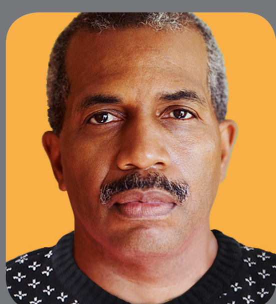
2011

Understanding the Accidental Investor

Baby Boomers on Retirement

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Table of Contents

Executive Summary

Today's American retirement system relies in large part on the 401(k), which shifts the responsibility for investing and managing market risk from employers to individual employees. With this shift, plan participants have been tasked with becoming their own investment managers, responsible for both growing their savings during their working lives and converting their savings into lifetime income in retirement. With the first Baby Boomers entering retirement in 2011, the retirement income of an entire generation of American workers will be heavily dependent on 401(k) plans—plans that did not even exist when many Baby Boomers started their careers. The title "Accidental Investor" refers to this generation of employees who find themselves unexpectedly burdened with the challenges of managing their retirement assets.

In the last 20 years, Baby Boomers have seen their traditional pensions frozen or discontinued, their job security threatened, their 401(k) balances rocked by booms, busts, and financial crises, and their health care costs skyrocket. In response, their behavior has been broadly characterized by inertia, one of the most powerful forces affecting 401(k) participant behavior. While many view inertia as irrational, we found that it was often an understandable response to past experiences and valid emotions surrounding retirement.

We developed this white paper to:

1. Provide perspective on the emotions around retirement we have observed in near-retirees and retirees (also referred to as "401(k) participants" in this report);

2. Help those responsible for retirement programs better understand how these emotions influence participant behavior; and

3. Identify what is required to reach these participants so they can get the professional retirement help they need.

To gain a deeper understanding of participant emotional perspectives, behaviors, and needs around retirement income, Financial Engines analyzed interview notes and detailed survey responses collected over a three-year market research effort. We conducted more than 300 one-on-one interviews with near-retirees and retirees between March 2008 and February 2011. To analyze the interview notes and detailed survey responses, we used "thematic coding," a social science technique used frequently to analyze qualitative data. After coding the interview notes, we identified the most prevalent emotions and needs and analyzed participants' words to understand the complex relationships between the emotions people felt and the product features they wanted in a retirement income solution.

Emotions

Of the 16 emotions identified in the data analysis process, the following were the four most prevalent emotions participants expressed about retirement. Each of the following emotions was expressed by at least one third of the participants:

- **Uncertain.** Participants said that they were overwhelmed by uncertainties, including investment losses due to stock market volatility, declining housing values, concerns about the future of Social Security, and about how long they would be able to work. They were also worried about longevity and rising health care costs.
- **Fear of Poverty.** Many participants expressed fear of burning through their savings in retirement and living in poverty or being a financial burden on their children.
- **Not Confident or Knowledgeable.** Some participants said that they lacked confidence and financial knowledge when it came to retirement planning and investing decisions.
- **Distrustful.** Due to the widely publicized financial scandals and negative experiences of feeling hunted by unscrupulous financial brokers or advisors, many participants said that they were highly guarded when it came to trusting others with their savings.

These emotions were not expressed in isolation; most participants expressed multiple emotions in response to retirement planning.

Behaviors

Analyzing the interviews of participants expressing one of the four primary emotions, the following were the most frequently observed behaviors:

- **Paralysis.** Regardless of the primary emotion, the most common resulting behavior was ubiquitous across participants: to do nothing. While some were paralyzed with fear and uncertainty, others were prevented from taking action by confusion or not knowing whom to trust.
- **Avoidance.** When faced with fear of unpleasant or difficult news, some participants said that they preferred not to know how bad the situation was rather than face the facts. Others said that they wanted to avoid spending their 401(k) assets altogether to give them something to fall back on if something unexpected came up.
- **Misplaced Trust.** Given their distrust of the financial services and insurance industries and lack of confidence in their own financial knowledge, participants often turned to a friend or family member—qualified or not—for retirement advice.

- **Magical Thinking.** Many participants resorted to magical thinking, telling themselves that everything would work out in the end, or that they could continue working indefinitely without having to adjust their standard of living.

Most of these behaviors, with the exception of misplaced trust, are a variation of inaction. All of these behaviors prevent participants from getting the professional retirement help they need.

Reaching Accidental Investors

Given these participant emotions and corresponding behaviors, what is the best way to reach accidental investors and get them the help they need? The five most common needs expressed by people who felt uncertain, had a fear of poverty, not confident or knowledgeable, or distrustful of unscrupulous financial services and insurance firms were:

- **Flexibility.** Given the uncertainty of retirement, participants expressed a need to have flexibility and control over their retirement investments. We define flexibility as having access to one's money at any time and the ability to make changes if necessary. We found that participants had a high reluctance to be locked into an investment vehicle—especially early in retirement when uncertainties are at their highest.

- **Safety.** Many participants were afraid of significant losses right before or in retirement. They sought investments that lowered investment risk or that could provide a steady and reliable source of income over time, and potentially for life. Many participants desired both. In addition, many of the participants that sought safety also wanted flexibility, creating challenges and opportunities for the development of innovative retirement income solutions.

- **Help from an Advisor.** Many participants expressed a desire to work with a financial professional they could trust to help them create a plan and decide on the appropriate course of action. This could take the form of a retirement coach or financial advisor.

- **Sponsor Evaluation.** Whether confused by the wide range of options or distrustful of aggressive financial salespersons or insurance agents, participants said that having their employer select and monitor independent retirement income providers made them more likely to accept professional retirement help.

- **Fee Transparency.** Many participants were especially skeptical of financial products with hidden fees or complicated fee structures. They simply would not act unless they fully understood the fees associated with a given product or service.

Conclusion

Through no fault of their own, members of the Baby Boom generation truly are accidental investors, and many are struggling with that responsibility. In the interest of creating a healthy and effective retirement system, it is important that we understand participant emotions about retirement and how these emotions create barriers to getting needed professional retirement help. If we ignore participant emotions and needs and solely focus on the money management, we risk significant participant inaction. Meeting the retirement income needs of this generation starts with developing solutions that address their emotions. In this way we can help accidental investors achieve the retirement security they seek and deserve.

Introduction

This white paper sets out to identify the unique perspectives, behaviors, and preferences of near-retirees and retirees as they approach and enter retirement. It seeks to answer the following questions:

1. What does it feel like to be entering retirement today?
2. How do these emotions influence behavior?
3. What preferences need to be met to modify behaviors?

Today's American retirement system relies in large part on 401(k) plans, which shift the responsibility and risk for investing from employers to individual employees. With this shift, plan participants are tasked with becoming their own investment managers, and their retirement security depends on their saving and investment decisions. With the Baby Boomers entering retirement in 2011, the retirement income of an entire generation of American workers will be heavily dependent on 401(k) plans—plans that did not even exist when many Baby Boomers started their careers. This is not the retirement their parents had, nor is it the retirement they expected when they started working nearly 40 years ago. It is clear that many participants need professional help with managing these new burdens.

Consider the sweeping changes members of the Baby Boom generation have experienced since they entered the workforce in the late 1960s and early 1970s. At that time, retirement was based primarily on defined benefit pension plans and Social Security. Personal retirement savings were not a meaningful part of the picture for most individuals. The 401(k) was originally introduced as a supplement to traditional defined benefit pension plans in the 1980s. By the 1990s, companies began replacing their traditional pension plans with 401(k) plans, transferring the investment risk associated with retirement assets to individual employees. In the late 1990s, years of stock market gains associated with the dot com boom generated significant wealth in 401(k) plans. However, the following decade exposed that the system was not without risk. The dot com bust, followed by 9/11 and the financial crisis of 2008 demonstrated that 401(k) plan balances could drop precipitously with market downturns. These experiences helped create strong emotional barriers that prevent many participants from seeking the professional retirement help they say they want.

As part of a market research effort for the development of a retirement income solution, Financial Engines spent over 300 hours in one-on-one interviews with near-retirees and retirees. After conducting the interviews, we developed an understanding of the range of emotions and needs exhibited by this group. However, without a rigorous analysis, our initial insights were more anecdotal than quantitative. To develop more formal insights, we used "thematic coding," a social science research technique used frequently to analyze qualitative data.

Our process for thematic coding had four key steps:

1. Defining a set of themes—in our case, investor emotions and preferences
2. Reviewing each interview and identifying occurrences of themes ("coding interviews")
3. Identifying the most prevalent emotions and preferences
4. Analyzing the relationships between emotions and needs

While we took several steps to reduce the subjectivity inherent in qualitative data analysis[1], the analysis is not completely objective or free of bias. Consequently, we caution you not to place too much emphasis on the specific percentages throughout this report. The strength of thematic coding is not in estimating precise population statistics. Rather, it is used to identify the prevalence of themes and the relationships between them. We used thematic coding to identify significant emotions and preferences and the relationships between the two. By identifying where emotions and needs intersected, we were able to move beyond the statistics to understand the complex and subtle nuances of the relationships.

Photos appearing in this white paper are not of actual participants. We used a standard agreement with each participant appearing in this white paper and participants were paid for their time. Participants are identified by first name and age only, and their quotes are in their own words. In some cases, their names have been changed to further protect privacy. Only aggregate account balance or other account information are used.

Let's start by meeting some of the near-retirees and retirees we talked with regarding their emotions around retirement.

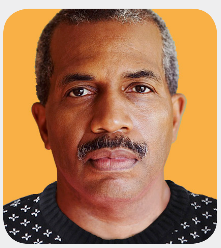
[1] First, each theme was clearly defined with explicit inclusion and exclusion criteria. Second, we contracted independent research assistants to code each interview. See About This Analysis for more detail.

Emotion: Uncertain

Definition: Lack of certainty of what tomorrow may bring. Fear or concern related to the participant's health and/or that of their spouse. The concern could be related to current or future unknown problems.

Prevalence:

More than half of the participants we spoke to made at least one comment that was coded as an expression of uncertainty.[2]



Meet **Mike**, a 62 year-old materials handler in the pharmaceutical industry. Although Mike has been in his position for many years, he was recently informed that his job would soon be outsourced. Given his age and the changes taking place in his industry, he is not confident about being able to land another similar job—and definitely not one at the pay he receives from his current position. About five years ago, Mike's wife passed away after a long illness, leaving him buried under a pile of medical bills. Now, Mike is worried about his own health insurance once his severance package and COBRA run out. He is not sure what his future holds and hasn't made a retirement plan because so much feels unsettled. "To be honest", he says, "I wouldn't even know where to start."

Mike is not alone. Many participants we interviewed said that they were overwhelmed by uncertainties. It is not difficult to understand why. Recent stock market volatility, housing market instability and the specter of future inflation can be intimidating to participants and require sophisticated planning. "I'm a little wary of how things are going—the last few weeks the market has been brutal," explained Joseph, age 63. "Market fluctuation is a big concern."

"I haven't started drawing down on the retirement accounts because I'm concerned that Social Security will not be around." *Maurice, age 62*

[2] 150 of the participants interviewed expressed the Uncertain emotion. 132 did not.

Worries over what could happen to their defined benefit pensions (if they are fortunate enough to still have one), the future of Social Security, and rapidly rising health care costs only make their situation feel worse.

Like many participants, Marta, age 60, is worried about health care costs. “I need a hip replacement and it will cost me about $3,000. That’s a major concern. You never know what’s going to happen with health care.” Keith, age 57, is in a similar situation: “Medical costs are one of the biggest unknowns for me. That is the reason why I want to work two years more.” Dennis, age 66, added, “I watched my mother go through her investments at a retirement home and it didn’t take long. I don’t want to be a burden on my children financially.”

> “I feel very uncertain about work. How long can I work and how long will my health hold up? I don’t know.” *David, age 59*

As if that was not enough, decisions that are difficult to make with all of the necessary information, feel nearly impossible to make in the face of uncertainty. David, age 59, said, “Everyone is so busy trying to keep their jobs that I don’t have time to worry about what investment vehicles I should be in.” Cindy, age 51, explained that “since I am more than 15 years away from retirement, I cannot imagine how to estimate the cost of living that far out into the future.”

Behaviors of Participants Expressing Uncertainty

We noted two common behaviors exhibited by participants that expressed uncertainty. They include paralysis and saving their 401(k)s strictly for emergencies.

Paralysis

Unfortunately, for many participants, a high degree of uncertainty often results in paralysis from fear of making a wrong decision. In their minds, it might be bad where they are, but other places might be worse. In particular, many participants expressed fear of getting locked into something and not having access to their money.

For example, Larry, age 62, said, “I’m facing many important decisions, and I’m overwhelmed. I’m thinking of all the stuff that can go wrong… you can get paralyzed.” Donald, age 59, sounded equally stuck: “In past years… you had to get out (of the market) or you lost a bunch. This is happening again now. Why would I want to go into something now? I would wait for the bottom. Do I know when the bottom is? No.”

Saving the 401(k) for Emergencies

Others decided to designate their 401(k)s as their last resort when it came to retirement spending. For example, Mike, age 62, said that he was "going to hang onto it as long as I can. I want to touch it only as a last resort… I don't know what the future holds, but I'm looking to have something to fall back on in case something significant occurs." Donna, age 61, echoes that sentiment: "I just want to make sure we have something to fall back on in case… the biggest thing is health care."

Emotion: Fear of Poverty

Definition: Fear of outliving their savings or experiencing poverty in retirement.

Prevalence:

Nearly half of the participants interviewed made a comment that was identified as being an expression of fear of poverty.[3]

Ellen is 60 and plans to work until she is 70. Her husband is a contractor and has been out of work for over a year due to the housing crisis. Ellen is terrified of outliving her money. You cannot exactly blame her, as she witnessed her father's (and some of her own) savings get wiped out due to his long-term nursing home bills. Today, neither she nor her husband have medical insurance, and Ellen is placing her hopes on not living past 85, at which point she worries that "I might be forced to become a bag lady."

Many participants we interviewed shared Ellen's fears. Given the individual responsibility of retirement, one of the most common emotions around retirement is the fear of poverty. In addition, many participants want answers to the following questions:

- How much money can I generate from my savings?
- Will my savings last?
- What is my quality of life going to be in retirement?

"If I knew how long I'd live, it would be easy to figure out how much I would need to have." *Mabel, age 58*

Longevity risk played a central role with many participants. Since no one knows how long they will live, it is even more challenging to know how much they can safely spend

[3] 132 of the participants interviewed expressed the Fear of Poverty emotion. 150 did not.

without running out of money in old age. Mabel, age 58, expressed frustration: "If I knew how long I'd live, it would be easy to figure out how much I would need to have."

Participants with lower balances were more likely to express a fear of poverty than those with higher balances. However, 30% of participants with relatively higher asset balances expressed a fear of poverty.

Percent of Participants Expressing Fear of Poverty by Total Savings

Total Savings*	All Participants**	Participants with Fear of Poverty	% of Participants
$0-$100K	52	30	58%
$100-$250K	48	26	54%
$250-$500K	50	18	36%
$500K+	44	16	36%

*Total savings includes 401(k) and other assets.
**Total savings data available for only 194 participants.

Joe, age 65, said, "I'm worried about outliving my money—my wife is, too. She gets a little nervous about that. Part of that is the uncertainty with not knowing how to manage the money. I pull out a spreadsheet to create assumptions and see how long we can go."

The fear of poverty in retirement has caused some participants great anxiety and loss of sleep. "I am worried about outliving my money," said Carol, age 61. "I wake up and worry about that—it's a big worry." Similarly, Melvin, age 66, said that he is "having 'night sweats' now. I'm really concerned about having enough. You never know how long you'll live and how much you'll need."

"I don't want to rely on my kids. I don't want to be in that position."

Carol, age 60

Others are focused on what will happen to them if they do run out of money in retirement, using worst-case scenarios to illustrate their fears. Irving, age 70, explained, "I'm trying to make sure that I make the right decisions so that I don't end up down the corner with a tin cup in my hand."

Another common fear was being a burden to one's children. "You want to make sure your money lasts," said Bev, age 63. "You don't want to rely on your children."

Behaviors of Participants Expressing a Fear of Poverty

In the face of such a powerful and real fear, near-retirees and retirees tended to avoid thinking about retirement altogether or employ "magical thinking." Magical thinking typically entailed participants maintaining an ungrounded optimism that "things would just work themselves out" or that they would be able to work forever without having to change their lifestyle.

Avoidance

Fear of knowing how bad things really are is a powerful force for participants, with denial and avoidance as common responses. "You stick your head in the sand because you don't want to know how bad things are," said Evelyn, age 65. Jacqueline, age 55, admitted, "I'm late to the game saving for retirement. It's scary. It's depressing. I avoid looking at retirement as a result." Mary, age not disclosed, agreed: "I know a lot of work needs to be done to plan this correctly," she said. "One reason I've put this off is that I know it's not going to be in my favor." Or take Lynda, age 61, who said, "I'm scared to death. I would really have to go to a lower state of living. It's one of those, 'I'll think about it tomorrow' things."

Magical Thinking

Many participants trusted in their own health and the idea that they would be able to work as long as they wanted, despite research from the Employee Benefits Research Institute (EBRI) that showed nearly half (45%) of participants end up in retirement sooner than they anticipated.[4] For example, Rudy, age 62, explained, "Retirement is probably not an option. You just work until you drop." Ingrid, age 62, felt similarly: "I'm not concerned about (retirement) too much right now as long as I'm healthy and have a job."

Some placed their retirement hopes in their ability to start their own businesses in retirement. The details of those businesses were often unclear. "I keep thinking in terms of starting my own business, but I can't come up with a clever enough plan that I think will be easy enough to manage in retirement and still bring in an income," said Nancy, age 55. Rudy, age 62, was optimistic something would work out: "I'm doing serial entrepreneurship. I keep trying things until something hits."

Similarly, many of the participants we interviewed believed that things would just work out on their own "I know things are going to work out," explained Liz, age 65. "When it's all said and done, it will be ok." Carol, age 63, put it this way: "I'm just basically baffled," she said. "I'm one of those believers that it will all work out somehow."

[4] EBRI 2011 Retirement Confidence Survey

Emotion: Not Confident or Knowledgeable

Definition: Admission (or expressed perception) of not understanding finance, financial planning, investing, or retirement. Expressions of not being confident about making financial decisions. Expressions of being overwhelmed by the scope of the decisions or the technical nature of the subject, making it difficult to act.

Prevalence:

More than one third of participants made statements that were identified as feeling not confident or knowledgeable.[5]

Next, meet **Willa**, a 60-year-old retiree, who, prior to retirement, had been a computer programmer with her employer for a rewarding 35-year career. While Willa was a skilled software engineer, she is confused about how to make the best use of her and her husband's retirement assets, including their 401(k)s and Social Security. She is unsure about how much money they can withdraw safely from their accounts and expressed difficulty in creating an appropriate household budget. While Willa is open to hiring professional help, the aggressiveness of so many advisors she has talked with in the past has turned her off and made her feel not confident and even, as she put it, "small."

Retirement today is far more complicated and uncertain for the Baby Boomers than it was for their parents. Many participants we talked with reported feeling not confident or knowledgeable in their ability to make the right decisions, especially given current global economic uncertainty.

"I have a general feeling that I just don't know enough to make decisions. I don't know how it all works. How do I draw down my money?" *Evelyn, age 65*

[5] 108 of the participants interviewed expressed the Not Confident or Knowledgeable emotion. 174 did not.

Some expressed deep concerns over not knowing how to generate retirement income. Tommy, age 63, put it bluntly and admitted to having his confidence bruised by the uncertain stock market: "In this market, I need help. I don't know what I'm doing anymore. I'm not comfortable."

Adding to the pressure is the fact that the personal stakes are so high. Participants are aware that if they make the wrong investment decision, the consequences could be catastrophic and irreversible. "Trying to shift stuff around at our age is scary," said Chris, age 60. "If you make a mistake, we're in a cardboard box eating dog food. I don't have 20 years anymore."

Many participants expressed confusion and concern over how all of their retirement pieces, including their pension, 401(k), Social Security, and Medicare fit together. "I am eligible for Social Security, but I don't have any plans for that. I'm sort of like clueless," said Connie, age 65. Mike, age 64, also admitted to being in the dark: "I'm not sure how my retirement pieces fit together—Social Security, pension, 401(k), etcetera… I'm puzzled."

"In this market, I need help. I don't know what I'm doing anymore. I'm not comfortable." *Tommy, age 63*

Some participants lacked confidence due to poor investing decisions they made in the past. "I've made mistakes," said Jeri, age 65. "A couple of companies that were sound when I bought them went astray and I'm not smart enough to stay on top of that kind of thing." Others, like Pat, age 60, reported being misled by a financial advisor. "We kind of had a bad experience once with a guy—we lost a lot of money," she explained.

Behaviors of Participants Expressing Lack of Confidence or Knowledge

Near-retirees and retirees who did not feel confident or knowledgeable in their ability to manage their retirement investments tended to exhibit paralysis and avoidance, and often mistakenly put trust in friends and family when it came to getting investment advice.

Paralysis and Avoidance

As we saw with participants who felt uncertain, participants who did not feel confident or knowledgeable in their financial abilities often reacted with paralysis or avoidance. Many said that they did not know where to begin. As a result, they avoided doing anything related to retirement planning. "Rebalancing sounds like a good concept, but I'm not sure what that really means," admitted Edward, age 62. "I don't know how to balance the money," said Pat, age 60. "My husband and I are bad at this… we are ignorant."

In addition, many did not have a plan for retirement. "I really don't have a financial plan," said Mike, age 64. I know I need one, but I don't know how to go about getting one. I don't know how to find an advisor."

Misplaced Trust

Participants that felt uneducated or not confident were searching for someone more knowledgeable they could trust. Unfortunately, many of the people they turned to may not have the expertise they sought. Lynda, age 61, said: "I have a friend that is pretty smart. She's not a professional, but she reads Money magazine." George, age 61, also relied on a friend: "I would talk to a friend of mine—he retired at 50 and is really good at this."

Some people, desperate for help, even turned to strangers. "To tell you the truth, I haven't been a financial wizard," admitted Marilyn, age 63, who worked as a nurse in a hospital. "A patient re-arranged my portfolio for a class she was taking. This woman at the hospital seemed really knowledgeable."

Emotion: Distrustful

Definition: Expressions of skepticism around the motivations and/or qualifications of the person, product or service. Often expressed as distrust surrounding how someone is making money/charging for services.

Prevalence:

Forty-six percent of the people we interviewed made statements that were identified as being expressions of distrust.[6]

Peter is 62 and recently lost his wife. About 10 years ago, an investment broker guided him into some limited partnerships that he did not fully understand. As a result, he ended up losing a large portion of his savings—losses that were compounded when the market crashed in 2008. Now he is gun shy about taking advice from anyone, and because he has no family left to rely on, he is completely dependent on his own investments for income. "The stock market is scary," he explained. "I had some really bad times last year and I'm not taking any big risks."

Across the participants we interviewed, we encountered a high degree of wariness of unscrupulous financial services and insurance professionals. Fox example, many said that they did not trust financial institutions to look out for their best interests, mentioning both large institutions as well as investment advisors during the interviews.

In general, participants were also highly sensitive to fees—especially hidden fees. Candace, age 63, said, "If I trusted an advisor, then I'm always wary because I know that they are out to make money… I don't trust them handling my money." Pat, age 60, had a similar view: "Financial advisors are in it for them to make money off of you. Why are they in business? To make money with your money."

"I'm always skeptical about the fees. The initial conversation is free, but there's always a fee for the service." *Dale, age 61*

[6] 130 of the participants interviewed expressed the distrustful emotion. 152 did not.

Some participants reported being burned in the past. One near-retiree, age 58, explained, "Some advisors are so aggressive. I can't trust them. It is just not for me. I am too uncomfortable with others working my money. I had my account churned with resulting bad losses and swore 'never again!'"

In addition, the recent high-profile fraud cases have not helped the reputation of the financial services industry. "Every other week there was some scam going on, besides Madoff—they just came out of the woodwork," said Charlotte, age 63. "You go into the thing [the investment] and they take away all your money."

> "My overall impression with investment advisors is that their ultimate goal is their own wealth, not mine."
> *Eddie, age 50*

Some participants were skeptical about the amount of attention they would receive from an advisor or financial services firm. For example, Roberta, age not disclosed, said, "I interviewed with (a financial services firm) to find out what's right for me, but I felt like I was only going to be a number there." Others were skeptical of the qualifications of advisors. "I'm probably at a point now to have my money last reasonably comfortably for the rest of my life, but I'm not convinced the calculations are right," said Keith, age 57. "Do I believe their assumptions? Based on what they asked and what they didn't ask, I'm a little skeptical. Their assumptions will have a significant impact on how I will live the rest of my life."

Finally, other participants reported feelings of being "hunted" by financial services and insurance professionals. Take Sam, age 64, for example: "I haven't met the one that I can trust. They want to know my balance only, and they want to sell me their products, but they are not asking questions to get to know me." Many were skeptical right off the bat. "All the companies that I've listened to have a fear tactic and it works on a lot of people," said Diane, age 65. Eddie, age 50, said, "I guess that I'm just a bit skeptical. If I am making the decisions about my investments then I can only hold myself responsible. If there is a decision between which investment will work best for my account and one that will bring the advisor a greater commission, then the one they will choose is that which will most benefit them."

Behaviors of Participants Expressing Distrust

As we noted with other emotions, participants that were distrustful tended to exhibit paralysis out of fear of trusting anyone with their money. Others turned to someone they knew for advice.

Paralysis

Participants that were skeptical of financial services and insurance industries behaved similarly to those that are uncertain or not confident or knowledgeable. While they may be constantly on guard, they often ended up doing nothing. In this case, their deep skepticism resulted in an inability to choose anyone qualified to help them with their retirement, even if they needed serious help.

Misplaced Trust

As we saw with participants who were not confident or knowledgeable, participants distrustful of financial services or insurance firms often reached out to people they knew—qualified or not—for financial advice. Some participants even turned to strangers. Tommy, age 63, met his retirement advisor on the bus. “I met this guy on a MUNI bus. Most of the time, I go with my gut, but some of the time the stuff he says creeps in.”

Those that have tried to find advisors reported having a difficult time finding someone that they could trust. Sam, age 64, for example, said, “I’ve met at least five (advisors) since I retired, but I haven’t met the one I can trust.” Tallulah, age 61, wasn’t sure where to turn for help: “I’ve been approached by a couple different firms that would like to handle the rollover. I’m sure I’m not the only one facing this dilemma. Where do you place it? Who do you trust? What are the options out there? I don’t know.”

Reaching the Accidental Investor

Given these participant emotions and corresponding behaviors, what is the best way to reach accidental investors and get them retirement help? The five most common needs expressed by people overwhelmed by uncertainty, with a fear of poverty, who felt uneducated, or distrustful of unscrupulous financial services and insurance firms were:

- Flexibility;
- Safety;
- Help from an Advisor;
- Sponsor Evaluation; and
- Fee Transparency.

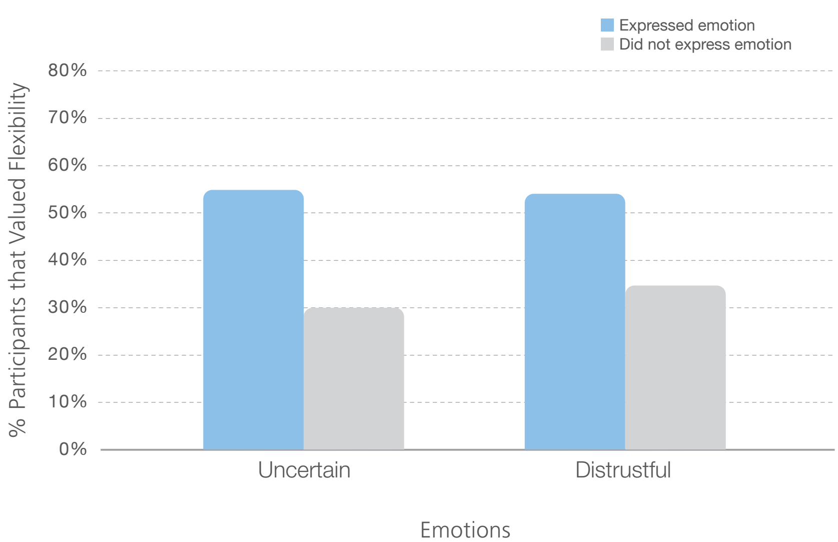
Reaching the Accidental Investor: Flexibility

Definition: The desire to be able to change strategies. The ability to cancel and regain control of the account. The desire to have access to one's money. The ability to have a trial period to evaluate a service.

Participants that expressed uncertainty or distrust of unscrupulous financial services firms were more likely to want flexibility. For participants near or in retirement, that meant avoiding being locked in to any investments or financial products especially early in retirement. Participants wanted the ability to change their minds in the future, or to react to changing life circumstances, such as a change in health status.

Participants that made statements identified as expressions of uncertainty were 85% more likely to express a need for flexibility, relative to those that did not express the emotion. Fifty-five percent of participants overwhelmed by uncertainties said that flexibility was important to them. This compares to 30% among the rest of participants not expressing this particular fear. That is not terribly surprising, considering that when the future is unclear, the best way to cope is to preserve the ability to adapt in the face of change. Similarly, participants that made statements identified as expressions of distrust were over 50% more likely to value flexibility relative to those not expressing the emotion. Fifty-three percent of those that expressed distrust also expressed a desire for flexibility, versus 34% of participants that did not express the emotion. For these wary participants, in particular, having flexibility and control provided a sense of comfort.

Need for Flexibility Highest for Uncertain and Distrustful Participants

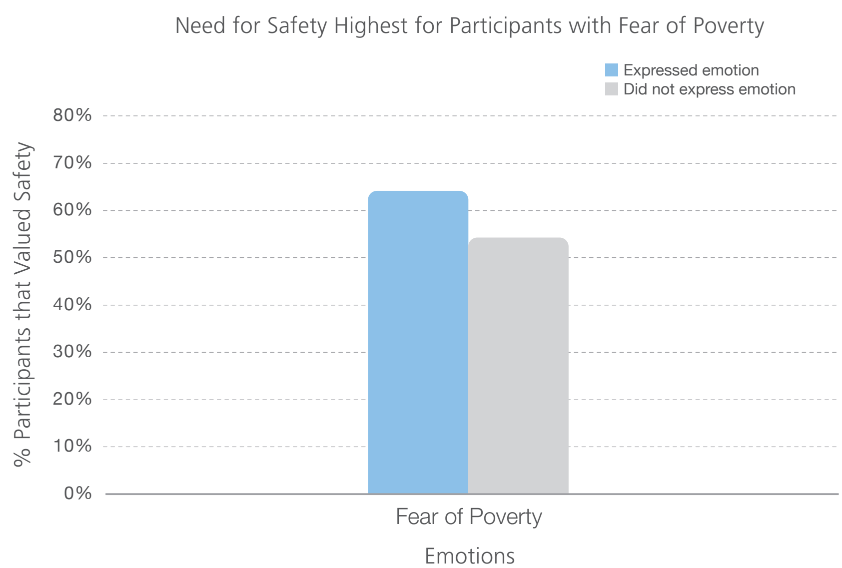


“I like having choices—I don’t want to be caged,” said Darlene, age 61. Fear of health problems (and the resulting costs) loomed large for many participants. Janet, age 63, explained, “What if there’s a catastrophic illness? It would be important for me to step away from something… and take back control if necessary.” Some participants have already experienced the drawbacks of a lack of flexibility first hand. “I purchased an annuity six months ago and put (my) whole $800,000 inheritance into it,” explained Raven, age 64. “I’m supposed to receive annuity payments for the rest of my life, but now I’m tied up and don’t have enough cash.”

Reaching the Accidental Investor: Safety

Definition: A desire to limit potential losses. A desire to protect what they've saved and minimize risk to their investments. A desire for income they can count on.

While safety was a priority for a majority of the participants we interviewed, those with a fear of poverty were 18% more likely to express a need for safety, relative to those that did not express this fear. Specifically, 63% of participants that expressed fear of poverty in retirement said that safety was important to them, compared to 53% of those not afraid of poverty in retirement. Faced with the fear of poverty, it is not surprising that people expressed a desire to limit potential investment losses, especially right before retirement.



To some participants, "safety" meant investing only in conservative investment with limited risk. "I'm sure I can't afford too much risk," said Pamela, age 59. Recent economic conditions have caused some participants to revaluate their risk-tolerance. "I'm more conservative now," said Cornell, age 65. "If I were to take the (risk) questionnaire now, my answer would be substantially different than what I would have said two years ago." Steve, age 61, agreed: "The way the economy has gone, I've got to be more careful with investments, get more conservative. Preserving capital is important."

To others, "safety" meant the ability to generate steady payouts without running out. "I'm looking for something that stabilizes and says that you can depend on this," said Cornell, age 65. "I don't want to draw down the principal." Likewise, Pamela, age 59, said, "I don't want my income in retirement to go up and down too much."

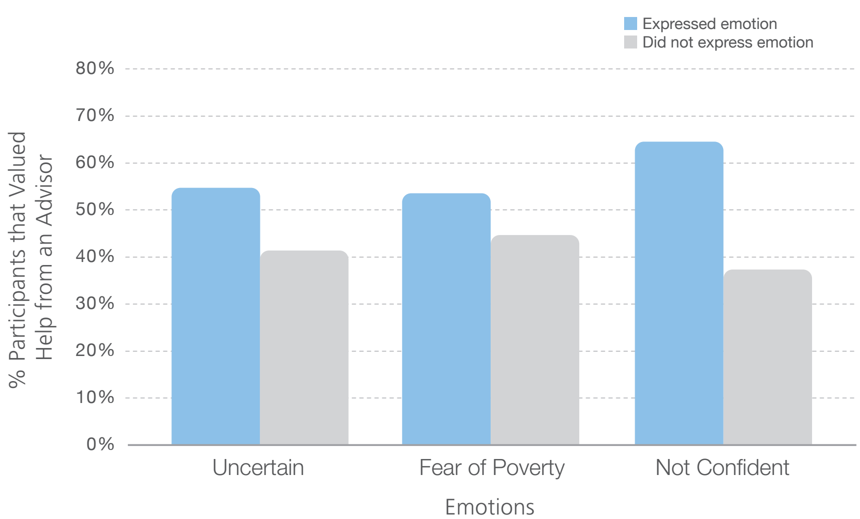
Reaching the Accidental Investor: Help from an Advisor

Definition: Access to a person (advisor) that can help. Could be expressed as a desire to talk to or communicate (via chat, phone, in-person, etc.) to help answer questions and to help guide decision making.

Participants concerned about uncertainty, fearful of poverty, and those feeling not confident or knowledgeable all indicated stronger needs to have an advisor to help guide decision making. Having someone help guide participants through whatever uncertainty they encounter can soften the blow of difficult news, reassure them, and validate the appropriateness of a decision.

Participants that expressed uncertainty were 32% more likely to value a relationship with a professional advisor compared to those that did not express the emotion (54% vs. 41%). Participants that expressed a fear of poverty were 19% more likely to value help from an advisor (52% vs. 44%). We found the strongest relationship with people that expressed not feeling confident or knowledgeable. This group was 68% more likely to also value help from an advisor compared to those that did not express feeling not confident or knowledgeable (64% vs. 38%).

Need for Help From an Advisor Highest for Participants that are Uncertain, Fear of Poverty, and Not Confident



In analyzing how participants expressed a need for an advisor, we saw that many wanted an advisor to help them identify the right solution or strategy. Some participants just wanted someone to tell them what to do. "If I feel like they are professionals, then I'm going for it," said Sue, age 61. "I just need some professional guidance… I feel very lost out there." Larry, age 62, expressed a similar desire: "I don't know what I'm doing and I'd love to have someone do it for me. I know it has to be done, I just haven't done it." Given many people's lack of confidence with financial planning and the importance of the decisions involved, it is not surprising that many won't act until they can talk to someone knowledgeable. For example, Percy, age 62, said, "If I can't talk to anyone, I won't do anything."

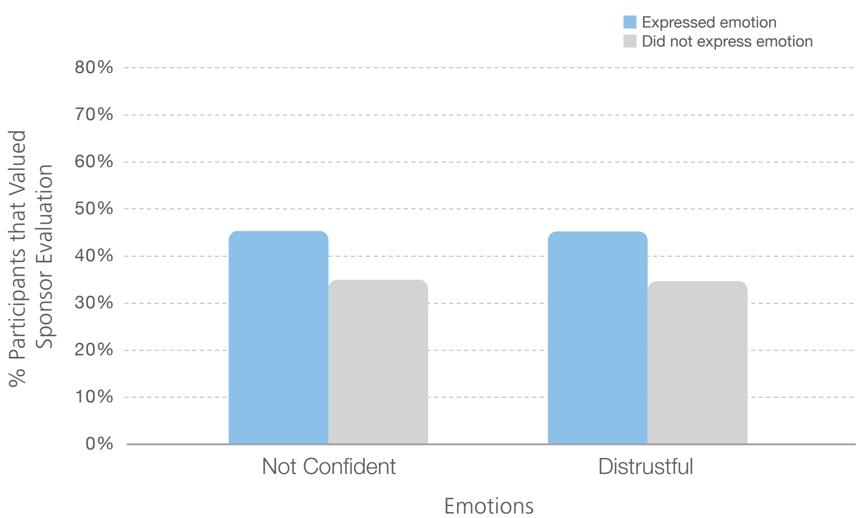
Reaching the Accidental Investor: Plan Sponsor Evaluation

Definition: The employer offers the solution, which adds credibility for the participant.

Plan sponsors are in a unique position to provide access to professional retirement help. In a world where it is difficult to know whom to trust, participants said that their employer's decision to select a retirement help provider was meaningful and could help them find providers they could trust.

Participants that did not feel confident or knowledgeable in their financial abilities are more likely to say that trustworthiness was important, with 45% of them indicating that their employer selecting a provider was important to them, compared to 34% of those confident in their own abilities. Similarly, participants that expressed distrust of financial services firms were more likely (44% vs. 34%) to say that an employer evaluating professional help was important to them compared to those who were not as distrustful.

Need for Sponsor Evaluation Highest for Not Confident and Distrustful Participants



Knowing that their employer had vetted a service could help participants get more comfortable trusting an advisor. "It is another level of review that I would assume had been done…," explained Tallulah, age 61. "I know our benefits person and some other people in benefits, and I don't think they would foist something off on participants."

Carol, age not disclosed, had a similar take on the situation: "I wish (my employer had) introduced (me to) an advisor to help me in retirement… I would probably take advantage of it. What role do they (the employer) play? They're doing the due diligence to make sure that the people are qualified.” For many participants, it all came down to trust: “I acknowledge that my understanding of investments is very limited and that they are the experts,” said Eddie age 50. “If they had some way for me to overcome the issue of trust, I might be more inclined.”

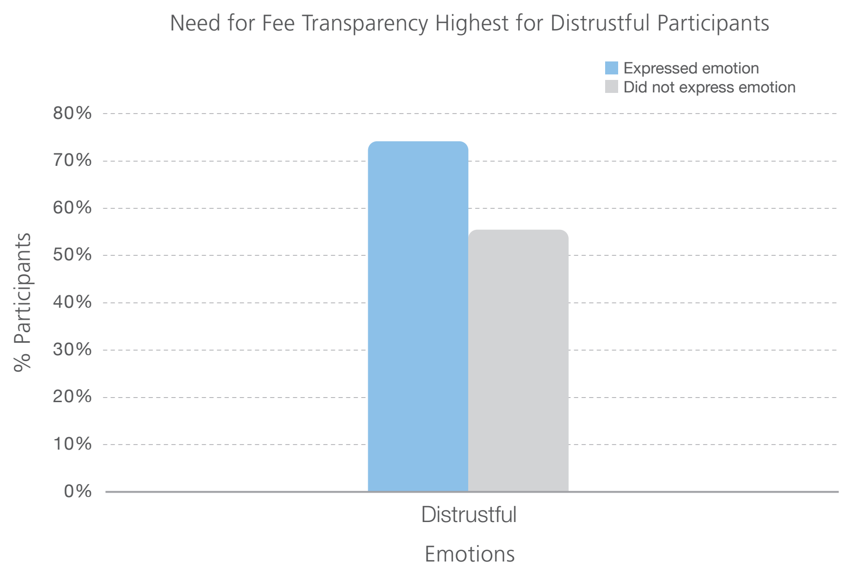
Participants seemed to recognize that sponsor evaluation was not necessarily a full-fledged endorsement, but they were looking for assurance that they would not be taken advantage of. For example, Michael age 61, said, “It (sponsor evaluation) doesn’t suggest that it is the best thing, but at least you can be sure it won’t be a bad thing.”

Reaching the Accidental Investor: Fee Transparency

Definition: Comments and questions regarding the price and how fees are earned. Comments regarding the perceived value relative to cost.

Finally, given the justified wariness of hidden fees, participants that expressed distrust were more likely to say pricing of retirement help products needed to be transparent, easy for them to understand, and reasonable.

Participants that expressed distrust were over 30% more likely to ask questions or make comments related to fees than those not expressing the emotion (74% vs. 54%).



“I like seeing the fees up front,” said Ed, age 60. Jayne, age 61, had a realistic perspective, but still insisted on clarity: “Everybody gets paid,” she said. “If you earn the money, I don’t have a problem with that. I need to know what I’m going to get for that money.”

Conclusion

To create a healthy and effective retirement system, it is important that we understand participant emotions and the barriers to seeking professional retirement help that these emotions create.

This white paper illustrates that if we ignore participant emotions and preferences and solely focus on portfolio management, we risk significant participant inaction. Meeting the retirement income needs of this generation starts with developing solutions that address their emotions. Solutions that will help the most people will incorporate the needs identified in this paper: flexibility, safety, help from an advisor, fee transparency, and plan sponsors to make it easy by selecting and offering solutions for their participants.

We believe that these participant interviews show that employers, policy makers, and financial services organizations all have roles in helping near-retirees and retirees.

The following are the implications organized by audience:

Plan Sponsors

Plan sponsors are in a unique position to provide access to professional retirement help. Participants said that an employer's selection of professional retirement help was meaningful and could help them find providers they could trust.

Participants are not looking to their employers to guarantee that a particular service is the best solution available. They simply want to know that a service has been evaluated and is not fraudulent.

Plan sponsors may want to consider evaluating product solutions against desired participant preferences. Products alone may not be enough; many participants want to have someone they can talk to before they can make a decision. If a product does not adequately address each of the emotions mentioned above, the emotions are likely to act as barriers preventing participants from availing themselves of the option.

Public Policy Makers

Public policy makers are increasingly focused on the legal and regulatory issues in providing lifetime income options for participants in retirement plans. For the accumulation phase, the automatic 401(k) is proving to be very effective in creating participant success by default. Since the decisions required by participants for successfully drawing down income during retirement are far more complex, extending the automatic 401(k) in the retirement phase will be critical. Determining which lifetime income solutions qualify as approved defaults will be an important policy decision.

However, any requirement to force participants into annuity options at retirement is not likely to help. This paper helps us understand why: given the profound uncertainties participants face at retirement, they often demand more flexibility than traditional annuity options provide. The inflexibility of traditional annuity options are significant impediments to participants' willingness to accept any solution that results in a loss of control.[7]

Financial Services Firms and Insurance Companies

To get near-retirees the professional retirement help they need, financial services and insurance companies will want to design retirement income products, services, and features that integrate participant preferences. The absence of key preferences may result in lower utilization. To gain the trust of these participants, it is critical to communicate all associated fees clearly and transparently.

Moreover, financial services firms that create or distribute products should explore ways they can provide unbiased professionals to help participants select the right solutions and strategies that meet their needs. No matter how compelling the features of a product or solution may be, many participants won't act unless they can talk with a professional they can trust.

Next Steps

This white paper is just the start of identifying better ways to help Baby Boomers with their retirement concerns. Historically, employers and the financial services industry have focused on helping participants meet the challenges of accumulation. Now that the Baby Boomers are entering retirement in large numbers, however, the focus has begun to widen to include helping participants with the challenge of how to convert their savings into income in retirement. Participants have shown us that without acknowledging and addressing their emotions around retirement, we risk ineffective participant engagement and widespread participant inaction. Successfully addressing their needs can help accidental investors achieve the retirement security they seek and deserve.

[7] See also: Garry Mottola; Stephen P. Utkus "Lump Sum or Annuity? An analysis of choice in DB Pension payouts," November 2007.

About This Analysis

Between March 2008 and February 2011, Financial Engines interviewed over 300 near-retirees and retirees. This analysis relies on all of the available feedback collected during this period.[8] Specifically, the data set includes notes from hour-long interviews (262), focus groups (23), and written responses to open-ended questions from an online survey (29). Financial Engines conducted these interviews, focus groups, and surveys in the development process for Income+, Financial Engines' retirement income solution. The data were collected between March 2008 and February 2011. While some participants responded to an e-mail message from their employers (a Financial Engines client), most were selected by a market research firm from companies that may not have offered Financial Engines retirement help services.

The one-on-one interviews consisted of both semi-structured and open-ended questions, in which participants were asked about their current situations, their retirement concerns and how they would respond to various financial services offers. While the interview format was consistent across the sample, the questions and offers we showed participants varied over time. All sessions had a dedicated note taker and some interviews were audio and/or video recorded.

Once the interviews were completed, we used a technique called thematic coding to provide a more formal framework for analyzing the interview transcripts. Thematic coding is used in social science research involving qualitative data and is ideally suited for identifying common themes in interview transcripts and exploring the relationships between themes. The thematic coding process we followed involved the following steps:

1. **Identifying themes:** We identified a set of approximately 25 themes that described emotions (e.g., "fear of poverty," "uncertain", etc.) preferences (e.g., "flexibility", "safety", etc.) and behaviors (e.g., "action", "inaction", etc.).

2. **Defining themes:** We created a dictionary for the themes, with each theme receiving a definition and examples.

3. **Coding themes:** Two research associates read each interview and "coded" instances of text that met the definition of a particular theme using software designed for thematic coding (MAX QDA).

4. **Refining definitions to reduce subjectivity:** To further reduce subjectivity, we began the coding process with a two-week training session aimed at reducing ambiguity

[8] Since the focus group notes were all combined into one document, the quotes were analyzed to understand the qualitative nature of the relationships between themes, but were excluded in calculations for all prevalence calculations. We excluded interviews that did not have complete interview notes.

in the theme definitions. Initially, the research associates coded the same transcripts independently. At the end of each day, we reviewed the coded transcripts and any segments that were coded with conflicting themes were identified. The definition of the themes was then refined, as necessary, to reduce ambiguity.

5. **Analysis:** Once we finished coding the transcripts, we aggregated the results across interviews to identify both the prevalence of themes and identify the themes that co-occurred most frequently (i.e., are people who express a particular emotion more likely to also express a preference for a particular need, such as flexibility).

Once common co-occurrences were identified, we analyzed the text segments where themes intersected to better understand the nuances surrounding the relationships between the themes.

Sample Demographics

The demographics of the interviewed sample are as follows:

Age & Assets	Age	401(k) Balance	Pension Income[9]	Social Security Income	Total Income[10]
Minimum	52	$300	$541	$3,936	$6,600
Average	62	$207,752	$26,176	$23,706	$48,107
Median	62	$130,000	$20,400	$21,600	$44,400
Maximum	79	$1,200,000	$150,000	$60,000	$150,000
Number	264	197	101	133	101

Retirement Status	Number	% of Population
Retiree	82	29%
Near-retiree	148	52%
Did Not Disclose	52	18%
Number	282	100%

Gender	Number	% of Population
Male	148	52%
Female	130	46%
Did Not Disclose	4	1%
Number	282	100%

[9] If a participant had a pension, but they did not provide a pension income amount, their information is not included here.
[10] When the information was available for all of a participant's retirement income sources, a household total income was calculated. Total Income equals Social Security + Pension Income + Other lifetime income streams (such as real estate, annuities, etc.). Spousal retirement income information was included when provided.

Has Pension	Number	% of Population
Yes	142	50%
No	57	20%
Did Not Disclose	83	29%
Number	282	100%

Has Advisor	Number	% of Population
Yes	87	31%
No	161	57%
Did Not Disclose	34	12%
Number	282	100%

About the Researchers

The participant interviews conducted from 2008-2011, as well as the research and analysis for this paper, were led by: Dave Boudreau, Principal Designer for Retiree Services; Shinichiro Inoue, Director of Retiree Services at Financial Engines; and David Ramirez, Portfolio Manager. They were assisted by independent research associates, Eva Glasrud and Elizabeth Weston. Boudreau, Inoue, and Ramirez were also lead designers of Financial Engines' retirement income solution, Income+.

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