

Individual Differences in Pension Knowledge

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January, 2011

This research was financially supported by CentiQ/Wijzer in geldzaken, TNS NIPO, and Stichting PensioenkiJker.nl

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1. Introduction

Having a realistic idea of the pension income during retirement is very relevant for people to plan their own life and to know their financial possibilities after retirement. Knowledge of the pension income at the age of 65 is however generally low among the Dutch population. Van Els, Van den End and Van Rooij (2003) conclude that pension knowledge is low among the Dutch population. Many people are not concerned about their pension and have an attitude of “we’ll see about that when we come to that.” The poor knowledge may not only be caused by a lack of interest, but also by imperfections in the information disclosure on pension contracts and acquired pension rights. Pension knowledge is also low in other countries. Many people are aware of the unsustainability of the present PAYG (pay-as-you-go) pension systems in countries such as Germany and Italy (Boeri, Boersch-Supan and Tabellini (2002).

Mitchell (1988, p. 21) concludes about pension knowledge in the U.S.A. that “missing and incorrect information is widespread. Unionized employees, higher income workers, better educated workers, and those with seniority are better informed about their pensions. There are also demographic differences: minorities have less pension knowledge than whites, but women are better informed than men along several pension dimensions. Myopia [short-sightedness] about pension incentive structures is troubling since workers may save or consume sub-optimally, change jobs, or retire earlier than they would have if equipped with better pension information.”

Mayhew (2003, pp. 2-3) concludes about pension knowledge in the U.K. that “Few people of working age thought that they had a good knowledge about pension issues (13%), or about what their income in retirement was likely to be (9%). This knowledge varied across respondents. People who had private pensions, and who had higher incomes, tended to be more knowledgeable about pension issues in general, and what their income in retirement was likely to be.” Especially for people who want to retire earlier, it is crucial to have good knowledge about their pension income 15 to 20 years before actual retirement.

Van Rooij, Lusardi & Alessie (2009) conclude from a survey among Dutch households that there is a strong and positive association between financial knowledge (literacy) and retirement planning. Using information on economics education when young, they showed that the causality runs from financial literacy to retirement planning rather than the other way round. This study points to the benefits of financial education for retirement planning and pension knowledge.

The Platform CentiQ/Wijzer in geldzaken and Stichting PensioenKijker.nl have a policy program to increase the pension awareness and knowledge of consumers/citizens. Also pension funds and pension insurers have taken initiatives to increase the pension knowledge of their clients and the general public. In order to test the effects of these initiatives, it is important to use a uniform definition of the concept of ‘pension knowledge’ and a uniform method to assess the pension knowledge of individuals. The Platform CentiQ, PensioenKijker.nl, TNS NIPO, and Tilburg University developed a measurement instrument to assess the pension knowledge of the people and to monitor the changes of pension knowledge over time. This paper gives a description of the measurement instrument and the individual differences in pension knowledge.

To develop this instrument a large-scale survey has been performed. In this survey, the pension awareness and knowledge of Dutch individuals has been assessed and also the influence of factors such as the personal (financial) situation, knowledge, motivation and expectations about the future, on pension knowledge.

The survey has been done with two representative samples of a total of $n = 2203$ wage earners saving for a (company) pension (second-pillar pension plans). The questionnaires of the survey have been filled out online by respondents of the TNS NIPO data base. The survey took place in the periods May, 11-18, and November, 18-29, 2009.

2. What is pension knowledge?

Based on desk research, a qualitative pilot study and consultation of experts on pensions the following definition of pension knowledge can be stated:

Pension knowledge is the degree to which people know their pension income at the retirement age, at death (for their partner) and at disability to work; know the (in)sufficiency of this income for their own situation; and know (if needed) of the possibilities to increase their pension income and make a trade-off between saving for their pension or spending now.

This definition contains three elements (building blocks). Based on this definition and on the results of the survey, an instrument to assess pension knowledge has been developed.

Building block 1: Knowledge of the pension income

Knowledge of the pension income has been determined based on three criteria.

a. Estimation of the expected pension income:

The estimated pension income as a proportion of the last income before retirement. In co-operation with Stichting Pensioenkijs.nl it has been assessed whether the self-estimates are realistic and correct, based on income, type of job contract, age, and additional pension savings.

b. Degree of certainty about this estimate:

It is important that the respondent is certain about his/her self-estimate of the expected pension income and that the respondent does not say to have 'no idea.'

c. Information sources:

To know one's pension income, the respondent should have read the UPO (Uniform Pension Overview) and/or should have informed him/herself at the personnel department of his/her employer, pension fund, pension insurer, or financial intermediary/adviser.

Building block 2: Sufficiency of the pension income

A respondent is considered to know the sufficiency of the pension income, if the respondent is able to estimate whether the income will be sufficient to have the desired lifestyle at retirement. If a respondent cannot estimate this, this respondent will be considered not to know the sufficiency.

a. Which income level is sufficient?

Respondents have to make an estimate of the proportion of the net income just before retirement that they think is necessary after retirement to have the expenditures and lifestyle as desired. This

proportion should be at least 40%, otherwise it is not a realistic estimation of the income. Persons that 'don't know' are not considered not to know the sufficiency of their pension income.

b. Second estimate:

A second estimate of this proportion, asked after the respondent has been confronted with a number of relevant issues, should not deviate more than 5% of the first estimate. These relevant issues are the number of years that pension premium has been paid, the state pension, the tax rates after retirement, the mortgage costs after retirement, lifestyle, family size, inflation, savings and debt. The idea behind this that individuals can make a 'better,' more realistic estimate if they consider these relevant factors. If the two estimates deviate more than 5% the respondents has obviously not been able to give a correct estimate.

Building block 3: Possibilities to increase the pension income

If the respondent indicates that he/she knows how to increase the pension income and accepts the responsibility for this, he/she is considered to be aware of this part of pension knowledge.

3. Pension knowledge in The Netherlands

3.1 Four groups

To what extent are employees (wage earners) in The Netherlands aware of these three building blocks? In other words, how extensive is the knowledge of their pension income? Four groups can be distinguished. See Figure 1.

- Insert Figure 1 about here -

The first group consists of the majority (66%; n=1405) of respondents. They cannot give a realistic and correct estimate of their pension income. We call this group the 'no pension knowledge' group.

The members of the second group (7%; n=161) have a partial knowledge of their pension income. They know the first building block. These are employees that know their pension income but do not know whether this income is sufficient or not for their desired expenditures and lifestyle.

The members of the third group (15%; n=360) have a partial knowledge of their pension income. They know the first two building blocks. These are employees that know their pension income, know whether this income is sufficient or not, but do not know the possibilities to increase their pension income.

The members of the fourth group (12%; n=277) have a complete knowledge of their pension income. They know all three building blocks: their pension income, whether this is sufficient or not, and they know how to increase their pension income. Unfortunately, this 'complete pension knowledge' group is only a small minority (12%) of the respondents.

3.2 Factors taken into consideration

The factors that respondents take into consideration when they give an estimate of their pension income, are the following (between brackets are the proportion of respondents that take that particular factor into consideration):

- Number of years that pension premium has been paid (87%)

- State pension (AOW; first pillar) (80%)
- Only the regular wage income taken into consideration (68%)
- Mortgage costs after retirement (64%)
- Savings (60%)
- Changes in lifestyle (59%)
- Changes in family composition (51%)
- Inflation (50%)
- Lower tax rate (49%)
- Income changes after retirement (45%)
- The fact that no premium has to be paid anymore for the state pension (44%)
- Changes in housing; moving to a smaller and cheaper house (43%)

Some factors are only relevant for some respondents:

- Debt (29%)
- Partner pension (29%)
- Expected changes in value of stocks (18%)
- An expected heritage (15%)
- Divorces of the past (14%)
- Work and income from a foreign country (9%).

The majority of the respondents (62,5%) consider 70 to 90 percent of their income before retirement to be sufficient as their retirement income. After having seen the relevant factors, many respondents give a downward estimate of the pension income they consider to be sufficient. The majority (62,5%) now considers 60 to 80 percent of their income before retirement to be sufficient as their retirement income.

4. Who have complete and no knowledge of their pension?

Employees (wage earners) who have complete knowledge about their pension (12%), deviate on a number of characteristics from employees who have no knowledge of their pension (66%). In Table 1, these contrasts are given.

- Insert Table 1 about here -

In Table 1 we observe that persons without pension knowledge are more often younger and female, and have a lower level of education. In general, persons in a one-person household have more pension knowledge than persons in a multi-person household. An explanation could be that a single person cannot delegate the responsibility for the financial affairs of the household to another person but has to be knowledgeable him/herself. A single person is also completely dependent on his/her own income and is forced to build financial buffers, wealth and pension savings him/herself.

A large proportion (30%) of the people without pension knowledge don't know whether their pension plan is executed by a pension fund or a pension insurer. And 45% don't know which type of pension they have.

4.1 Pension knowledge and financial knowledge

If we compare how much people know about financial products, 71% of the respondents state that they have sufficient knowledge about saving. Only 33% of the respondents state that they have sufficient knowledge about pensions. Only the knowledge about investing is lower: 18% of the respondents state that they have sufficient knowledge about investing. Pension knowledge is however necessary for everyone and investment knowledge is not. In general, a low level of pension knowledge corresponds with a low level of knowledge about financial products. See Table 2.

- Insert Table 2 about here -

People without pension knowledge also have fewer experiences with financial misfortune such as knowing someone with a bad pension plan. People without pension knowledge have bought fewer risky financial product. This may be partly related to their lower age. Young people have a shorter period of experiences, including pension experiences.

4.2 Pension knowledge and motivation

The group without pension knowledge does not feel responsible for pension saving and does not create time to organize things. These people don't like to worry about the future and they don't like to think about pension, retirement, and old age. This means that this group is less likely to act if this is needed. The people with complete pension knowledge have less problems with this and they prefer to organize their own future. They feel responsible and reserve time to organize their pension. See Table 3.

- Insert Table 3 about here -

4.3 Pension knowledge and behavior

The differences in knowledge and motivation about pensions also have their impact on financial behavior. People without pension knowledge do not have a financial plan, spend their money immediately, and have problems with saving money. Often people without pension knowledge think that the government will help them if they should run into financial problems. The consequence of this may be that these persons have no 'incentives' to do something about their financial situation and their pension. See Table 4.

- Insert Table 4 about here -

We also observe that people without pension knowledge and people with complete pension knowledge differ in the way they make financial decisions. This is based on the four AFM segments (Authority Financial Markets) in a study from 2004. In the AFM study, four segments were distinguished: controlled, ambitious, advise-sensitive and convenience decision styles. A controlled decision style means that people consider many alternatives and deliberately search for the best alternative. People with an ambitious decision style are more adventurous and take risks with the alternative they select in order to make more money. People with an advise-sensitive decision style rely on trusting their adviser; their choice is 'satisficing' (finding an acceptable alternative rather than the best alternative) rather than maximizing, and emotions play a role. People with a convenience

decision style do not like financial decisions and restrict the number of alternatives; they do not trust advisers that much. See Table 5 for an overview of the results. People with complete pension knowledge often have a controlled decision style (41%) and less often an advise-sensitive decision style (14%). This means that they take their financial decisions deliberately, independently and carefully. People without pension knowledge often have an advise-sensitive decision style (39%). They are strongly influenced by their advisers. The number of alternatives and amount of information is restricted and one stops as soon as a financial has been found that is satisfactory. It is problematic that this is mainly a matter of feeling towards than of content of the financial product. Trust in other persons also plays a major role in making decisions. The convenience decision style is evenly (15%) distributed over the four groups of pension knowledge.

- Insert Table 5 about here -

5. Pension knowledge and age

Obviously, pension knowledge and age are related. In general, the older a person is, the better is the pension knowledge, because the pension comes closer and is more relevant, and it becomes easier to extrapolate the pension income from the present income. In the age bracket 21-35 the proportion of no pension knowledge is 76% and the proportion of complete knowledge is 6%, whereas in the 50-65 age bracket the proportion of no pension knowledge is 54% and the proportion of complete knowledge is 18%. See Table 6.

- Insert Table 6 about here -

Life events may contribute to pension knowledge, in the sense that with a life event people often have to reconsider and to reorganize their financial affairs. Life events such as marriage, starting living together with a partner, moving to another home, starting a new job, mainly occur in the 21-35 age bracket and seldom occur in the 50-65 age bracket. See Table 6.

The type of pension saving also differs between age brackets. Most respondents have a saving account to safe for old age. Home ownership is also an old age provision, in the sense that having paid off the mortgage, the home is a major type of wealth for most people. A home may also be sold to acquire money for the old age. It is obvious that older people have more savings and wealth than younger people.

6. Pension knowledge, gender, education, and household size

Pension knowledge of man is generally higher than the pension knowledge of women. This is related to the fact that the main wage earner of a household is more often a male than a female. Men also have a higher income than women. In most households the husband contributes more to the household income than the wife. The pension income of the husband is thus also higher and more important than the pension income of the wife. See Table 7.

- Insert Table 7 about here -

Pension knowledge also varies with the level of education. The higher the education level, the better the pension knowledge (Table 8).

- Insert Table 8 about here –

People living in one-person households generally have a somewhat higher pension knowledge than people living in households with three or more persons. See Tables 1 and 9.

- Insert Table 9 about here –

7. Pension knowledge, income and wealth

Pension knowledge increases with income. Respondents that do not know their income or are unwilling to say their income, also have a lower pension knowledge. See Table 10. The type of pension saving does not differ very much between income brackets. Two-thirds of respondents have a saving account. People in the highest income brackets participate more often in company pension plans, have more investments, and are somewhat more often a home owner.

- Insert Table 10 about here –

Pension knowledge also increases with wealth and savings. People with more than €100,000 of wealth and savings have a better pension knowledge than people with lower levels of wealth and savings. Wealth and savings are also correlated with home ownership. People with higher wealth and savings are more often a home owner and not a renter. See Table 11.

- Insert Table 11 about here –

8. Risk groups

Four risk groups may be defined within the group of people without pension knowledge. These four risk groups may run a larger risk than others in not having an adequate pension plan. Note that the percentages are based on the total number of employees (wage earners) in The Netherlands. Entrepreneurs and independents are not included.

1. No pension knowledge and lower pension than partner
(16% of respondents).
2. No pension knowledge and retirement in less than twenty years
(20% of respondents).
3. No pension knowledge and low financial reserves and buffer
(less than €5000; 14% of respondents).
4. No pension knowledge and overestimating own pension knowledge
(16% of respondents).

These four risk groups are not exclusive: one person may be a member of more than one group. Of all respondents 24% belong to one risk group, 15% belong to two risk groups, 4% belong to three risk groups, and no respondents belong to all four risk groups.

The persons in the first risk group that have a lower pension than their partner, are in almost all cases female. This is often the case in households with three or more persons, thus families with children. The second group that will retire in less than 20 years, is obviously older and often has a medium or lower level of education. The third group without financial reserves is relatively young. The fourth group overestimating the own pension knowledge is often male and older.

The persons with two or more risk indications have often a medium or low level of education and are in majority older than 40 years. These persons are often member of two-person households.

9. Communication and information behavior

Only 28% of respondents read the Uniform Pension Overview (UPO) carefully and want to know whether they will have sufficient income at retirement. People without pension knowledge do this less often than people with complete pension knowledge. It is part of the definition of these groups. This is also true for consulting other information sources. The employer (personnel department) and the pension fund or the pension insurer are mentioned as the most often consulted. Other sources are colleagues, relatives and friends, intermediaries and television programs. The employer and the pension fund/-insurer are the parties that are preferred as information sources. Mayhew (2003, p. 3) finds that in the U.K. the most mentioned information sources about pensions are financial advisers (31%), (personnel departments of) employers (26%) and banks/building societies (24%).

About half of the respondents indicate to have trouble to find the correct and relevant information. The problem is not that the information is not or difficultly available. It is especially difficult to filter the relevant information from the total information supply and to understand this information correctly. There is an obvious need for clear and personalized information and good search facilities for persons to find the relevant information easily.

The media behavior of people without and with complete pension knowledge do not differ that much:

- Television viewing is similar.
- People without pension knowledge read fewer newspapers: 25% read no newspapers at all. This percentage of reading no newspapers at all is only 2% for people with complete pension knowledge.

10. Conclusions

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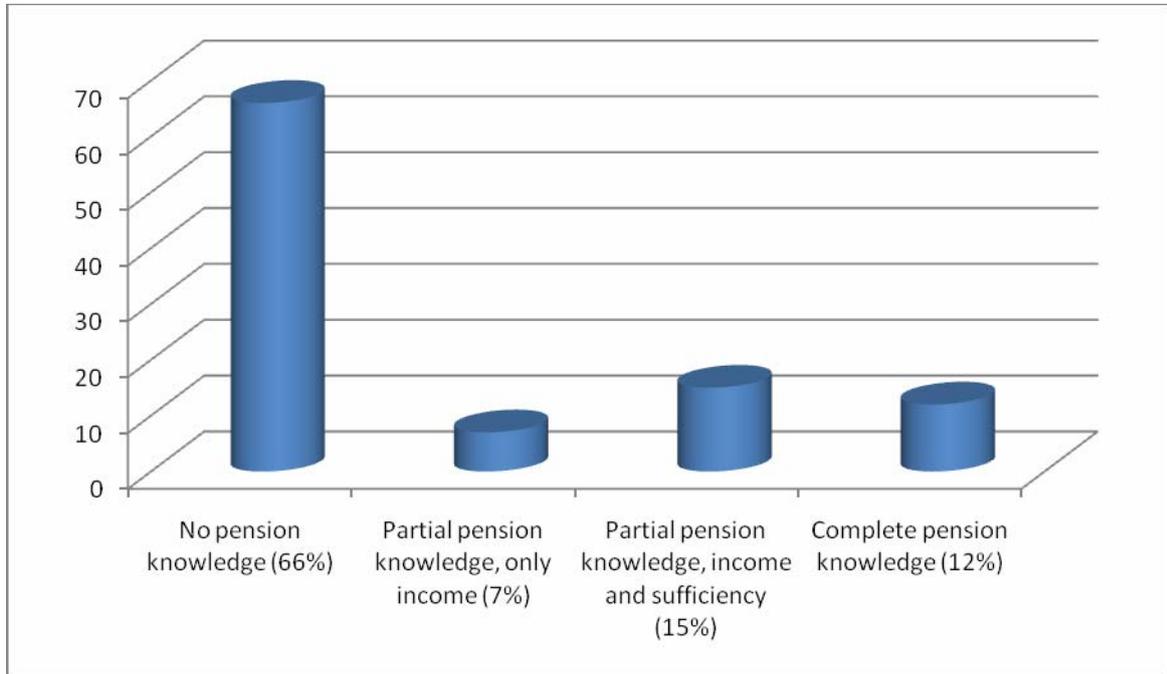
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Figure 1. Pension knowledge in The Netherlands



No pension knowledge (66%)	Complete pension knowledge (12%)
<i>Socio-demographics</i>	
<ul style="list-style-type: none"> • younger • more often female • lower education • more often many-persons households 	<ul style="list-style-type: none"> • older • more often male • higher education • more often one-person households
<i>Financial situation</i>	
<ul style="list-style-type: none"> • lower income • small wealth of savings and investments • less often a home owner 	<ul style="list-style-type: none"> • higher income • larger wealth of savings and investments • more often a home owner
<i>Pension situation</i>	
<ul style="list-style-type: none"> • know less often whether they have their pension with a pension fund or an insurer • often don't know which type of pension they have 	<ul style="list-style-type: none"> • know better whether they have their pension with a pension fund or an insurer • often know which type of pension they have

Table 1. Comparison of respondents with no and complete knowledge of their pension.

No pension knowledge	Complete pension knowledge
<p><i>General financial knowledge</i></p> <ul style="list-style-type: none"> • hve less knowledge about financial products 	<ul style="list-style-type: none"> • have more knowledge about financial products
<p><i>Specific knowledge about pensions</i></p> <p>Know less often:</p> <ul style="list-style-type: none"> • what is a partner pension • that if you have no pension, you only get a state pension (AOW) 	<p>Know more often:</p> <ul style="list-style-type: none"> • what is a partner pension • that if you have no pension, you only get a state pension (AOW)
<p><i>Experiences</i></p> <ul style="list-style-type: none"> • know less often someone who has a poor pension plan • did less often purchase a risky financial product 	<ul style="list-style-type: none"> • know more often someone who has a poor pension plan • did more often purchase a risky financial product

Table 2. Comparison of respondents with no and complete knowledge of their pension.

No pension knowledge	Complete pension knowledge
<i>Motivation</i>	
<ul style="list-style-type: none"> • pension not seen as their own responsibility • read less often information about pensions • know less often where to go to change one's pension • plan to organize their pension the coming years • reserve less time to work on their pension • don't like to think about their retirement and old age • do not worry about what may happen in the future • external control (not taking your own future in your hands but let it happen) • low motivation to think about financial affairs 	<ul style="list-style-type: none"> • pension seen as their own responsibility • read more often information about pensions • know more often where to go to change one's pension • plan to organize their pension now • reserve more time to work on their pension • have less problems with thinking about their retirement and old age • do not like to take risks about the future • internal control (taking your own future in your hands and organize it) • motivation to think about financial affairs

Table 3. Comparison of respondents with no and complete knowledge of their pension.

No pension knowledge	Complete pension knowledge
<i>Behavior</i>	
<ul style="list-style-type: none"> ▪ do less often have a financial plan for the future ▪ spend money immediately ▪ have more problems with saving money for the future ▪ more often think that the government will solve their financial problems ▪ have an advisory financial decision style 	<ul style="list-style-type: none"> ▪ do more often have a financial plan for the future ▪ do not spend money immediately ▪ have less problems with saving money for the future ▪ less often think that the government will solve their financial problems ▪ have a controlled financial decision style

Table 4. Comparison of respondents with no and complete knowledge of their pension.

	<u>Financial decision style</u>			
	<u>Controlled</u>	<u>Ambitious</u>	<u>Advise- sensitive</u>	<u>Convenience</u>
<hr/>				
<u>Pension knowledge</u>				
No knowledge	27%	19%	39%	15%
Partial knowledge 1	34	24	28	15
Partial knowledge 2	32	20	33	15
Complete knowledge	41	29	14	15
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Total	29	20	36	15
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Table 5. Pension knowledge in four decision styles (decision styles based on AFM study, 2004).

	<u>Age</u>			
	<u>21-35</u>	<u>35-49</u>	<u>50-65</u>	<u>Total</u>
<u>Pension knowledge</u>				
No knowledge	76%	64%	54%	66%
Partial knowledge 1	8	7	7	7
Partial knowledge 2	10	15	21	15
Complete knowledge	6	13	18	12
<u>Life events (of last 5 years)</u>				
Marriage	20	13	2	12
Living together	37	7	3	15
Moving home	49	21	9	27
Child born	23	13	0	13
Marriage separation	2	2	3	2
New job	46	24	9	27
Part-time job	11	7	3	7
End of job	14	10	6	10
Illness/accident	2	1	4	2
Death of partner	0	1	2	1
Start own company	4	2	1	2
None of these	17	47	72	44
<u>Type of pension saving</u>				
Saving account	64	58	67	62
Life insurance	7	19	23	17
Investment	5	9	10	8
Home ownership	34	48	47	44
None of these	20	16	11	16

Table 6. Pension knowledge, age, life events, and type of pension saving
 Partial knowledge 1: Knows pension income
 Partial knowledge 2: Knows pension income and sufficiency

	<u>Gender</u>		
	<u>Male</u>	<u>Female</u>	<u>Total</u>
<hr/>			
<u>Pension knowledge</u>			
No knowledge	62%	70%	66%
Partial knowledge 1	7	7	7
Partial knowledge 2	16	14	15
Complete knowledge	15	9	12
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<u>Income earner</u>			
100% by me	32	8	21
70-90% by me	37	5	23
40-60% by me	28	43	35
0-30% by me	3	44	21
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Table 7. Pension knowledge, gender, and income earner
 Partial knowledge 1: Knows pension income
 Partial knowledge 2: Knows pension income and sufficiency

	<u>Level of education</u>		
	<u>low</u>	<u>medium</u>	<u>high</u>
<u>Pension knowledge</u>			
No knowledge	15%	44%	39%
Partial knowledge 1	9	39	52
Partial knowledge 2	11	43	45
Complete knowledge	7	36	56
Total	13	43	43

Table 8. Pension knowledge and level of education
 Partial knowledge 1: Knows pension income
 Partial knowledge 2: Knows pension income and sufficiency

	<u>Household size</u>		
	<u>1-person</u>	<u>2-persons</u>	<u>3 or more persons</u>
<u>Pension knowledge</u>			
No knowledge	15%	29%	56%
Partial knowledge 1	15	33	52
Partial knowledge 2	14	34	52
Complete knowledge	21	32	47
Total	15	31	54

Table 9. Pension knowledge and size of the household
 Partial knowledge 1: Knows pension income
 Partial knowledge 2: Knows pension income and sufficiency

	<u>Net monthly income (in euros)</u>				<u>Don't know, unwilling to say</u>
	<u>0-1200</u>	<u>1200-1800</u>	<u>1800-2500</u>	<u>>2500</u>	
<hr/>					
<u>Pension knowledge</u>					
No knowledge	18%	31%	25%	9%	17%
Partial knowledge 1	12	40	27	15	6
Partial knowledge 2	13	34	30	15	8
Complete knowledge	6	25	39	19	12
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Total	15	32	28	12	13
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<u>Type of pension saving</u>					
Saving account	63	67	70	70	60
Life insurance	15	11	12	11	10
Company pension plan	16	12	9	20	7
Investment	9	5	5	10	4
Home ownership	49	49	51	57	27
None of these	12	10	12	7	28
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Table 10. Pension knowledge, net monthly income, and type of pension saving
 Partial knowledge 1: Knows pension income
 Partial knowledge 2: Knows pension income and sufficiency

	<u>Wealth & savings (in euros)</u>					
	<u>No</u>	<u><5,000</u>	<u>5,000-</u>	<u>20,000</u>	<u>>100,000</u>	<u>Don't know,</u>
	<u>wealth</u>		<u>20,000</u>	<u>100,000</u>		<u>unwilling to</u>
						<u>say</u>
<hr/>						
<u>Pension knowledge</u>						
No knowledge	13%	13%	7%	16%	6%	39%
Partial knowledge 1	9	10	19	21	13	29
Partial knowledge 2	8	16	17	17	15	26
Complete knowledge	9	6	15	18	26	26
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Total	11	12	15	17	10	34
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<u>Home ownership</u>						
Renter	39	32	28	13	6	21
Owner	46	56	67	83	93	64
Living with parents	15	12	5	4	1	15
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Table 11. Pension knowledge, wealth & savings, and home ownership

Partial knowledge 1: Knows pension income

Partial knowledge 2: Knows pension income and sufficiency