Pillar 2: Keep it Simple

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PPRG: Objectives for Pillars 1 & 2
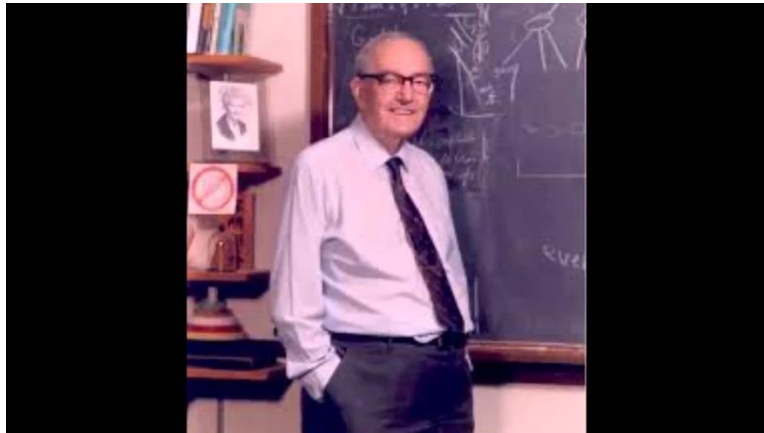
29 June 2018

Objectives

- To convince you that we have to look at DC pension communication (and structure) differently to reduce complexity

- To explain new approaches to evaluate, then develop pension communication

- To demonstrate the use these techniques with two pieces of written communication
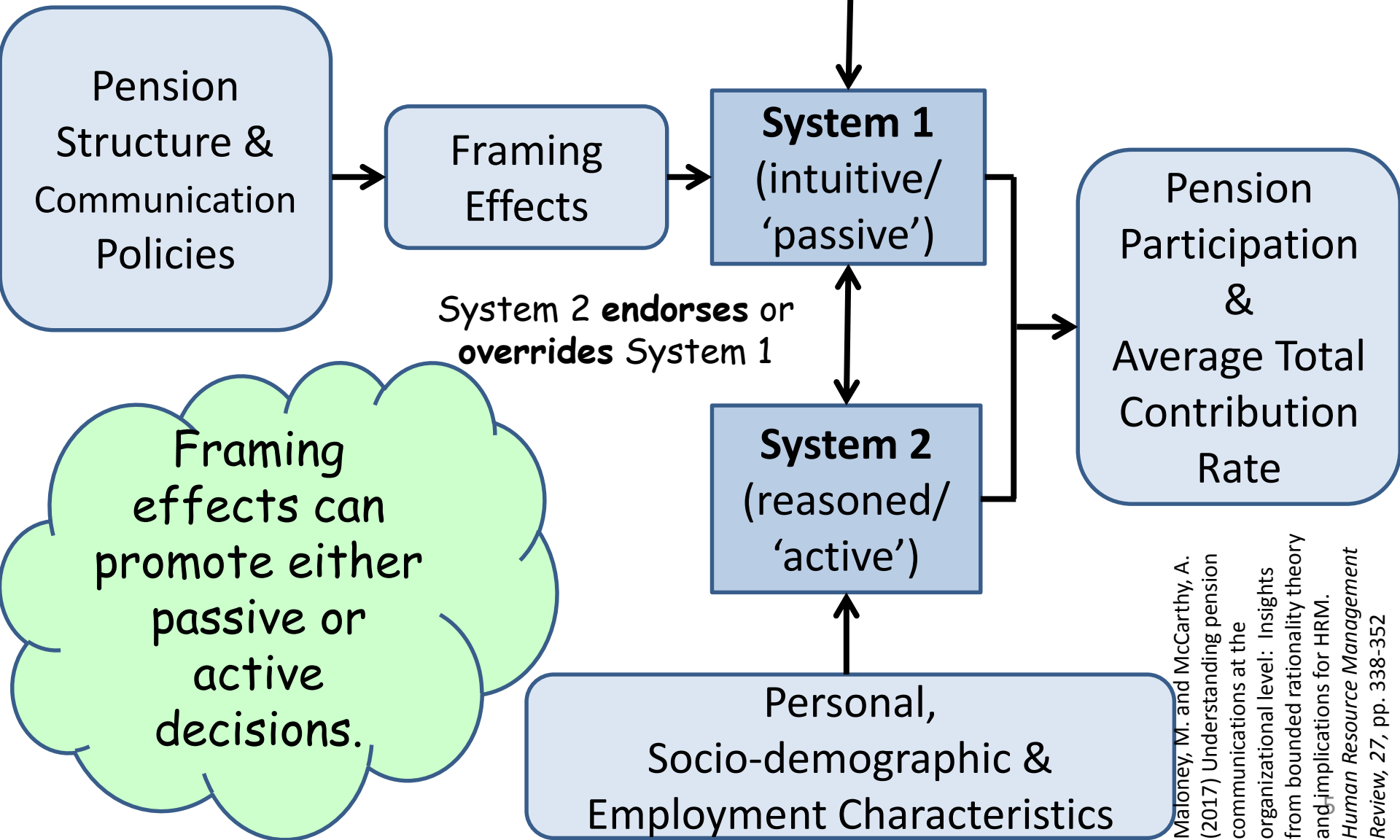
Background

- Current PhD research is about identifying the impact of pension communications on employee decisions to join an occupational pension scheme and to change their pension contribution

- Quickly identified 'bounded rationality' as an appropriate theoretical perspective

- Slowly developed a model to evaluate pension communications

- Model is not sufficient to evaluate pension communications

Background: Bounded rationality

Simon (2008) stated that, "The term '**bounded rationality**' is used to designate rational choice that takes into account the cognitive limitations of the decision-maker—limitations of both knowledge and computational capacity" (p. 893).
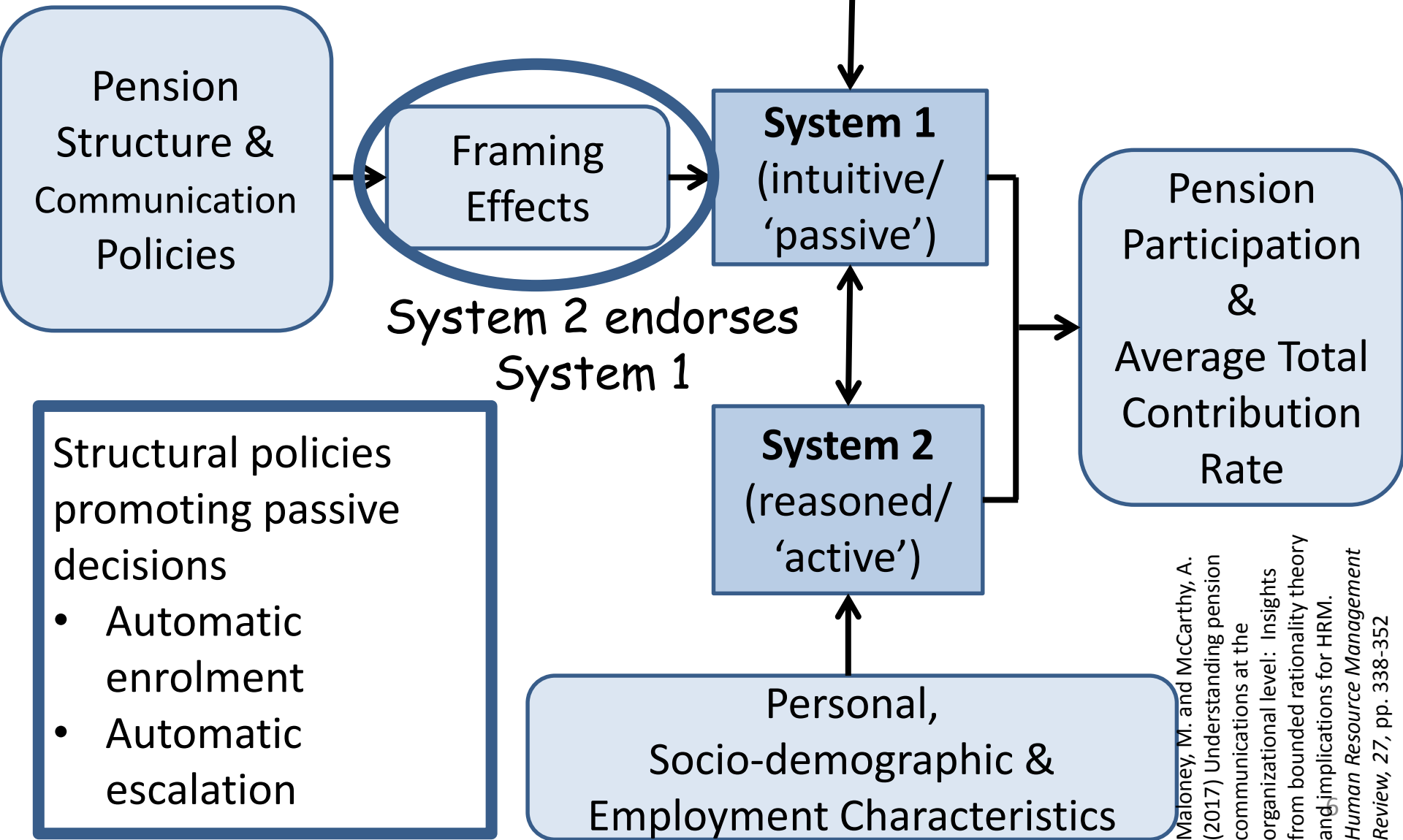
Bounded rationality framework for **defined contribution** schemes

Heuristics Biases

Pension Structure & Communication Policies

Framing Effects

System 1 (intuitive/ 'passive')

System 2 **endorses** or **overrides** System 1

Framing effects can promote either passive or active decisions.

System 2 (reasoned/ 'active')

Pension Participation & Average Total Contribution Rate

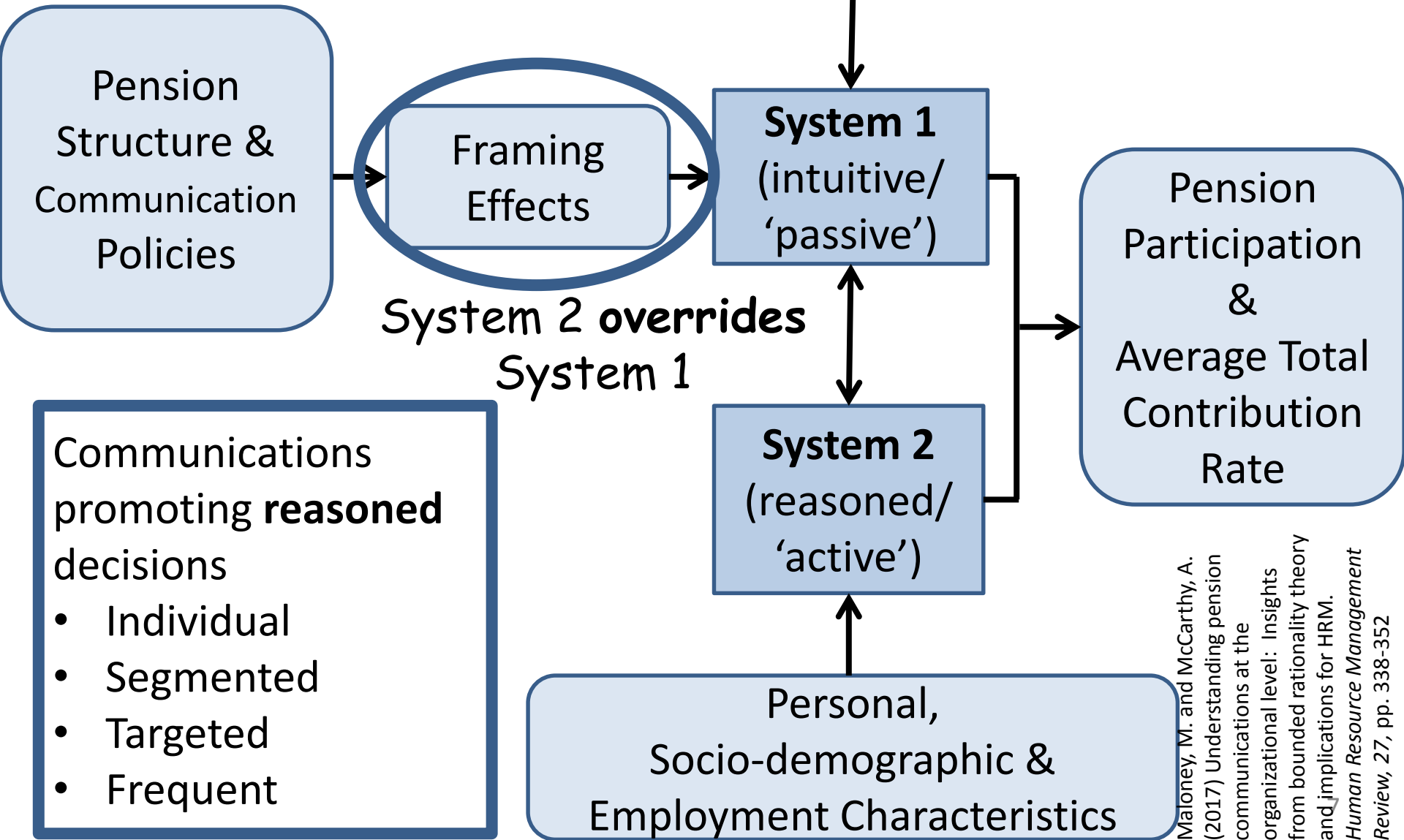Personal, Socio-demographic & Employment Characteristics

Maloney, M. and McCarthy, A. (2017) Understanding pension communications at the organizational level: Insights from bounded rationality theory and implications for HRM. *Human Resource Management Review*, 27, pp. 338-352

Bounded rationality framework for **defined contribution** schemes

Heuristics Biases

Pension Structure & Communication Policies

Framing Effects

System 2 endorses System 1

System 1 (intuitive/ 'passive')

System 2 (reasoned/ 'active')

Pension Participation & Average Total Contribution Rate

Structural policies promoting passive decisions

- Automatic enrolment
- Automatic escalation

Personal, Socio-demographic & Employment Characteristics

Bounded rationality framework for **defined contribution** schemes

Heuristics Biases

Pension Structure & Communication Policies

Framing Effects

System 2 **overrides** System 1

System 1 (intuitive/ 'passive')

System 2 (reasoned/ 'active')

Pension Participation & Average Total Contribution Rate

Communications promoting **reasoned** decisions
• Individual
• Segmented
• Targeted
• Frequent

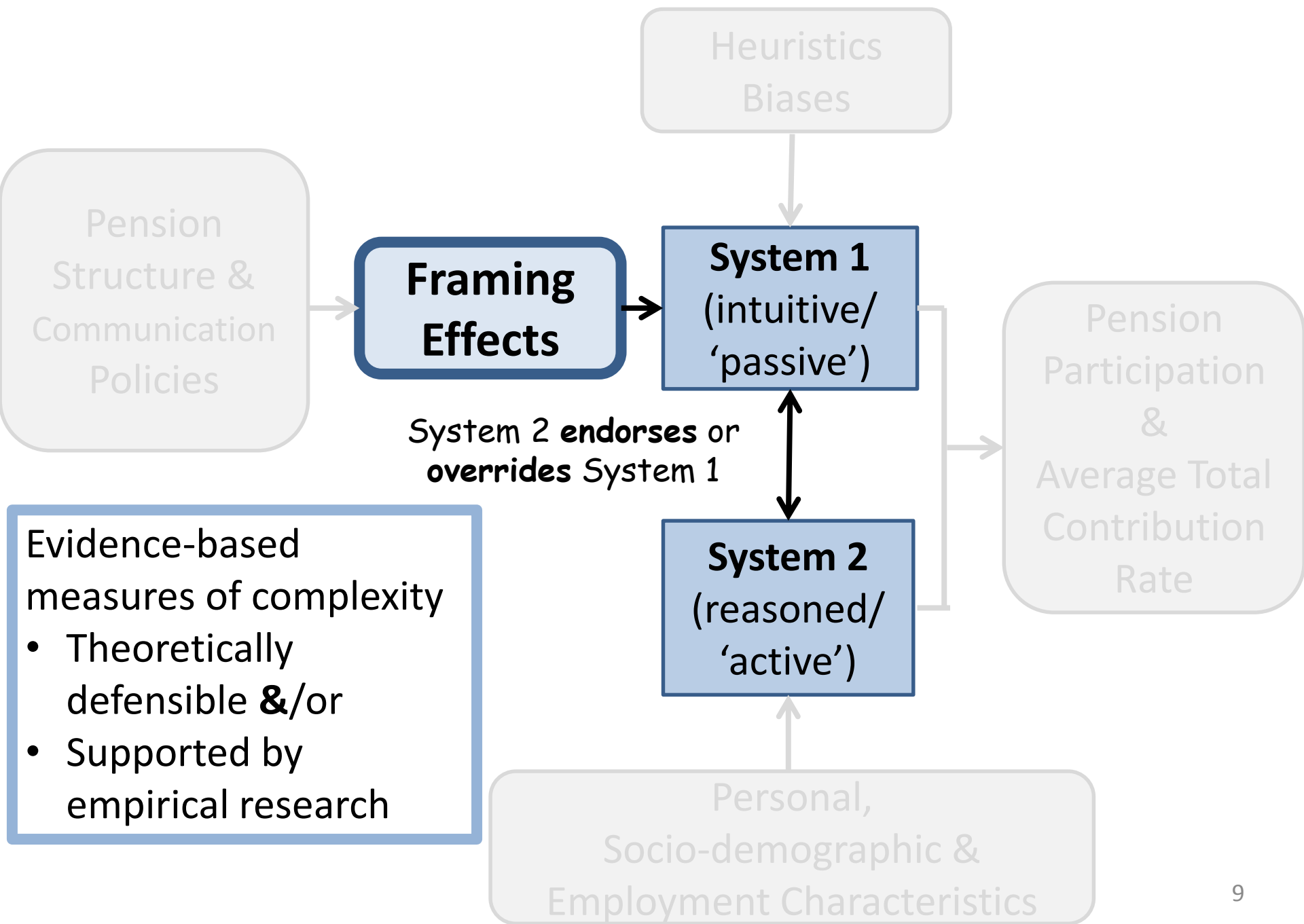Personal, Socio-demographic & Employment Characteristics

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Background

- First case study – Service provider, 150 employees
  - Eight interviews with member, nons-members of an occupational pension scheme
    - Most knew little about their pension scheme, investment fund choices, % of income invested
  - Content analysis of written communication
    - Although examples of individualisation, segmentation and targeting were present, there was little evidence of employee understanding
    - Communication was too complex
   - How should pension communication be evaluated?

Heuristics Biases

Pension Structure & Communication Policies

Framing Effects

System 1 (intuitive/ 'passive')

System 2 **endorses** or **overrides** System 1

Pension Participation & Average Total Contribution Rate

Evidence-based measures of complexity
- Theoretically defensible **&**/or
- Supported by empirical research

System 2 (reasoned/ 'active')

Personal, Socio-demographic & Employment Characteristics

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Cognitive load

"**Cognitive load** disrupts the controlling operations of System 2, increasing the rate of errors and revealing aspects of intuitive thinking that are normally suppressed." (Kahneman & Frederick, 2002, p. 57)

Cognitive load theory (CLT)

"… learning happens best under conditions that are aligned with human cognitive architecture" (Paas et al, 2004, p. 2).
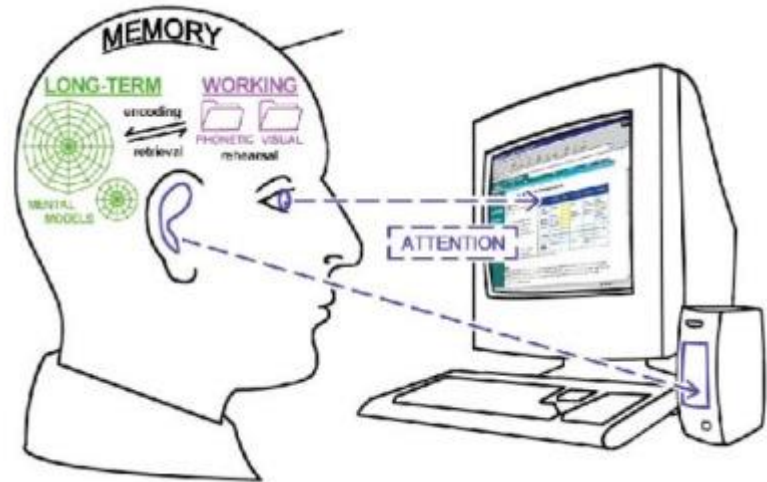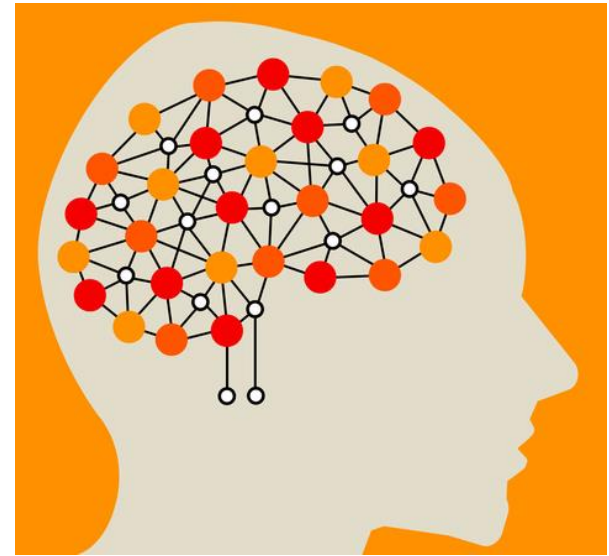
CLT: cognitive architecture
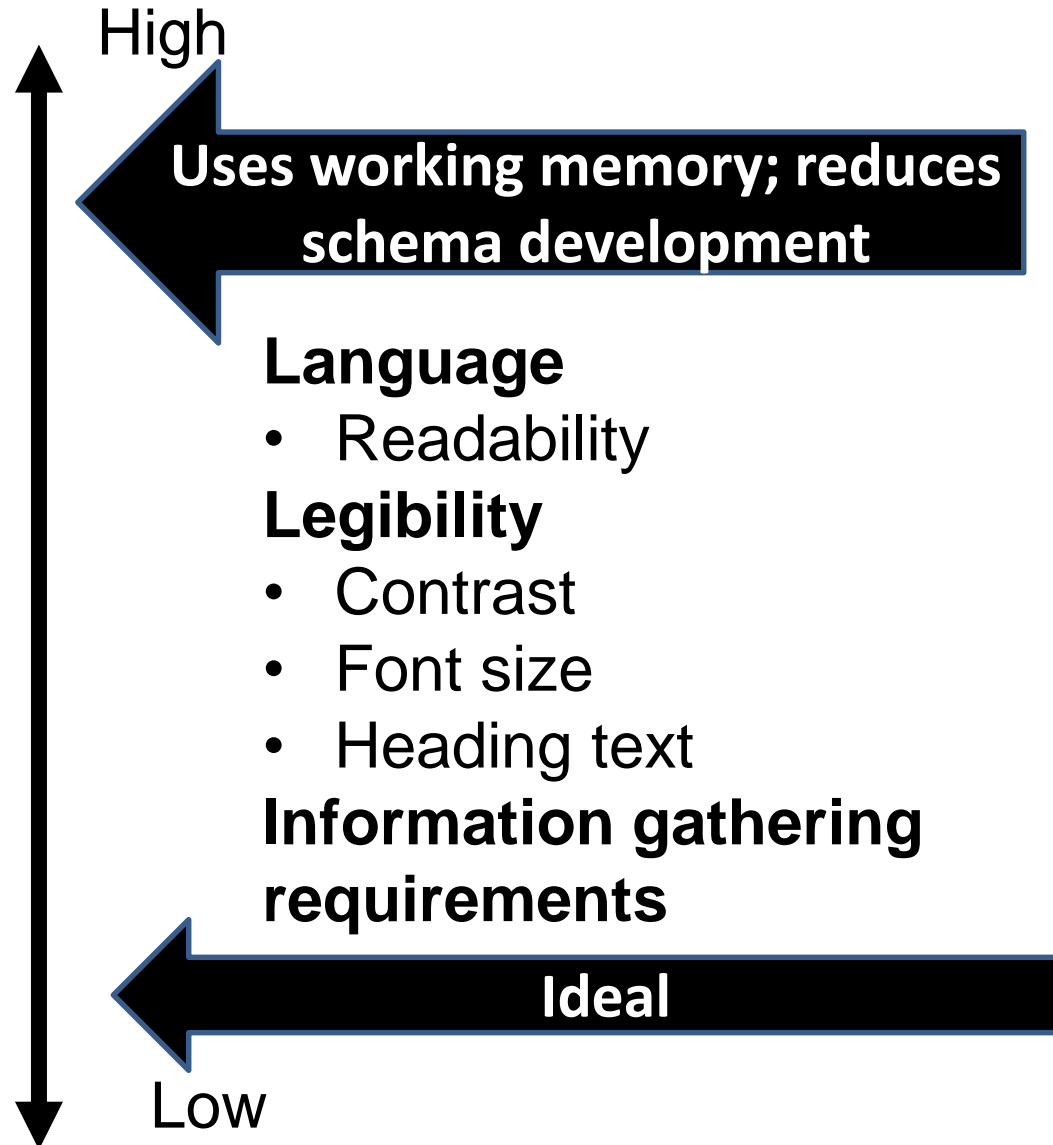
Working memory

Limited capacity

Long-term memory

Unlimited capacity

CLT: forms of cognitive load

Extraneous cognitive load – "…is imposed by the cognitive activities that a learner is involved in because of the way the learning tasks are organized and presented, rather than because the load is essential for achieving instructional goals" (Kalyuga, 2011, p. 2).

High

Uses working memory; reduces schema development

Language
- Readability

Legibility
- Contrast
- Font size
- Heading text

Information gathering requirements

Ideal

Low

Extraneous cognitive load criteria

Criteria	Benchmark (for low extraneous CL)
Language	
Readability	≤12th grade
Legibility	
Contrast	High colour contrast between text and background
Font size	% of content that is ≥10 pt
Headings	• Different visual format to text • Distinct hierarchy
Information gathering requirement	Available in a single location

CLT: forms of cognitive load

Intrinsic cognitive load – based on the content of the material and the demand it places on working memory

Low ⟷ High

CLT: forms of cognitive load

Intrinsic cognitive load – based on the content of the material and the demand it places on working memory
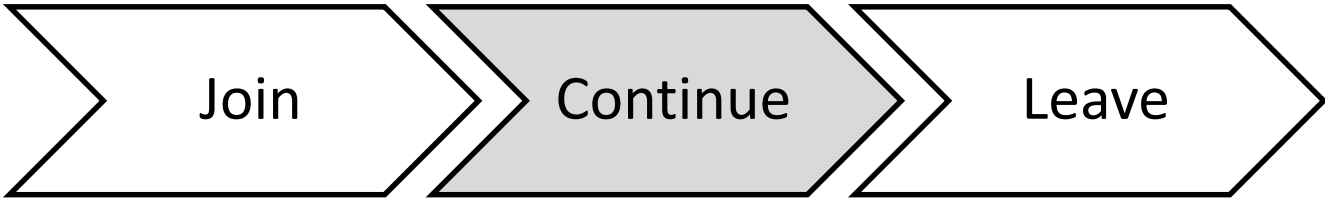
Question: What is 'appropriate' content to evaluate pension communication?

Answer: The information should help the employee to make their current pension decision (and comply with legislation).
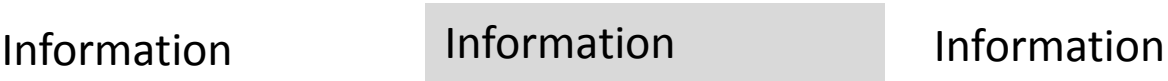
Intrinsic cognitive load criteria

- Percentage of content that is useful in making the current pension decision
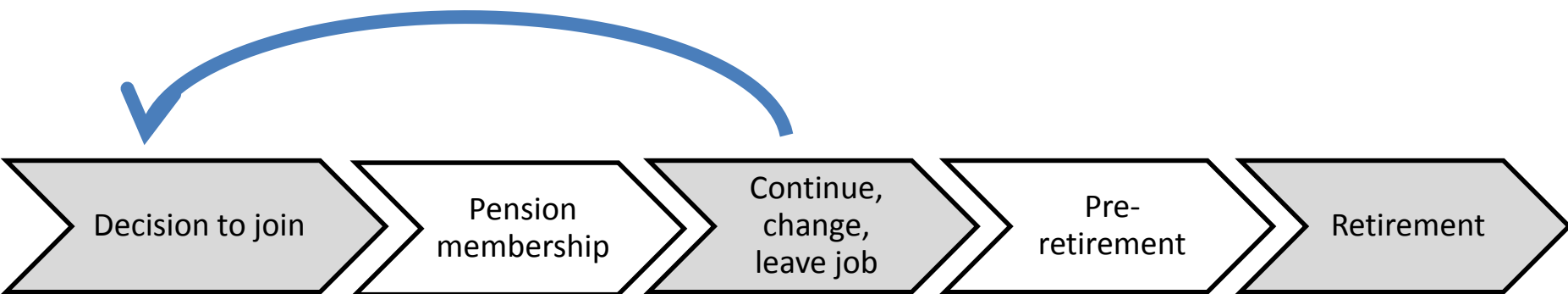
Employee pension decisions

Join → Continue → Leave

Employee communication needs

Information   Information   Information

Adapted from: Waller, R. and Waller, J. (2011) 'Exploring alternative formats for simplified legal documents'

Decision to join	Pension membership	Continue, change, leave job	Pre-retirement	Retirement

State age-related benefits	Application process	State age-related benefits	State age-related benefits	Investment options
Matching arrangements	Investment fund choice	Savings-to-date	Savings-to-date	State age-related benefits
Tax relief	Contribution amount	Pension adequacy target	Pension adequacy target	Risks/returns
Risks/returns		Savings target	Savings target	Risk appetite
Risk appetite		Tax relief	AVC	
Investment fund choices (including default investment strategy)		Risks/returns	Risks/returns	
		Risk appetite	Risk appetite	
Pension adequacy target		Investment fund choices	Investment fund choices	
Savings target		AVC	Retirement options	
		Application process for AVC or to stop, change, resume	Tax relief	
		Leaving job options	Application process	
			Working options	

Case study 1: written information for potential, new members/extraneous

Criteria		Brochure 1: Default fund description	Membership handbook
Readability	12th grade	College	College
Contrast	High/low colour contrast between background & font	High except for tables	42 low-contrast heading/sub-headings
Font size	≥10 pt	13% of text	9% of text
Headings	• Distinct from text • Distinct hierarchy	• Yes • Yes	• Yes • Yes

Case study 1: written information for potential, new members/extraneous

Criteria		Brochure: (default fund description)	Membership handbook
Information gathering requirement	None	Basic description	• 9 referrals to 4 other documents • 7 'if applicable' references along with person to contact (trustee, Pensions Authority) for more information

Case study 1: written information for non-members/intrinsic

Content criteria	Brochure 1: Default fund description
Matching arrangements	No
Tax relief	No
Risk/return	Misleading
Risk appetite	No
Investment fund choice	Yes, but not identified as 'default'
Pension adequacy target	No
Savings target	No
% related to decision to join	37% (63% relates to pre-retirement decision)

Conclusions

- Defaults are the 'easy' policy option
- Members can literally lose some or all of their savings therefore understanding is important
- Regulation is overly prescriptive
- The 'big picture' is, 'Can a second level graduate understand their pension plan?'
- Pension structure and communication choices should be built around cognitive limitations

Any ?s