THE ROAD LESS TAKEN

The road map starts at an individual's first teachable moment – the instant they sign up for their first job.

What follows is an idealised road map – one that runs parallel to the course of an individual's employee benefits track and yet allows them to evolve their personal financial wellness at the same time.

The road map starts at the individual's first critical **teachable moment**: the instant they sign up at their first job. It then tracks the individual through the various life junctures that may demand a rethink of the optimal strategy – how can they best protect existing accumulated assets and guarantee the continuation of future asset accumulation?

In an electronic delivery, the portal to this road map could be an online site or smartphone app that would be a dedicated interactive workspace for each employer and their employees. In a world without this technology, the road map provides an important engagement framework for the HR department and financial coaches.

STEP 1 Understand the employee–employer contract

Think back to your very first job. Think back to that very first employment contract. Did you *really* have any idea what was on offer? And yet this was potentially one of the most important moments in your life.

What makes this moment so important is that it sets out the financial pact between an individual and their employer. Here is the make or break moment for helping the new employee understand the complex interplay between establishing a compensation structure that meets their immediate consumption needs, provides for future consumption needs (when they retire and no longer earn a salary) and provides the safeguards that both protect the individual's earning power and asset accumulation as they move through life. If this *one* step can come right, it sets a powerful behaviour pattern for the future.

We made exactly this point in *Benefits Barometer 2013*[7]. But in many employment environments, that important opportunity is wasted – simply because of fairly normal disjunctures that often occur between establishing that all-important take-home pay and clearly understanding the full range of other employee benefits that come with that contract. Typically, these are more fully explained to the individual at their first induction meeting, one or two months after they have started. And that's too late.

But let's consider what most new employees actually see in that first employment contract. For the sake of simplicity, our example will be drawn from an employer who uses a total cost to company basis for determining how to calculate that take-home pay.

Typically, a new employee is provided with a salary package proposal that provides, at the top of the page, the total cost to company or basic pay that the company is prepared to offer. Then, on each line below this total package figure is a series of deductions that represent either the cost of some employee benefit (medical aid or risk benefits), or all the future deductions that may be channelled into savings vehicles or taxes.

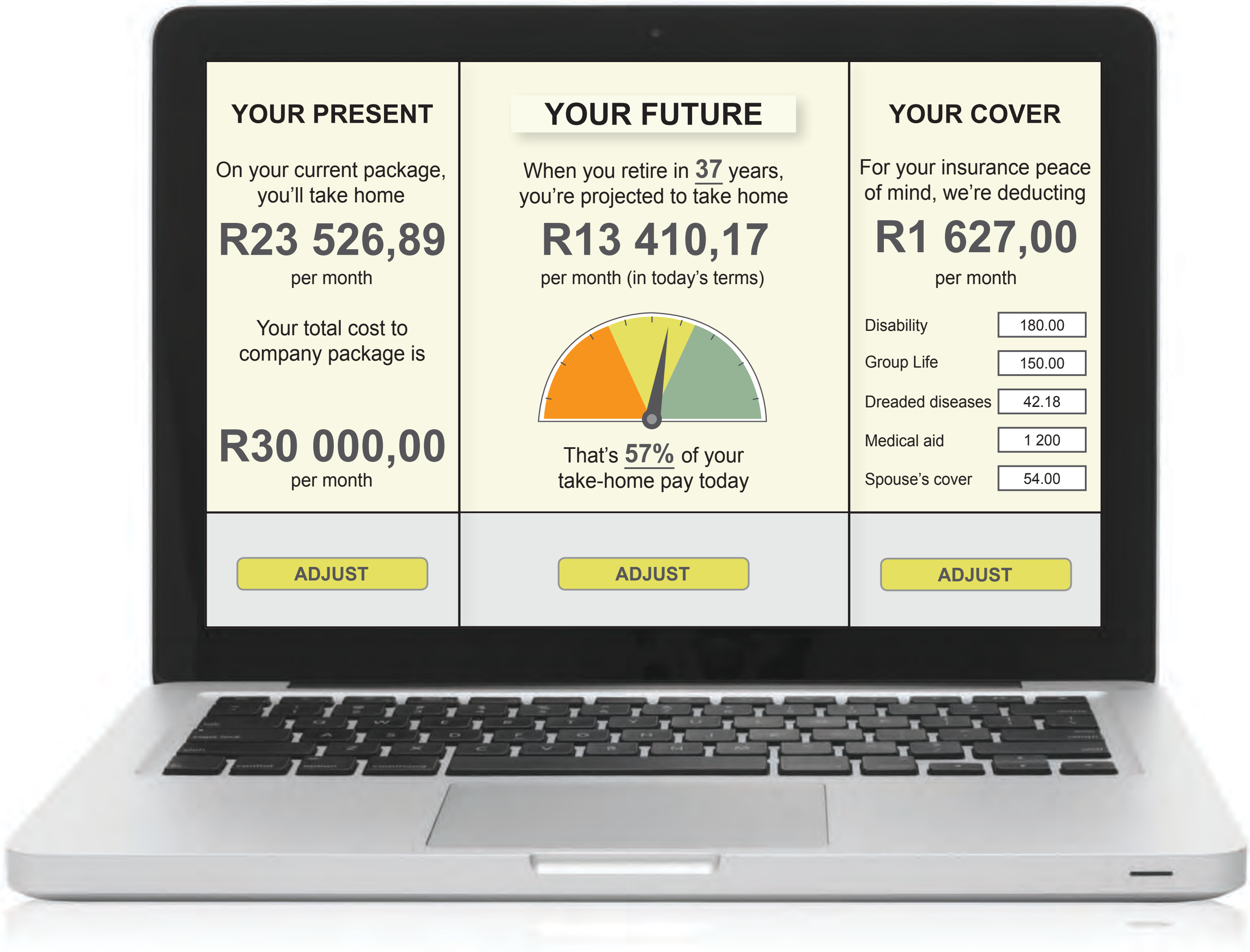
Each one of these items is deducted from an individual's take-home pay. But if there is anything a young, first-time employee is going to do, it is trying to maximise that take-home pay. It at the bottom of the page, the take-home pay, that defines what the individual and their family will be living on each month.

Now consider the psychological dynamic in this exercise. In the absence of any further information on the value of these additional benefit choices, the first instinct of individuals is that they reduce the burden of these additional benefits so as to maximise their take-home pay.

So, how do we get them to think twice at this critical point?

7 Part 3, Issue 9: Young Workers

A SALARY PACKAGE PROPOSAL



We need to **help the employee understand** that **for each deduction** from their current take-home pay, **there is a benefit** that will vest **further down the line.**

The first instinct of individuals is that they reduce the burden of additional benefits to maximise their take-home pay.

The reality is that most individuals are completely at sea when it comes to fully grasping the implications of such a decision. In some companies, this is just a sheet of paper listing the different components of salary. Sometimes there is an HR representative available to explain the various lines – sometimes not.

If we are going to change people's attitudes towards their employee benefits, we have to completely change the process a new employee experiences – and continues to experience throughout their employment. What they need is a way to help them understand the total picture of what's on offer – and what's at stake.

Tackling this change in mindset demands a multipronged approach.

First prize would be the introduction of an interactive tool in companies with easy access to technology. **Just-in-time education** research indicates that if you can get individuals to test changes and ideas when they have to make decisions, both their learning experience and quality of decision making improve[8].

Similarly, before the new employee has even considered what they will do with their existing retirement savings, we want them to be able to stress-test the impact of *not* preserving their savings. This isn't just about having the capability to illustrate what financial potential you forgo when you cash out of your retirement assets. It's also about being able to show exactly what it would take should you decide to 'fill in' this hole in your savings at a later date. Additionally, they need to be able to interpret the future potential value of all their risk benefits.

That means that every element in the interactive tool should provide a teaching opportunity. Move the cursor over each item on the deduction list and the information bubble gives you insights into the true value of those benefits (and the nature of the event that would trigger their release). Getting confused and need help? Press the 'call' button and get a real, live consultant to help you with your query (or, failing that, a real-time communicator capability that links you to a call centre). But we're getting ahead of ourselves with our idealisations of our road map.

Beyond interactive tools (or interactive HR departments) that are critical at that first point of decision making, the message needs to be constantly reinforced and constantly evolving. Monthly payslips provide an ideal opportunity to reinforce the message of the total rewards concept. This means that beyond agreeing to that initial contract, every time an employee opens their payslip they are reminded that their pact with their employer goes significantly beyond the provision of a salary. We are effectively designing a 'living document' that could be reviewed continually (or at least once a year) to understand how all the elements represented in that document would change dynamically over time. Every additional benefit, training opportunity or discounted services opportunity is given a mention and a value.

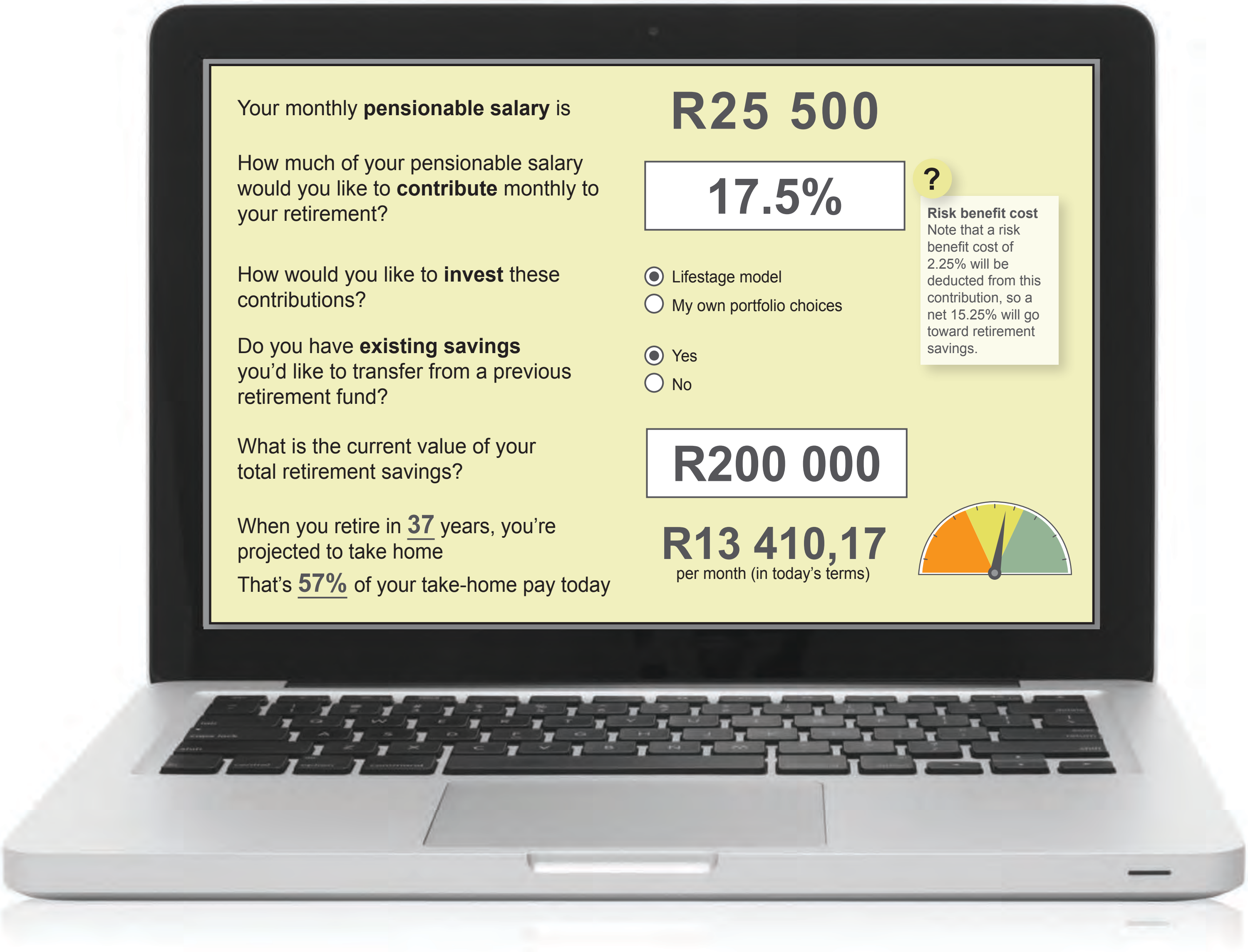
Let's go through some of the features that research suggests are essential:

Toggling between the 'totals' boxes: take-home pay versus retirement income

To formulate a holistic picture of their compensation package, we need to help employees integrate the past, the present and the future all in one place. More importantly, if we make the tool interactive, we can demonstrate the knock-on effect of each decision on outcomes both today and in the future.

8 Fernandez, Lynch & Netemeyer (2014)

TAKE-HOME PAY AGAINST RETIREMENT INCOME



The power of new contract design is inestimable. For the first time, a new employee has the ability to see how any adjustments to their deductions might affect not just their take-home pay, but, from day one (while there is still time to act) they see whether the structure of their pay package will be adequate for providing a viable income after retirement. Adjustments and critical decisions can be weighed out before the ink on the contract is even dry.

Reduce your retirement fund contributions in the hopes of increasing your take-home pay, and instantly you would be able to see the impact on your potential income for retirement. Select a more conservative portfolio for your investment choice and see how that too has the potential to affect your eventual savings. Increase your risk benefit coverage or your medical policy coverage and again these can be translated into a financial value that you or your family could tap into should the need arise.

What a new employee would see would need to be displayed simply for best effect. The key here is not to overwhelm the decision maker, particularly at this critical point of potential stress: the new job.

The best time to do all this is during that magical **teachable moment**. Not three months later during employee induction; not after you've already quit your previous employer and simply grabbed the cash and ran; but during the actual discussions you may have with your new employer about the salary package you require.

But note that 'repeat exercise, repeat exercise, repeat exercise' is the mantra that will ensure the lesson persists and evolves. This is where reinforcing the message each time an employee receives a payslip that updates their total benefit package (and highlights areas of slippage) becomes the critical next step.

ADDING THE ICING TO THE CAKE

There are many companies that have developed additional benefits for their employees like:

- Training programmes
- Low-cost housing or educational loans
- Preferential rates on short-term insurance
- Additional medical benefits.

These additional sweeteners can and should be added on the opening page to provide an even more comprehensive picture of the total rewards potential that an employer offers. Here is where employers can advertise their compensation packages to greatest effect if the intent is to provide competitively attractive rewards to attract and retain employees.

STEP 2 What else could we add to this picture?

Once we have built this first portal to an individual's total rewards package, it's relatively simple to turn this facility into an extremely powerful just-in-time self-training tool for an individual who may be confronting complex financial decisions as they move through life.

Here's what our research suggests about how to maximise this potential:

- Just-in-time educational training experiences are most effective if answers are readily available and easy to understand. That means building in facilities that explain everything on display by simply moving a cursor over the word.
- Effective just-in-time educational experiences need to be able to deal with uncertainty in an instant. This means that the most effective sessions will be linked to a communicator that allows the individual to ask specific questions and get immediate feedback.
- Many financial decisions have long-term implications that are extremely complex to compute. And yet, because of the magnitude of personal differences, these same decisions cannot be accommodated in a default solution. Conversely, most employees are unlikely to consult financial planners either because of cost or trust issues.

Under these circumstances the most effective way to nudge the individual towards an optimal decision is to illustrate the **trade-offs** that each financial decision would trigger.

EXAMPLE 1

A preservation trade-off tool could help an individual see what the impact on their long-term potential savings would translate into (again using monthly income in today's terms) if they don't preserve. How much would they lose in long-term tax benefits? If they decided to make up the gap at a later date, how much more would they have to put aside each month to get back to their retirement target?

EXAMPLE 2

Various embedded tools in the package could allow an individual to test the impact of different pensionable pay, or contribution rates, or investment portfolios on their retirement income.

EXAMPLE 3

By creating a framework that also allows us to incorporate additional information about yourself and your family, you can also answer questions like: "Does my retirement fund provide adequate life coverage?" "Do I have appropriate disability coverage?"

As the decision tool grows with the member and gradually accumulates more and more information, a valuable feedback mechanism evolves.

Members of pension funds span the full range of socio-economic possibilities, from the financially or technologically literate to the individual who is introduced to these concepts for the first time. Some have easy access to and are comfortable using online tools, others have no chance of access. What we know from the recent meta-analysis of where we are failing and where we are succeeding in the quest to get individuals to make better financial decisions, is that success accelerates when:

- We recognise that there is considerable heterogeneity among members in both their financial literacy and their economic behaviour and we design programmes that address these differences[9].
- Members are provided with projection tools or tools that help them understand the potential trade-offs they may have to make with each financial decision. In fact, members tend to boost their contributions and contribution rates (or other similarly desirable financial actions) when such tools are available[10].

The framework we propose here allows the individual to dial up or dial down the simplicity or functionality according to their needs.

We believe these concepts go significantly beyond traditional budgeting tools currently available. Setting a budget, and being able to combine all your expenditures, is the cornerstone of good financial planning. But our intent here is to give individuals the power and resources to assess the complex interplay of financial decisions on potential future outcomes. It's like having an actuary in your pocket.

This approach has the potential to assess **all** of an individual's financial decisions: medical coverage, life and disability, motor and household insurance, as well as credit and debt considerations. Its primary role is to provide a just-in-time educational tool for anyone who needs any financial insight into their own choices. That insight is just the starting point. It then needs to be put into action – whether that means adding items, subtracting items, or simply rearranging the items in your suitcase.

The framework we propose here **allows the individual** to **dial up or dial down** the simplicity or functionality **according to their needs.**

9 Lusardi & Mitchell (2013)
10 Goda, Manchester & Sojourner (2012)

STEP 3 Make the investment solution meaningful

So, your bags are packed and you're ready to go. Now what? Life happens. And this is where most individuals without financial planning support fall apart.

But first, let's just challenge a bit of convention here.

Changing the mindset on the investing approach

What if we could completely change the way we think about investments? Instead of dedicating a considerable amount of time and resources to ensure that your retirement and discretionary savings are all invested with the top performing manager in the country (and then invariably failing), what if we became a bit more circumspect with why we invest and what we want to achieve?

Let's take the problem of funding retirement income: the challenge for employees is to save enough over their 30 or 40 working years until retirement to buy a financial instrument (an annuity) that will give them the post-retirement income they need to live on for the rest of their lives.

From the start, the expectation for most individuals does not appear unrealistic. The assumption is that your retirement savings will gradually grow – ahead of inflation – for most of your life. As such, you should be able to make the transition into retirement without having to make too dramatic a change in your life circumstances.

In response to this expectation, life stage portfolios evolved as the preferred strategy for retirement funds. The life stage model appeared to be the best of both worlds. For the first 30 to 35 years of their employment, members would be invested in a portfolio whose primary goal was to accumulate the highest possible return for the risk appetite of the member (usually aggressive for this period in the cycle). Whether members selected active portfolios that combined multiple specialist asset managers or a blend of active balanced managers or even a blend of passive asset class indices, knowing which strategy to use was effectively irrelevant. There was simply no way to know after a specific 35-year period which one of these strategies would perform better.

But the real value-add in the life stage investment strategy was the fact that in the 5 to 10 years before retirement, this strategy would completely shift to one that tried to gain more certainty around the maximum income that an individual could buy in the annuities market (either by preserving capital or by targeting the cost of securing an income appropriate to the individual's needs). Essentially, life stage investment strategies provided investors with the means to plan their retirement needs more effectively. But in many ways, life stage investment strategies at the fund level are like chainsaw art.

Chainsaw art reflects an attempt by an artist to replicate an image or statue out of a block of wood with a very bulky chainsaw. The necessary result is at best a very crude representation of the original concept.

While it's better than doing nothing, it assumes that everyone entering into the de-risking phases of a life stage strategy has the same fund credit and, more importantly, has the same expectations for their income requirements after retirement.

Beyond chainsaw art

In fact, technology and financial modelling have moved to the level where it is theoretically possible for every individual in a fund, irrespective of their income or fund credit level, to have their own tailor-made solution that would consider exactly where they were coming from (had they preserved in the past or contributed enough?) and helped them maximise where they could go in the future, given the specific objectives.

Sounds excessively costly? Not if you employ low-cost passive building blocks to construct the myriad solutions. Think of each of these building blocks as targeting different investment requirements: long-term growth, short-term growth, capital preservation, income targeting, and so on. Different blends of these building blocks would solve just about any investment problem an individual might face. As an individual moves through their financial life, the blend of these building blocks will shift to accommodate whatever strategy they need to maximise at that point in time.

The shift in mindset would not be trivial. A particularly pressing concern for fiduciaries would be how to fulfil their monitoring responsibilities if every member potentially has a different strategy. But that assumes that the way we currently monitor and assess performance is correct.

Consider the significant value destruction that occurs when trustees, members and their advisers chop and change managers or strategies that don't outperform their benchmarks on time frames that may be completely meaningless given the context of the strategy.

In our brave new world of optimised solutions for members, trustees would still be able to assess whether each of the building blocks was fulfilling its respective performance expectations.

And with technology now allowing us to track the progress of every member in a fund in meeting their long-term funding requirements, we would be able to immediately identify any journey that has gone off track.

What the change in thinking would do though, is to significantly transform the effectiveness of a life stage investment strategy into something that far more neatly recognises the considerable variability that exists for members of a given retirement fund in their current fund credits and their aspirations for those savings.

The important point to note, though, is that we have now, ever-so-subtly, introduced the first steps of financial planning to **all** members of a fund, irrespective of their income levels or level of financial sophistication and, with the right building blocks, we can do so cost-effectively.

STEP 4 How should you pack your bags?

Taking this new framework to the next logical step

Tailoring solutions to individual circumstances in the retirement space is hardly new. For example, although in its infancy, some funds have been introducing dynamic solutions in the risk benefit space that recognises that members have variable needs for different risk benefits as they move through life. By using an individual's basic demographic information, we can create a far more efficient allocation of resources by ensuring that they only buy cover when circumstances demand it. Collect the necessary information such as age, gender, marital status and family circumstances and this becomes a solution that's reasonably straightforward to automate.

But outside the pension fund, the real world and the real challenges await. Remember our suitcase problem: we each have our own size suitcase that requires us to consider trade-offs. If we want individuals to understand the critical interplay between their pension fund benefits and their families' or dependants' other day-to-day financial needs, we need an optimisation framework that allows us to get the optimal balance, given the constraints of that suitcase, between:

- What the individual needs to consume now, with
- What they need to save for in the future, with
- What they need to cover home loans or debt, to
- What they need for their children's education, to
- Maximising the opportunities they have to reduce tax, to
- Funding medical expenses both now and in the future (when they will likely increase).

The real financial decision-making challenges are not with the adequately wealthy, but with people who are financially stretched.

The difference between this optimisation problem and the one that we used to solve for maximising our retirement funding, is that here individual families will want to prioritise for themselves what they believe is important in their lives.

Does funding your child's education take precedence over paying off your bond? What's more important than protecting your ability to generate an income?

Intriguingly, if more granular data about a family's financial circumstances and priorities is available, we can create an even better decision-making framework that can weigh out the various trade-offs implicit in a full range of financial decisions.

The link to Step 1 here is critical. The more information available, the more we can assist individuals by modelling the trade-offs. The framework we described in Step 1 gives an individual the opportunity to add other elements to create a holistic picture of all the financial demands on their income.

Why should we bother? Because the real financial decision-making challenges are not with the adequately wealthy who may be trying to determine which of their savings vehicles they should draw from in retirement to achieve the greatest tax efficiency. Rather they are with people who are financially stretched, because this is where human beings make their worst decisions.

Perhaps a few thoughts from Mullainathan and Shafir's book *Scarcity* provide an apt closure to this section:

- "Scarcity captures our minds automatically. And when it does, we do not make trade-offs using a careful cost-benefit calculus."[11]
- "Scarcity alters the way we look at things; it makes us choose differently."[12]
- "Scarcity directly reduces bandwidth – not a person's inherent capacity but how much of that capacity is currently available for use."[13]
- "Scarcity doesn't just lead us to overborrow or to fail to invest. It leaves us handicapped in other aspects of our lives. It makes us dumber. It makes us more impulsive. We must get by with less mind available, with less fluid intelligence and with diminished executive control – making life that much harder."[14]

Mullainathan and Shafir have used much of their research to tackle the issue of poverty. But we believe their thinking goes right to the heart of why it has been so difficult to build a savings culture in South Africa. A framework that helps individuals who are financially stretched make sense of the complex interplay of decisions and trade-offs must surely be an important step in creating more stability for the journey.

11 Mullainathan & Shafir (2013)
12 Ibid page 38
13 Ibid page 47
14 Ibid page 66

STEP 5

Why should individuals bother? What's the incentive?

We can focus on solutions that 'sleepwalk' our members to retirement or we can introduce a framework that educates and helps individuals to properly prioritise their financial decisions. Clearly, we believe that the latter should be the top priority if this is within our means as an industry. But it would be naïve to think that the merits should be immediately obvious to the participants. Getting people to focus has been one of the great challenges.

This leads us to the question of carrots. What's in it for an individual to go through all the trouble if there's no payoff for another 20 or 30 years? Or if there just seems to be so many other more important priorities? 'What-if scenarios' can only take us so far to motivate individuals to do the right thing for themselves.

There are so many rewards programmes in the financial services sector, all trying to promote different behaviours. But none of them effectively promote a healthy financial journey.

All the big players in the banking sector have launched rewards programmes, the oldest of which has been around for over 13 years. These are essentially 'buy' programmes. The more you buy, the more rewards you get. You are rewarded for improving the finances of the bank, not your own finances. These programmes help to create the exact problem we need to solve.

On the other side of the coin, some companies have created rewards programmes for good behaviour. They are driven by regulation in these industries that rightfully prohibit 'buy' programmes and the behaviour they promote.

Discovery, through their Vitality programme, radically changed our thinking about health by creatively rewarding us for meticulously cataloguing everything we could possibly do to promote our health – from eating better, to monitoring our vital signs, to following prescribed health routines tailored to our specific circumstances. What is the pay-off for doing this? Discounted travel opportunities, sunglasses, movies, golf, gadgets and other luxuries.

They promote the right kinds of behaviour, but the rewards mechanism creates its own set of problems if we want to promote better financial decision making. Large retail discounts may not be the best way to reward people when our main objective is to minimise spending. But there's clearly a point beyond which people are not willing to exert themselves, no matter what the promised retail reward and no matter what the implicit benefit of engaging with the programme.

What does the financial services industry have to offer to this mix? There are companies that offer rewards programmes they claim to be financial wellness programmes, but they only reward people for buying their products or meeting with the advisers of that specific company.

Traditionally, companies offer financial rewards to customers on the programme if they do business with the company over a period of time. These loyalty programmes can consist of:

- Point-of-sale discounts at the originating company.
- Free units for each *n* units purchased.
- Financial incentives for own and partner organisations by accumulating points.
- Special treatment (access to goods and services that non-members don't have access to. This could include education or targeted offers[15]).

We could consider the first three points collectively as financial incentives. Each reward has advantages and disadvantages. The point-of-sale discount system is becoming less popular, because it doesn't encourage ongoing loyalty. Similarly, free units don't encourage heavy buying.

Financial incentives work better than non-financial incentives[16] and points-accumulation programmes have lower attrition than simple discount models[17]. Nobody has tested the effectiveness of the financial and special treatment components in betterment programmes, but researchers suspect the incentives are the driving factor.

These rewards don't address an individual's full financial journey, only the element of it that can make the company money. These are essentially 'buy' programmes masked as financial wellness programmes. These programmes don't build the trust needed

The travesty of most financial rewards programmes is that **you are rewarded for improving the finances of the bank, not your own finances.** These programmes create the exact problem we need to solve.

15 Berman (2006)
16 Furinto, Pawitra & Balqiah (2009)
17 Zhang & Breughelmans (2012)

We need to start building programmes that don't just engage and build loyalty, but rather change behaviour through effective partnering.

for someone to fully engage with them. In the financial wellness stakes it would hardly be appropriate to reward people who have made the right decisions about their savings and financial planning with opportunities to buy more goods or services – even at reduced rates.

It's also important to understand that the response to different rewards evolves constantly. What is exciting and motivating one day soon becomes stale and ineffective. Retail rewards may have been the 20th century solution, but are quickly becoming archaic.

A financial wellness programme should provide appropriate and tangible measures for educating an individual about ways to improve their current position as well as rewarding them, not in a way that enhances the problem, but rather one that helps them along their journey, and ultimately helps them reach their end goals.

A rewards programme needs to assist people to buy what they do need rather than adding to a whole new list of wants. The problem is that this may not be sexy enough to work in practice. The right solution is not always the one that works. Essentially, the promise to educate and guide people to improve their finances will not be enough of a tangible reward. We need to engage people's emotions and natural impulses. We have to combine real monetary rewards with human behavioural elements – many of which are the basis of the soaring use of 'gamification' – like feelings of competition and accomplishment. It can't be a boring process. Your financial life is a journey and we need to help you enjoy the ride. Rewards should complement the core purpose of the programme – to assist people with their financial journey.

So, the space is wide open to create a whole new model of engagement here. We are rapidly learning what doesn't work – and by 'work' we don't mean the end game of making more money for the industry. We mean leading people to better outcomes. We need to start building programmes that don't just engage and build loyalty, but rather change behaviour through effective partnering.

STEP 6 Know what would be ideal

Finally, we end our discussion of *The Journey* by recognising that as much as people want to be able to set their own goals and agendas, they also need guidance about what is appropriate for their particular circumstances. We know from Akerlof's work that one of the more powerful influencers on behaviour is the power of the social norm[18]. Conformity, acceptability and social identity can powerfully affect decision making[19].

One way to harness that motivator is to tell individuals what other people in their socio-economic circumstances are likely to do. This could motivate them to do the same.

This concept ties directly into the financial wellness index we discussed in greater detail in **Part 2, Chapter 2** on Targets.

If we can couple these insights into what behaviour is optimal at what stage and under what circumstances, with an effective incentive programme that rewards decisions that lead to better outcomes, we think we could quietly nudge much of the country towards financial well-being.

If we can couple these insights into **what behaviour is optimal at what stage and under what circumstances,** with an effective incentive programme that rewards decisions that lead to better outcomes, we think we could **quietly nudge much of the country towards financial well-being.**

18 Akerlof & Kranton (2010)
19 Bikhchandan (1998)