Pension Research Council
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"Insights from Behavioral Research for Retirement Policy and Practice"

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Important Success Story

- Academic research has had a significant positive impact on the practical design of retirement/pensions plans.

- A combination of regulation, nudges (e.g., defaults) and financial education have had a significant impact on retirement savings decisions:

  – Defaults (opt-out instead of opt-in) or active choice

  – Automatic escalation

  – Target-Date Funds

How much to save and how to invest it

- Individuals saving for retirement face two important decisions:

1) How much

   to save:

2) How to invest

   those savings:

How much to save and how to invest it

- The savings decision is more important/valuable, but academics/financial advisors are better able to influence the portfolio allocation.

- <u>Portfolios</u>: Rapid adoption of TDFs through defaults (see, for example, Mitchell and Utkus (2022)).

- <u>Savings</u>: "Defaulted" employees eventually move away from the default, take money out (e.g. roll-over withdrawals or loans) or reduce contributions in future jobs, are more likely to stay at the default and not increase contributions going forward (see, for example, Beshears et al. (2018), Choukhmane (2023))

Asset Allocation Decision

- **Re-designing TDFs**: Risky share for the young should be above 100% (remember: this is only retirement wealth).

  - TDFs can generate fake (thus costless) in-house leverage.

  - Limited liability: price of implicit Put would be trivial.

  - Could be one of their significant benefits.

- **"Replacing" TDFs?** Crucial state variable is W/PV(Y), not age. Condition on W/Y? (PV(Y) too complex to measure and explain).

  - Probably more intuitive than age: most people probably don't know the logic, or even pattern (!) of TDFs

  - Don't observe all wealth: use "account balance" as default, or let people self-select (as for retirement age).

  - Double sort? Too complex, simple is good. Is sorting on W/Y only better than sorting on age only?

  - (For countries that already use TDFs) Don't rock the boat!

Savings Decision

- Optimal savings is a particularly tough problem because one-size does not fit all (e.g. Choi et al. (2003) and Carroll et al. (2009)). (also for asset allocation, but the cost is (again) smaller).

- Savings defaults might have had more modest results, but:

  - Larger impact for low income and younger workers (e.g., Beshears et al. (2022), Falk and Karamcheva (2023), Choukhmane (2023)).

  - <u>Conclusion:</u> Maybe modest aggregate impact, but helped those that they are particularly supposed to help.

Savings Decision

- Contrast: Australian or Danish model.

- Middle ground: minimum mandatory contribution

  – Positive: good for (almost) all, no issue with heterogeneity.

  – Concern: those with low financial literacy might think this is the optimal, and procrastinators might stay there.

  – Implication: must be combined with (higher) default and automatic escalation.

- Moving away from one-size-fits-all?

  – Schlafmann et al. (2024): Contribution rates should increase with age and decrease with balance-to-income.

  – Could also condition on industry, homeowner/renter, marital/family status, but would raise "fairness concerns".

Elephant in the Room?

- Most retirement wealth accumulation in the U.S. is now in IRAs, not company/state-sponsored plans (Bretscher et al. (2024):
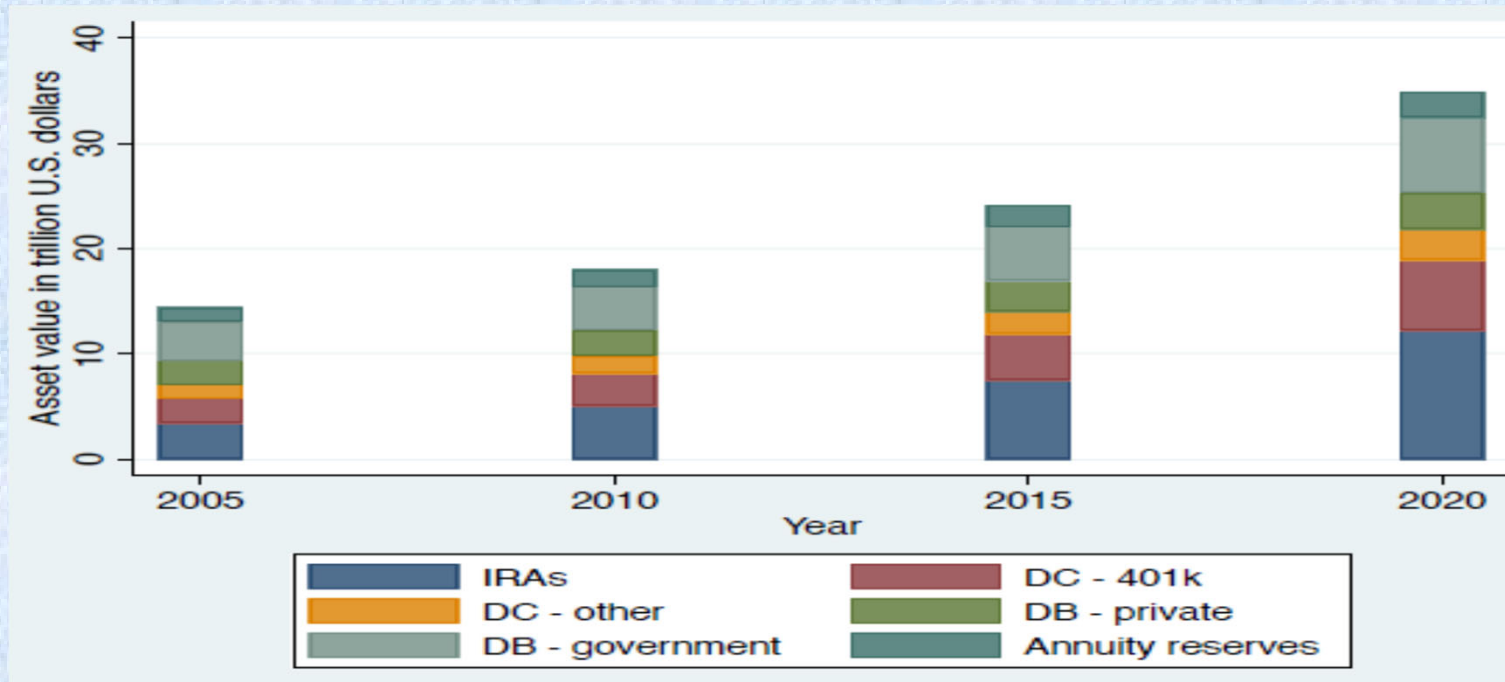
- Important part of this growth appears to be driven by high-income individuals exploiting the features of Roth IRAs (Bretscher et al. (2024).

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What about Retirees?

- In contrast with the advice and rules that we developed for workers, there is very little on offer for retirees!

  – Use annuities (how much?)

  – Use reserve mortgages

  – Move to a very conservative portfolio (rubbish!):
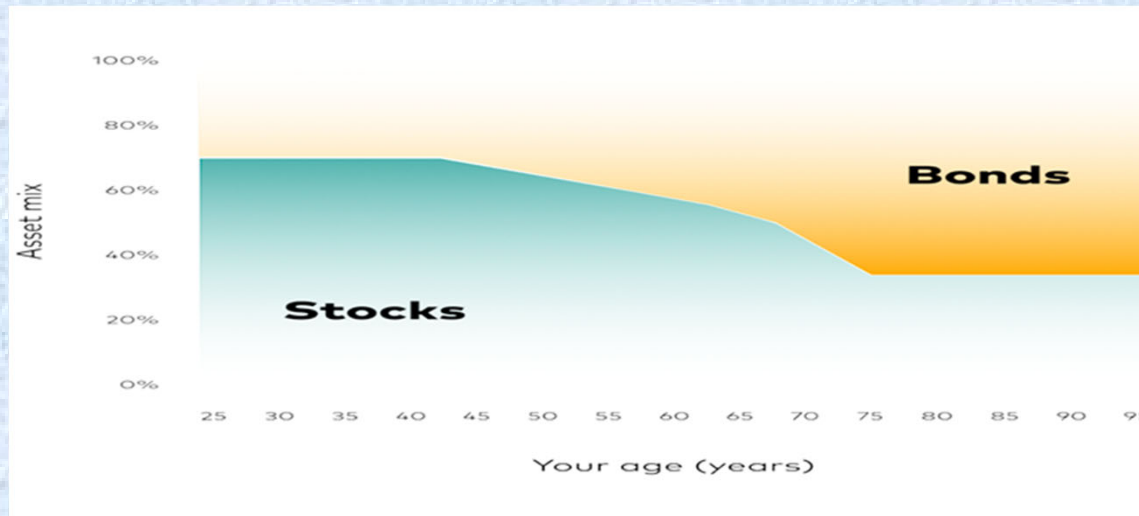
Designing Better Retirement Plans

- Pension plan design is one of the good success stories for academic research.

- Hopefully, as we learn more and more, we can eventually tackle even the toughest cases: