused on the DC plan member. Data were gathered through web and paper based surveys completed by 2013 DC plan members from a total of 17 different Canadian based plans. Participating plans had an average membership of 1095 (median membership was 750) and average assets under management of \$86 million (median

assets were \$11 million). The weighting of responses was limited to no more than 150 members per plan, while the research sample was geographically representative of DC pension plan distribution across Canada. Surveys were completed from March 1 to April 7, 2004 in the member’s preferred language, English or French.

The most current research investigating attitudinal segments was conducted based on DC plan member data and formed by a statistical technique known as cluster analysis. This idea is to find commonalities among respondents based on their answers to the survey questions. Questions dealing with confidence, pension comfort, self-perceived knowledge, and attitudes on education and advice were chosen to differentiate individuals. Technically, this approach attempts to minimize within-cluster distance and maximize between-cluster distance. The resultant clusters were validated by their ability to predict various demographic attributes and behaviours.

Fieldwork was conducted by Q:Quest, a market research firm.