



How to Design Your Benefits Plan to Impact Participant Behavior

Enhanced Active Choice

Speaker:

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A Quick Lesson in Behavioral Finance

What is the difference between:

classical economics,

standard finance, and

behavioral economics or ("behavioral finance")?

A Quick Lesson in Behavioral Finance

Answer:

The assumption of rationality.

Modern Portfolio Theory

Assumptions:

- All investors aim to make as much money as possible, regardless of any other consideration.
- All investors are rational and risk adverse.
- All investors have access to the same information at the same time.
- Investors have an accurate conception of possible returns.
- All investors are price takers, (i.e., their actions do not influence prices).
- Risk/Volatility of an asset is known in advance and is constant.

Standard Finance vs. Behavioral Finance

- People in standard finance are rational. They are not confused by frames, they are not affected by cognitive errors, they do not know the pain of regret, and they have no lapses of self control.
-Meir Statman
- People in behavioral finance may not always be rational but they are always normal. Normal people are often confused by frames, affected by cognitive errors and know the pain of regret, and the difficulty of self control.

Behavioral Economics vs. Classical Economics

- Are we studying rational employees?

Rationality is the foundation of standard economic theories, predictions, and recommendations. We are capable of making the right decisions for ourselves.

- Dr. Dan Ariely

- Behavioral finance allows for the possibility that we may consistently behave irrationally.
- Who decides what is rational? What is rationality?

A Definition of Rationality: Kahneman

- The only test of rationality is not whether a person's beliefs and preferences are reasonable, but whether they are internally consistent.
- A rational person can believe in ghosts so long as all his/her other beliefs are consistent with the existence of ghosts.
- A rational person can prefer being hated over being loved, as long as his/her preferences are consistent.
- Rationality is logical coherence - reasonable or not.
- Economics are rational by this definition, but there is overwhelming evidence that Humans may not be.

Question

Can something as “soft” as behavioral finance really modify behavior? significantly?

Two Examples

The Power of Framing

- Choice architecture describes the way decisions can be influenced merely by how the choices are presented

Risk: Calculative vs. Intuitive

- Risk descriptors can impact how participants evaluate and make decisions

The Power of Framing

- The numbers of lines on the investment election form affects the number of funds selected.

Source: Benartzi and Thaler (2006)

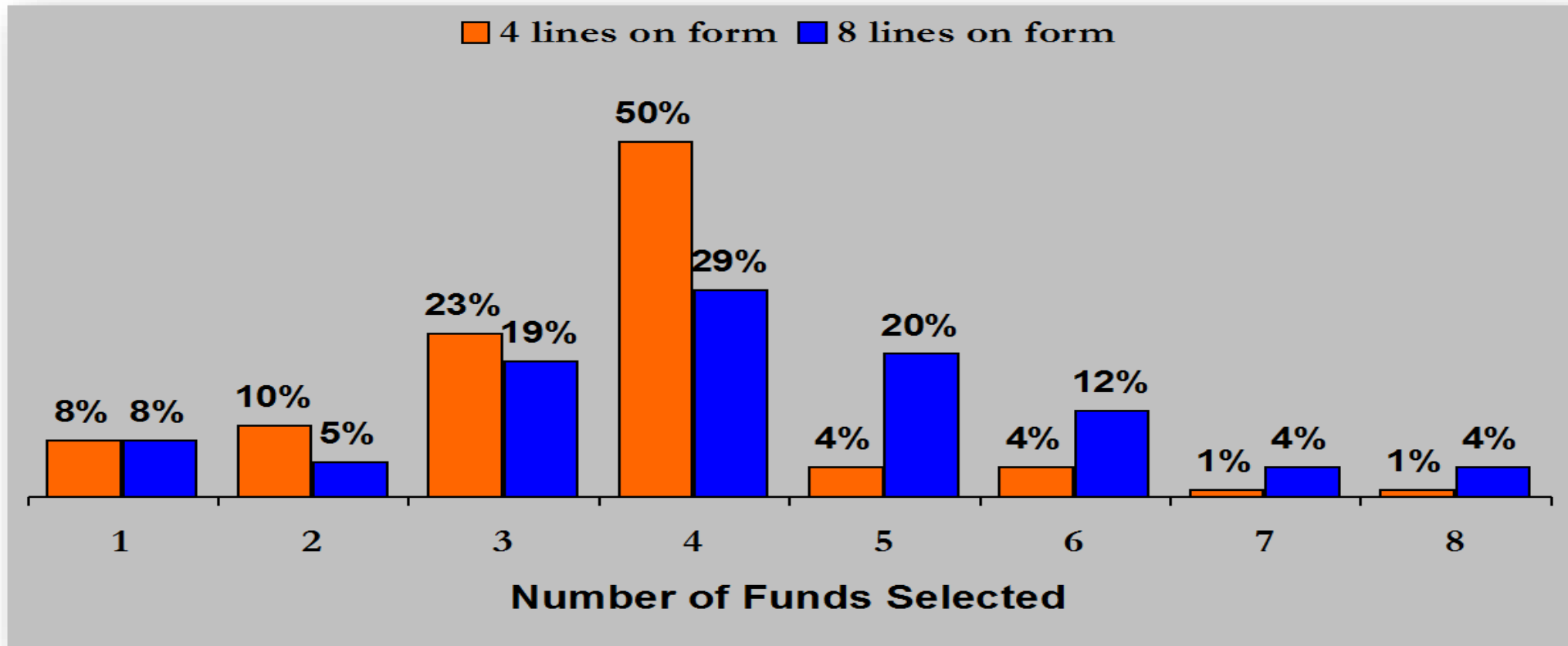
Experimental Data: Number of Lines Hypothesis

- Morningstar.com subscribers were presented with eight investment funds and were asked to construct a portfolio.
- One group was presented with an investment election form with eight lines.

Experimental Data (Con't.)

- Another group was presented with an investment election form with four lines, though selecting more than four funds was just a click away...
- “... If you would like to elect more than four funds, please [click here](#).”

Results



Source: Benartzi and Thaler (2006)

Risk: Calculative vs. Intuitive

- Two different ways of eliciting a person's preferences for risk
- Which (if either) is the truth?

1. Driving In Bolivia

The Stremnaya Road is extremely beautiful with gorgeous mountains, cliffs and greenery. While the road offers dramatic scenery, it is considered by some the most dangerous road in the world. The combination of extremely narrow roads and tall cliffs could easily result in a deadly accident, and an average of two vehicles per month fall from the road. The danger of the road ironically though has made it a popular tourist destination starting in the 1990s. Mountain biker enthusiasts, in particular, have made it a favorite destination for downhill biking.

QUESTION 1: Would you be interested in taking an all expenses paid trip to the Stremnaya Road?

- Yes
- No
- I am not sure

2. The Stremnaya Road



2. The Stremnaya Road



2. The Stremnaya Road



2. The Stremnaya Road



2. The Stremnaya Road



2. The Stremnaya Road



2. The Stremnaya Road



What Is Trust?

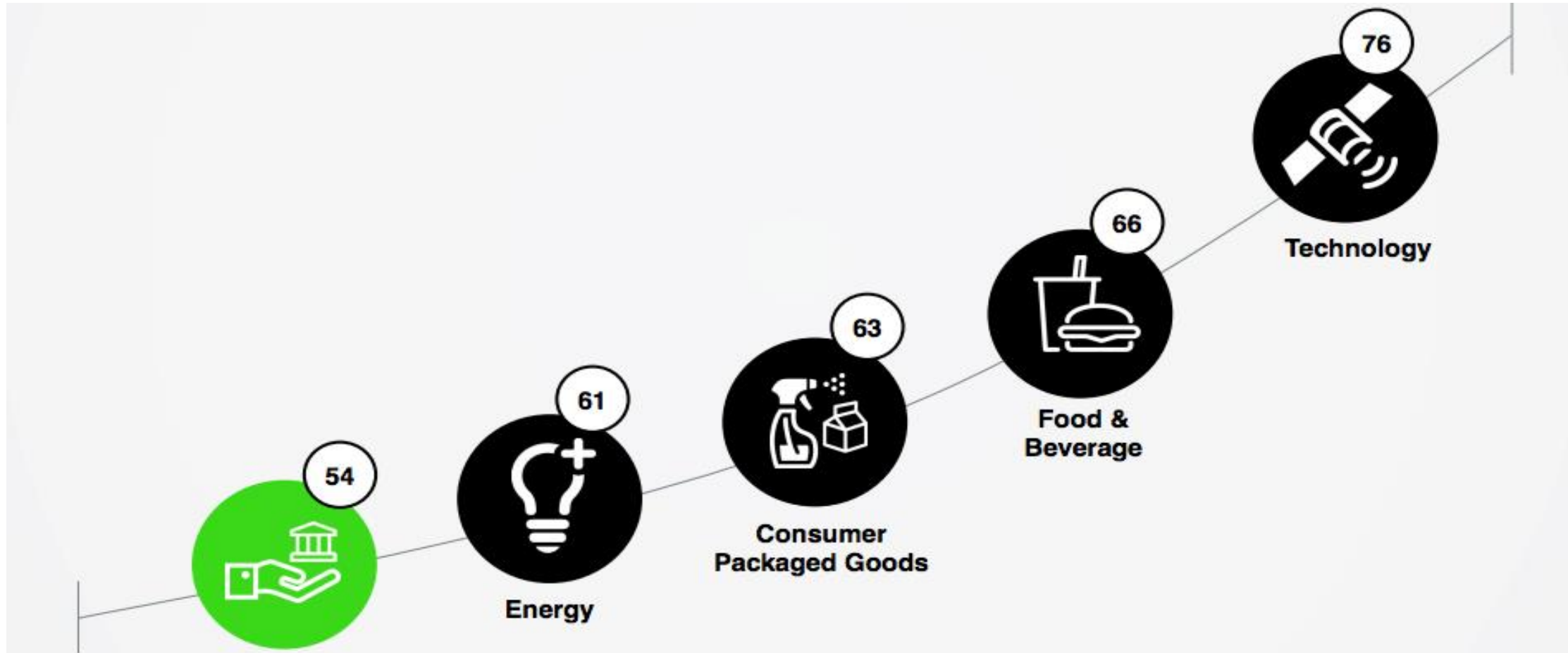
Trust is primal, an integral component of human evolution

We look for signals of trust in every interaction

Trust is the bedrock of loyalty

Most importantly, trust allows people to take risks, to engage and to change behaviors that may not feel natural or intuitive

Financial Services Least Trusted Sector



Trust in Recordkeeper 2016 NARPP Studies

Participant level of trust in their current recordkeeper:

➤ 26%

Plan sponsor's level of trust in their current recordkeeper:

➤ 29%

Plan sponsor's level trust in their advisor:

➤ 26%

Increased Trust Leads to Increased...

Plan Participation

Use of other products &
services

Savings Rates

Financial courage &
confidence

Engagement

Sustained loyalty

2. Low trust requires a shift in nudge features

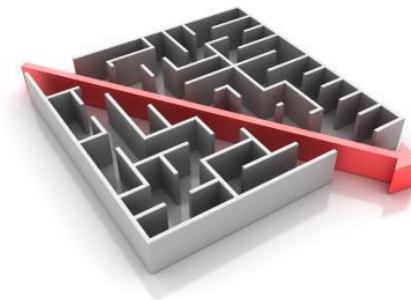
<u>High Trust</u>	→	<u>Low Trust</u>
Construal: Feasibility		Desirability
Mindset: Implemental		Deliberative



3. Hard and soft nudges focus on feasibility not desirability

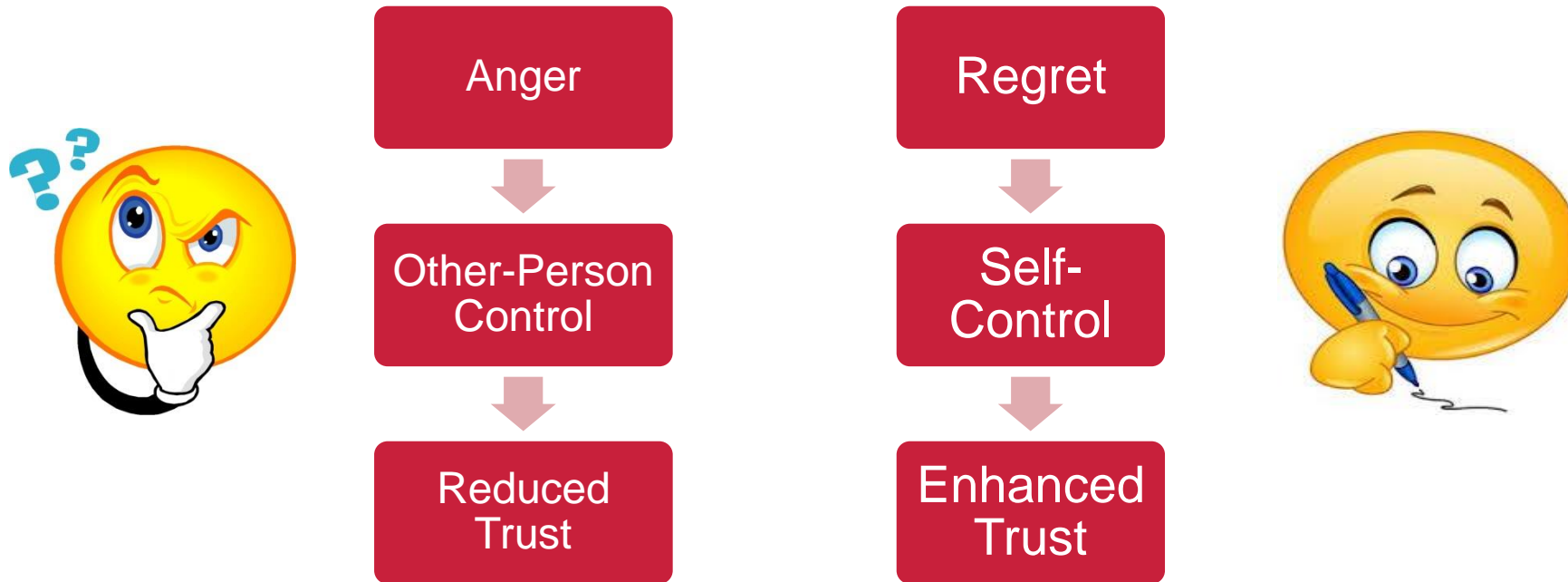


Highlighting text



Keller – Don't leave 401k alone...

But current nudges do not increase Regret Aversion and Trust



Dunn and Schweitzer, Feeling and Believing: The influence of Emotion on Trust.
JPSP, vol. 88, 2005

4. The ABCE of Enhanced Active Choice

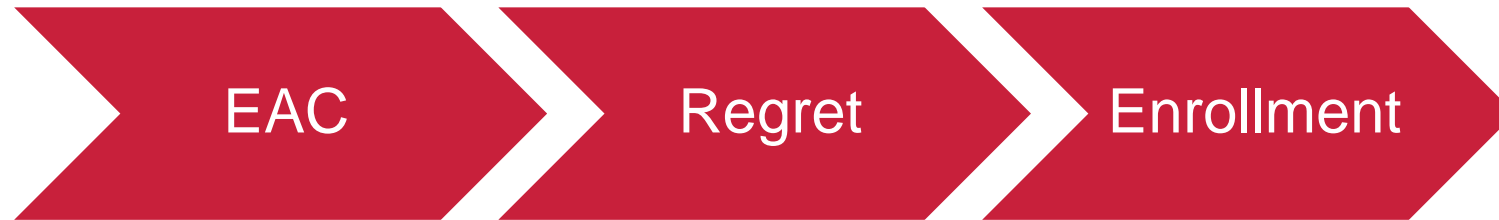


Keller, Punam Anand, et al. "Enhanced active choice: A new method to motivate behavior change." *Journal of Consumer psychology*

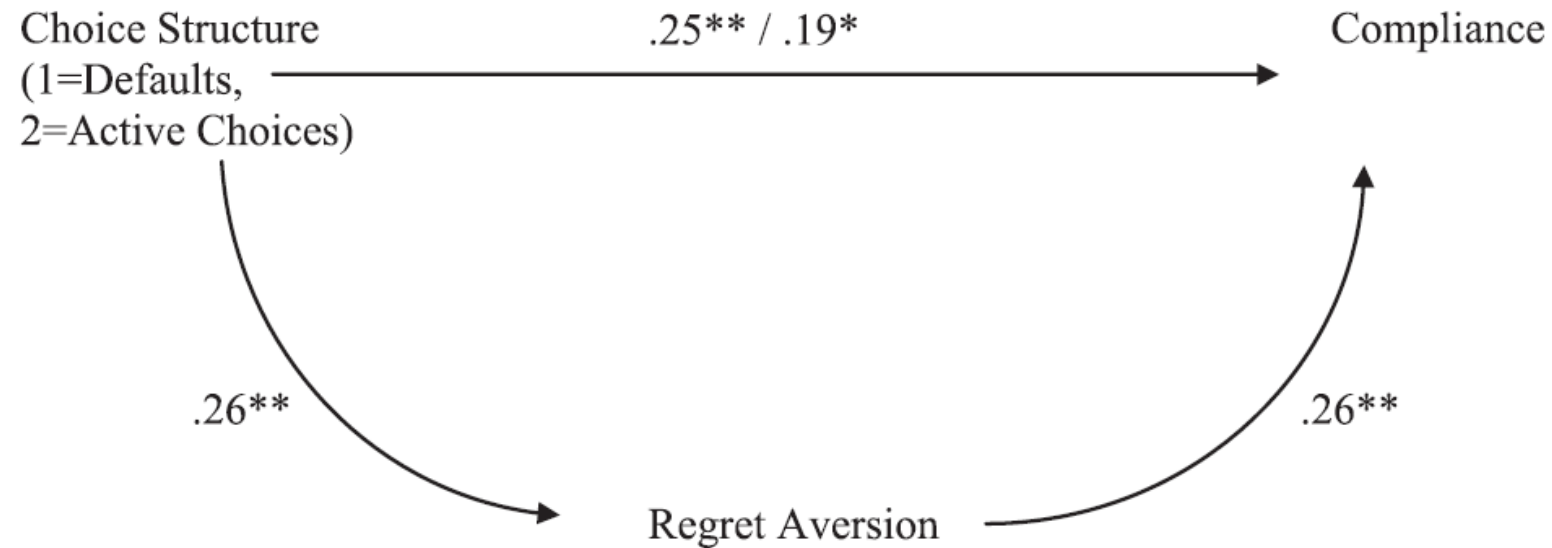
Choice Architecture Options to Encourage Participation in a Savings Plan

OPT-IN	Information on 401k plan.	
AUTOMATIC ENROLLMENT	Action required only if you do not choose to enroll in the firm's 401k plan.	<input type="checkbox"/>
ACTIVE CHOICE	<p>Check one box.</p> <ul style="list-style-type: none"> • I will enroll in the firm's 401k plan. • I will <u>not</u> enroll in the firm's 401k plan. 	<input type="checkbox"/> <input type="checkbox"/>
ENHANCED ACTIVE CHOICE	<p>Check one box.</p> <ul style="list-style-type: none"> • Yes, I want to enroll in the firm's 401k plan to ensure I will enjoy a comfortable lifestyle for the rest of my life, even after I stop working. • No, I don't want to enroll in the firm's 401k plan even if this step will help me avoid a poorer lifestyle knowing someday I will have to stop working. 	<input type="checkbox"/> <input type="checkbox"/>

Conceptual Framework–Benefits of EAC

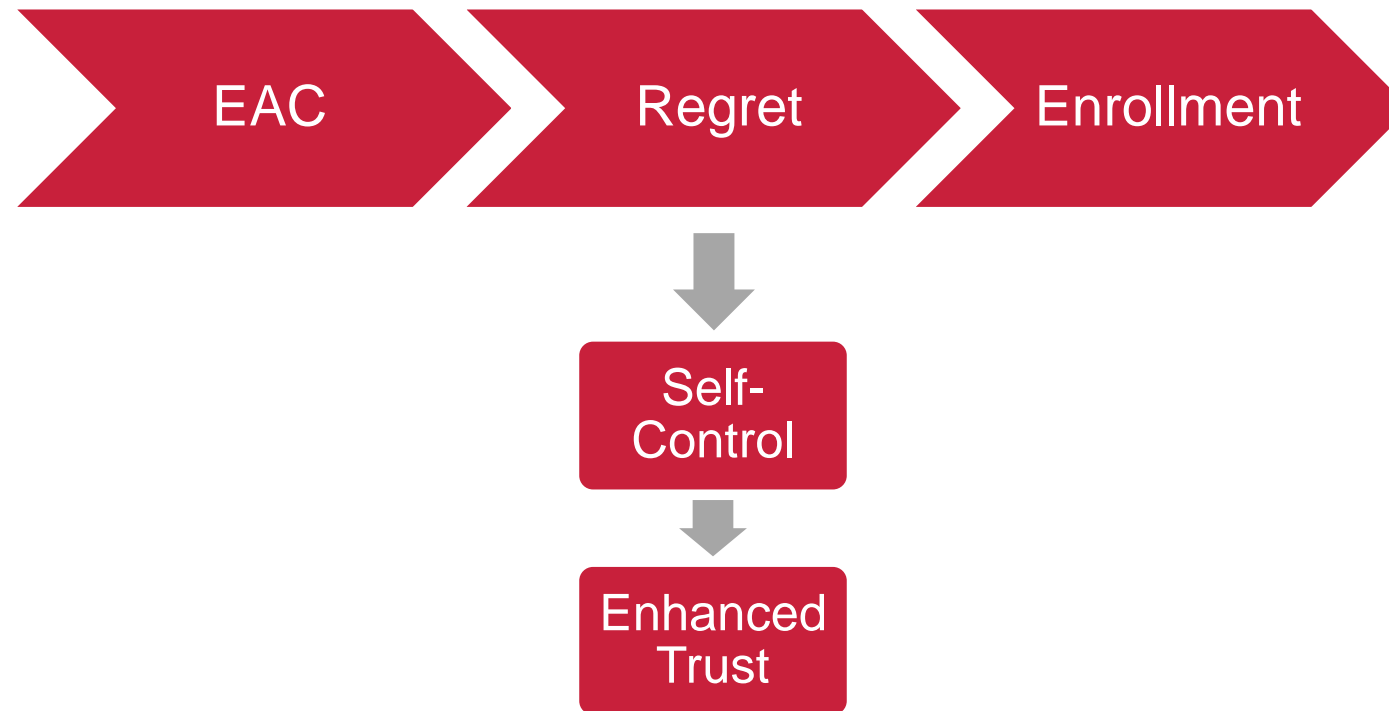


EAC increases Regret Aversion and Compliance



Keller, Punam Anand, et al. "Enhanced active choice: A new method to motivate behavior change." *Journal of Consumer Psychology*, 2011

5. Conceptual Framework–Benefits of EAC



Lab Study: Effects of EAC

- **FirstFirm Announces a 401k Matching Contribution for 2017!**
- Your 401k retirement savings plan at FirstFirm is one of the best ways to save for your retirement. FirstFirm encourages you to take advantage of your 401k plan and all the benefits that it offers you, so that you can look forward to a more secure financial future.
- **YOU HAVE TO ENROLL FOR 2017 TO GET MATCHING CONTRIBUTIONS:** Enrolling in the 401k plan is quick and easy! Once you enroll, your salary deferrals are deducted automatically from your pay, which makes saving in the plan convenient. You can elect from a wide range of investment options under the 401k plan. Your own deferrals plus the matching contributions made by FirstFirm can help you achieve your goal for a more comfortable retirement. By participating in the 401k plan sooner rather than later, you also have the potential to benefit significantly over time from compound earnings. Compounding enables you to build retirement savings not only from your own deferrals and company matching contributions, but also from all reinvested earnings!
- **YOUR MATCH GOES IN AS OFTEN AS YOUR DEFERRALS:** FirstFirm will be making a matching contribution to your participant account as often as you defer – in other words, as often as you get paid – weekly! FirstFirm will contribute \$0.25 for each dollar that you contribute up to a maximum of 4% of your eligible pay.

Test – EAC vs. Opt-In

1

EAC - 1

- Place a check in one box.
- Yes, I will enroll in FirstFirm's 401k plan to increase the chances I will enjoy a comfortable lifestyle after I stop working.
- No, I do not want to enroll in FirstFirm's 401k plan even if my decision may mean I may have to work longer or may not be able to retain my lifestyle after I stop working.

2

EAC - 2

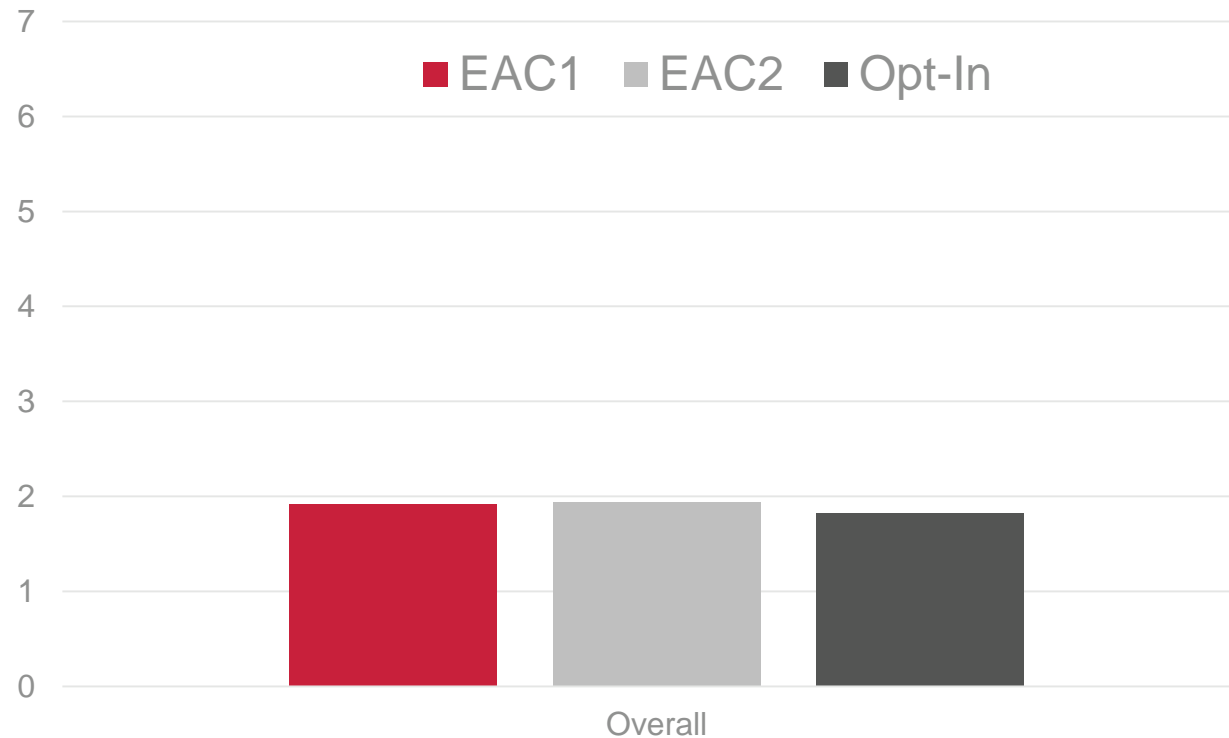
- Place a check in one box.
- Yes, I will enroll in FirstFirm's 401k plan to increase the chances I will enjoy a comfortable lifestyle after I stop working. 0
- I prefer not to take advantage and decline this opportunity to get help in maintaining or improving my retirement options.

3

Opt-In

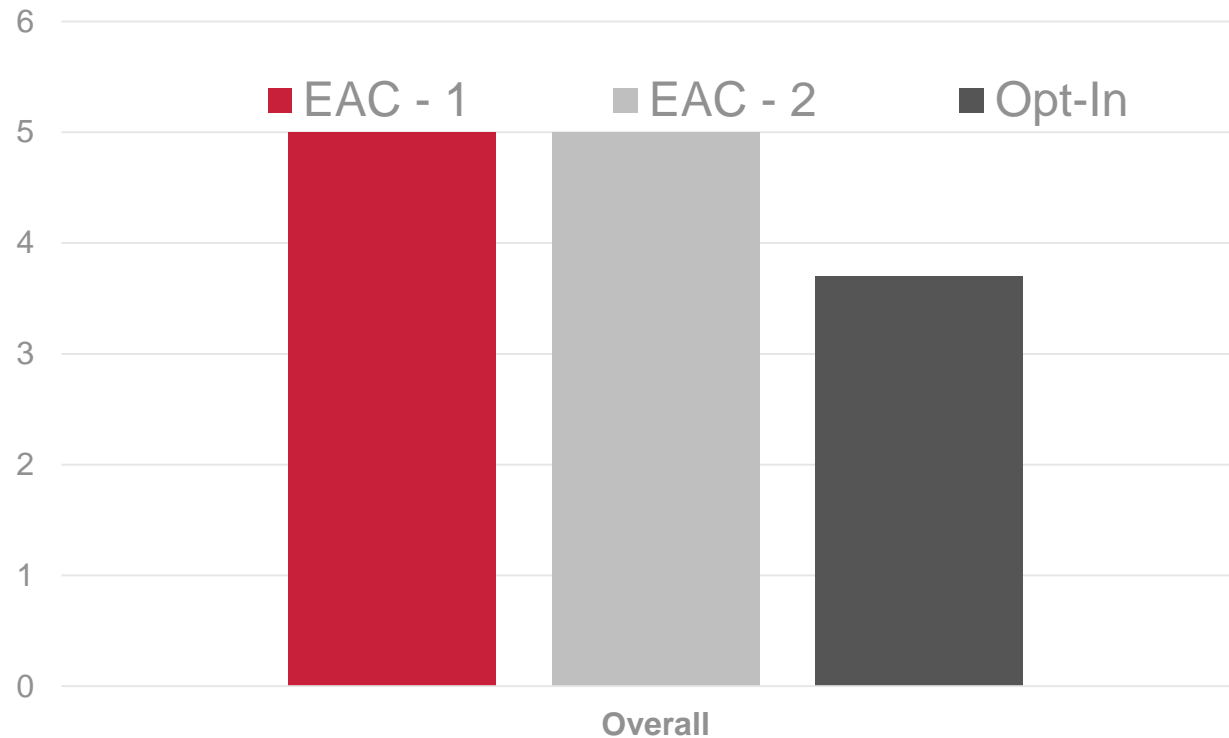
- Information only
- No choice architecture

Test – EAC vs EAC does not evoke more anger than opt-in



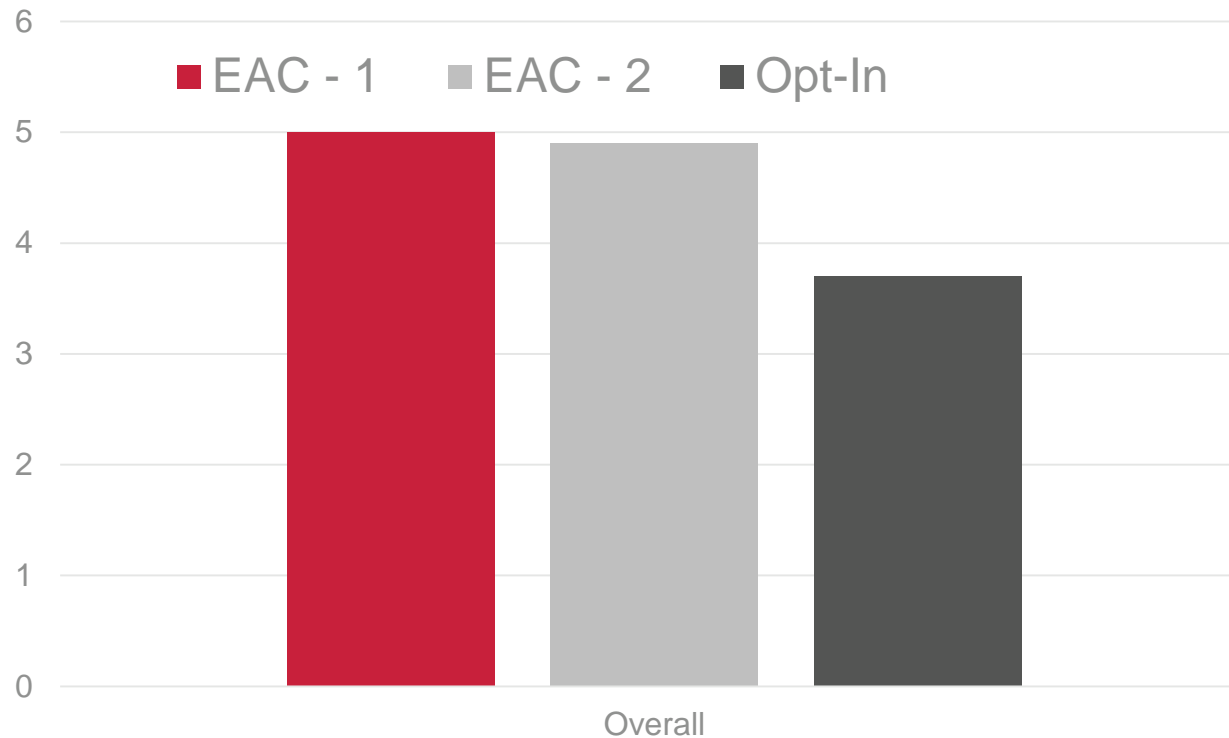
1. This 401k enrollment offer makes me angry 1 2 3 4 5 6 7

EAC creates More Regret Aversion and Less Procrastination



- | | | | | | | | |
|--|---|---|---|---|---|---|---|
| 1. I would regret it if I did not enroll | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 2. I am less likely to procrastinate | 1 | 2 | 3 | 4 | 5 | 6 | 7 |

EAC creates more Trust in Planned Sponsor

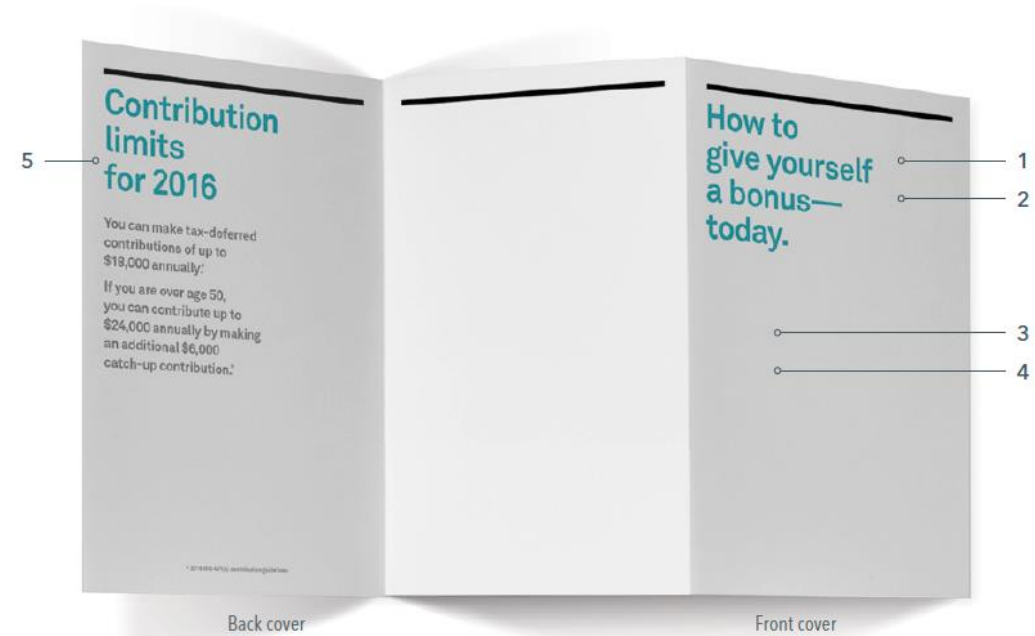


- | | | | | | | | |
|---|---|---|---|---|---|---|---|
| 1. This offer reflects FirstFirm cares about me | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 2. This offer will make me think I can rely on FirstFirm if I have problems | 1 | 2 | 3 | 4 | 5 | 6 | 7 |

6. Can EAC be used with Communication tools and other Nudges?

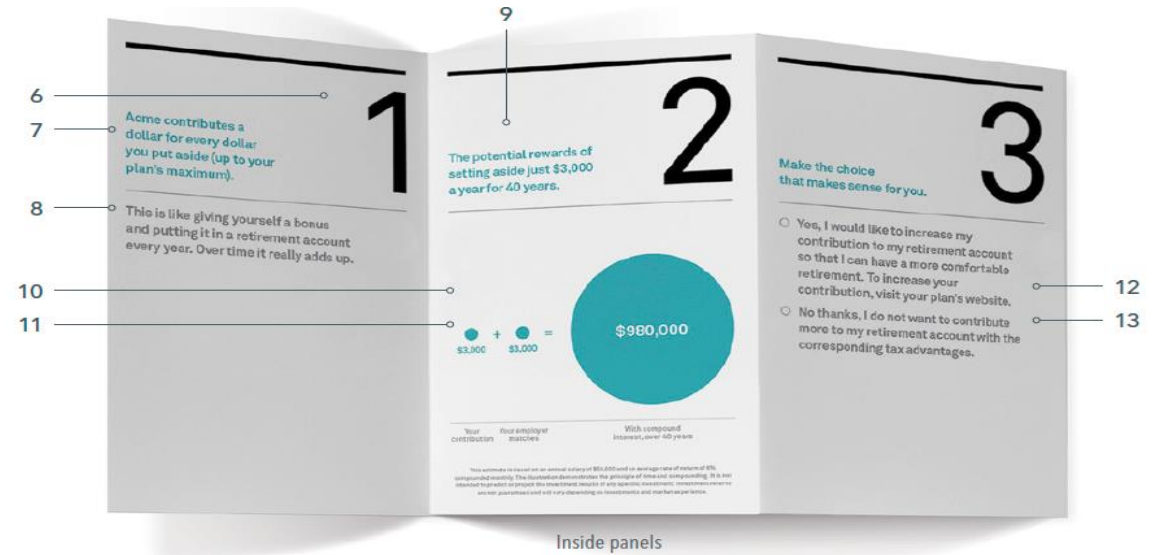


Putting principles into practice:



- 1 Build trust through optimism. When you assume the reader can and will make the right decision for themselves, they will be more likely to do so.
- 2 Express empathy by eliminating jargon.
- 3 Use white space to focus attention and remove clutter. Deleting unnecessary information encourages the reader to pause during stressful moments.
- 4 Don't include abstract or unfamiliar lifestyle images, which can detail emotionally charged decision-making.
- 5 Design the whole journey in each communications piece and give the same level of design treatment to all information, such as plan details, so that the experience is cohesive and continuous.

Putting principles into practice:



- 6** Give guidance with step-by-step instructions. Help the reader build confidence in learning and assist them in the decision-making process. "Start here," "1, 2, 3" and "Just begin by" can help greatly in this process.

7 Express empathy by demonstrating reciprocity and focusing on the user's needs.

8 Build trust by not overwhelming with more information than is absolutely necessary at each touchpoint.

9 Build trust by not talking down to or using an institutional tone that implies a paternalistic sense of knowing what's best.
- 10** Embed education by contextualizing information at key moments.

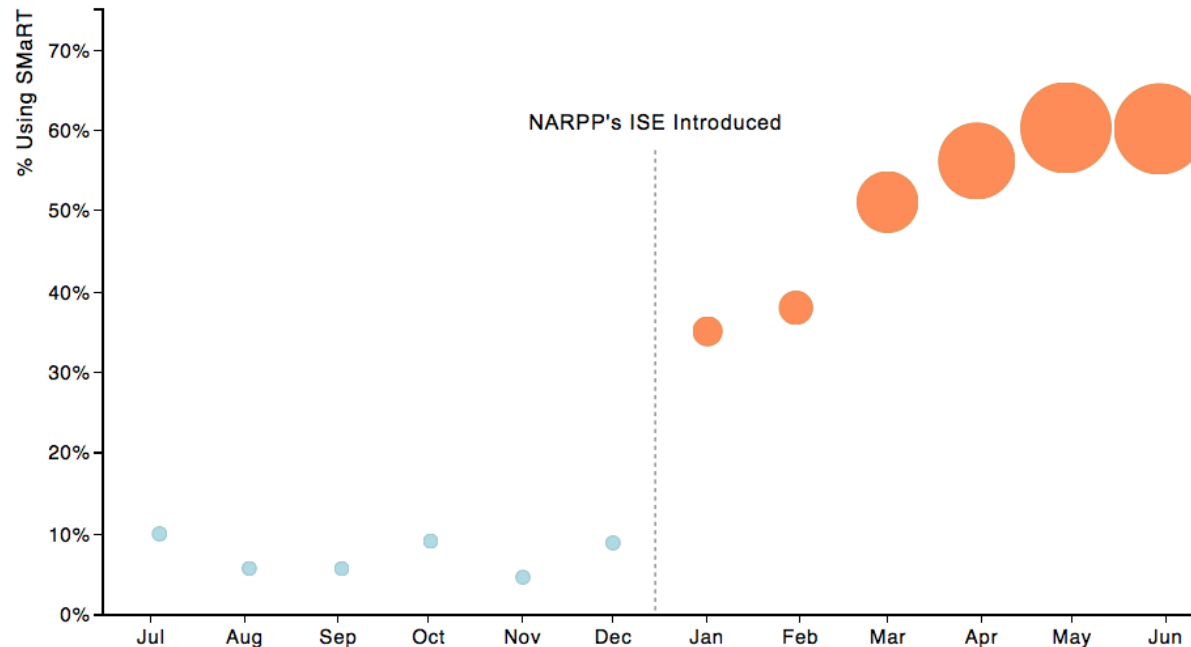
11 Use visual language and replace complex statistical displays with simple visuals such as circle charts.

12 Utilize Enhanced Active Choice by highlighting the potential negatives of the non-preferred alternative, and the positives of the preferred alternative, increasing the likelihood that an individual will take an action that positively impacts their future and maximizes gains.

13 Focus on the most important action required, minimizing the number of "calls to action" in a single piece.

ISE-EAC improves outcomes

By redefining the communication materials with a scientifically-proven, people-centric design strategy, we effected a 25% increase in voluntary enrollment in the Sponsor's 457 plan, as well as a 600% increase in the use of SMaRT.



<https://www.blackrock.com/investing/literature/whitepaper/communicating-trust-saving-more.pdf>

FOR INSTITUTIONAL AND FINANCIAL PROFESSIONAL USE ONLY

Relevant Health EAC Studies

Health EAC studies to be tested in the financial decision-making context

1. Can we use EAC to increase engagement?
2. Can EAC be used to increase reliance on the sponsor?
3. Will EAC work if people cannot be forced to respond?
4. Do people get upset because EAC makes them feel bad or angry?

Q1: Can EAC increase engagement?

TAKE ONE

- Visit the Health and Wellness Center to maintain or improve your health. It's a powerful online tool.
- If you have a chronic condition, take off your bi-weekly health coaching.
- The Health and Wellness Center provides Results from your health screening to determine treatment options.

- I prefer to take advantage of this opportunity to get help in maintaining or improving my health and wellbeing.
- I prefer not to take advantage and decline this opportunity to get help in maintaining or improving my health and wellbeing.

TAKE ONE

I've taken the Live Well pledge. So can you!


It's cool and it's confidential


Take the **Live Well pledge!**

Step 1: **Take action** - Take a Live Well health screening (date), which includes blood pressure and cholesterol testing, height, weight and body mass index (BMI), plus in-person health coaching.

Step 2: **Learn more** - Find out about your current health status by taking an easy, confidential online health and wellness assessment and receive personalized health coaching just for you.

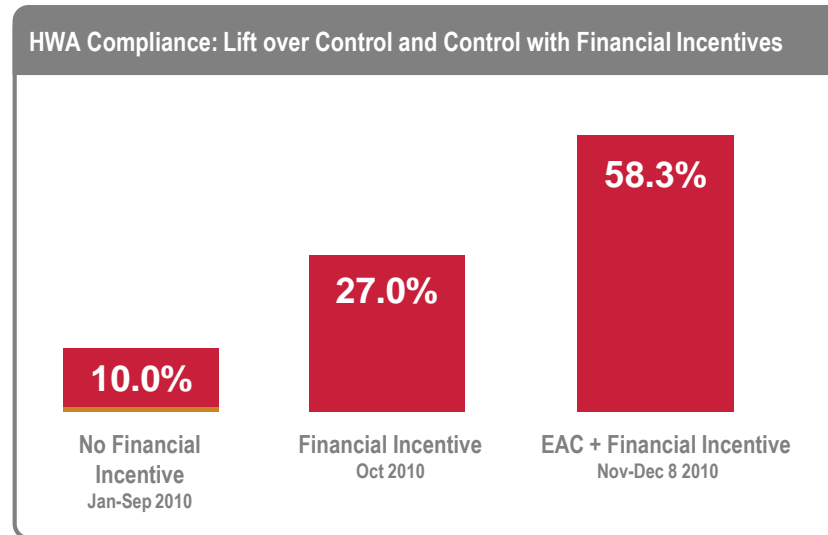
Step 3: **Keep Going and Live Well!** After you know what your current health status is and you've established your personal health goals, keep going! The Live Well/Work Well program is here to help! Go to: Send an e-mail to: LiveWellWorkWell@blitz.hitchcock.org

 **Dartmouth-Hitchcock**
MEDICAL CENTER



Dartmouth-Hitchcock
MEDICAL CENTER

Data: EAC results in higher engagement than Opt-In formats with and without financial incentives



**EAC +
Financial
Incentive:
116%**
more effective
than opt-in +
incentive

Q2: Can EAC be used to increase reliance on the service provider?

CVS CAREMARK

Make your Prescription Refills Easier with ReadyFill at Mail

Enjoy on-time delivery of your prescriptions, at no additional cost with ReadyFill at Mail, our automatic refill program. You can order your prescription refill each time or your refill order can be automatic with ReadyFill at Mail*.

You get the following benefits if you choose automatic refill:

- Your prescription will automatically be filled 14 days prior to the refill due date. We will contact your doctor for a new prescription once the last refill is up or the prescription has expired.
- We'll contact you before the refill due date, so if for any reason you don't want your refill to be automatic, you can simply cancel your order and switch to ordering your own refill anytime.

JANE SMITH -01- 01-1970

Drug Information	Prescription Number	Enroll in ReadyFill at Mail
VITAMIN D2 50000IU CAP	33477990	<input type="checkbox"/>
VIGAMOX 0.5% OP DRO	33449988	<input type="checkbox"/>
<input type="checkbox"/> Select All		

JEFF SMITH -11- 11-1968

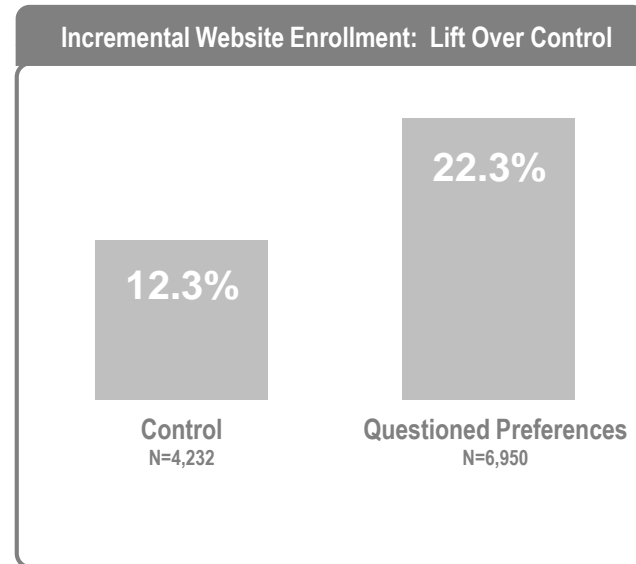
Drug Information	Prescription Number	Enroll in ReadyFill at Mail
VITAMIN D2 50000IU CAP	33477990	<input type="checkbox"/>
VIGAMOX 0.5% OP DRO	33449988	<input type="checkbox"/>
<input type="checkbox"/> Select All		

I Prefer to Order My Own Refills **Enroll in ReadyFill at Mail**

I Prefer to Order My Own Refills **Enroll in ReadyFill at Mail**

Added button – “I prefer to order my own refills” – to require members to test their preferences.

Data: More members enrolled when status quo self-reliance preferences were questioned in EAC



EAC:
79%
more effective than
opting in

Application: EAC can be used to increase participation and prevent leakage

Increase Participation

- I prefer to increase my participation because the minimum level will not cover my retirement needs.
- I want to remain at the lowest level because I will get more money from somewhere to cover my retirement needs.

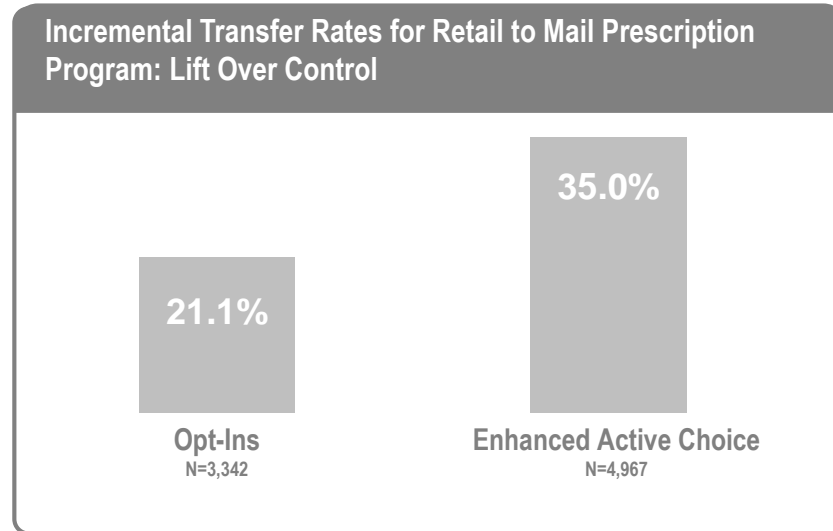
Prevent Leakage

- I prefer to manage my own retirement saving plan.
- I want to remain in the employer plan because it is difficult for me to manage my own retirement savings.

Study 4: Does EAC make people upset or angry?

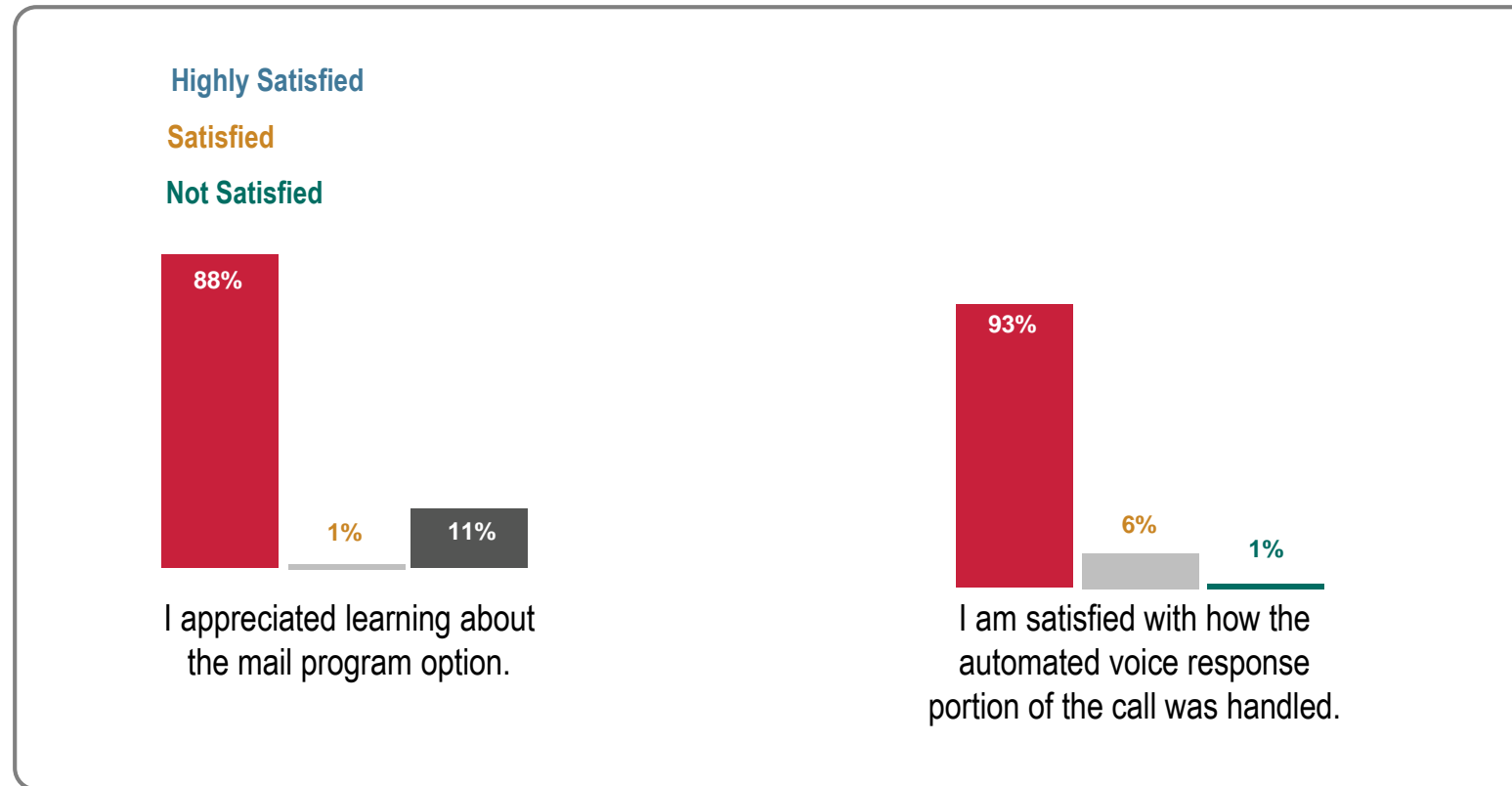
OPT-IN	<p><i>“Would you like to speak with someone about getting started with mail service? Please say ‘yes’ or ‘no’.”</i></p>
ENHANCED ACTIVE CHOICE	<p><i>“If you would rather pay more and continue making many trips to the pharmacy, say 1.”</i> <i>“If you’re tired of paying more and making unneeded trips to the pharmacy, say 2.”</i></p>

Data: More members transferred prescriptions to mail when EAC was used



EAC:
66%
more effective
than opting in

More data: EAC increases employee satisfaction



EAC is persuasive because...



- Simple choice task
- No default required
- Highlights desirability of new option
- Increases salience of status quo costs
- Reduces procrastination

- And it makes the audience feel:
 - more accountable
 - more in control
 - more committed
 - more regretful if they do not act
 - more satisfied with the decision
 - more sponsor trust

Key Take-Aways

1. Trust is a key factor in retirement financial preparedness.
2. Current communications and nudges are not designed to enhance trust in key stakeholders – planned sponsors, record keepers, asset managers, and government agencies.
3. Effective communications relies on interdisciplinary strategies from behavioral finance, communications theory, and human-centered design.
4. EAC has several important features – no defaults, highlights benefits, increases commitment.
5. EAC increases regret aversion, self-control, trust in sponsor, engagement, and enrollment.
6. EAC be used with other communication tools and different hard and soft nudges.

Q&A