Evaluating the impact of DC (defined contribution) scheme structure and communication policies using a bounded rationality framework

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Outline

- Definitions
- Bounded rationality framework
- Examples of policies using the framework
- Conclusions

Definitions: defined contribution schemes

- Post-retirement benefits are determined by the contributions paid into the scheme and the rate of return on investments

Definitions: pension plan policies

Structure –plan design

Communication – content and media

Weiner and Doescher (2008)

Definitions: structural policies

Defaults	**Description**
Automatic/ mandatory enrolment	Employees enrolled when employed or after vesting period. With automatic enrolment, employees are allowed to opt out.
Contribution rate	% of income automatically deducted from pay at the time of enrolment if the member does not make a choice. Member may be allowed to increase/decrease.
Investment fund choice	Generally 'lifestyle' strategy. Members can switch.
Automatic escalation	Percentage of income contributed automatically increases with age or pay.

Definitions: structural policies

Other	**Description**
Matching	Employer agreement to increase contributions at a stated ratio to employee contributions up to a 'cap'
Investment funds choices	The number investment funds that differ in relation to risk and the composition of assets

Definitions: objectives of communication policies

Objectives	Defined
Persuade	Policies designed to attract new members or to convince people to increase their contributions
Inform	Policies designed to convey the member's current situation, impact of possible actions, impact of budget and legislated changes, changes due to increased age…
Educate	Policies designed to improve financial literacy defined as, "…peoples' ability to process economic information about financial planning, wealth accumulation, debt and pensions" (Lusardi and Mitchell 2014, p. 6)

Definitions: characteristics of communication policies

Characteristics	**Examples of policies**
Individualised by name, personal circumstances	On-site access to financial advisor On-site access to pension provider (Understandable) individual benefit statements
Segmented by personal, socio demographic or employment characteristic	‘Layered communication’ that is age appropriate E-mail shots appropriate to certain groups Pre-retirement seminars
Targeted	Savings rate that will usually achieve pension adequacy
Frequency	The **number** and **timing** of pension communications per year

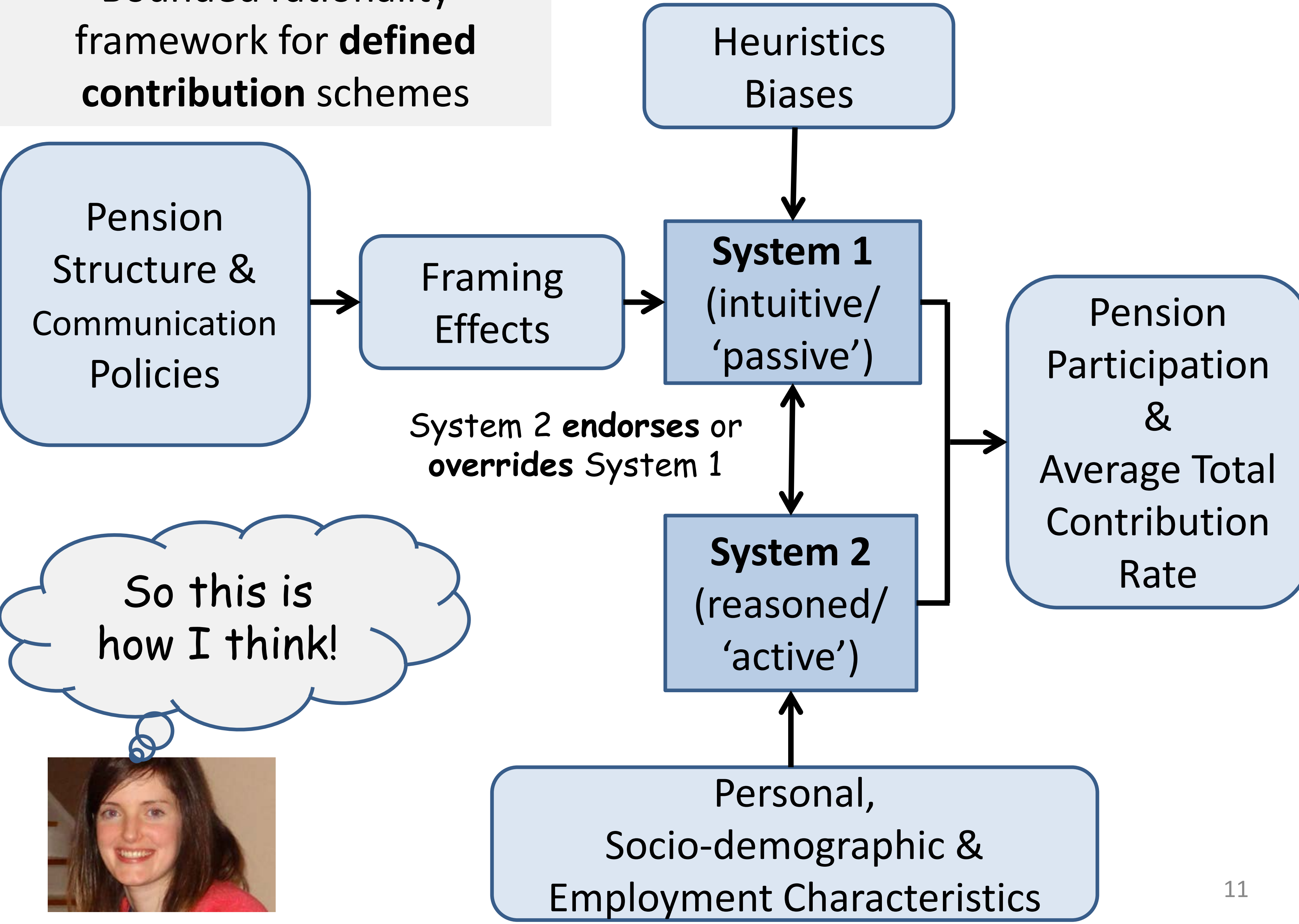
Definitions: outcomes

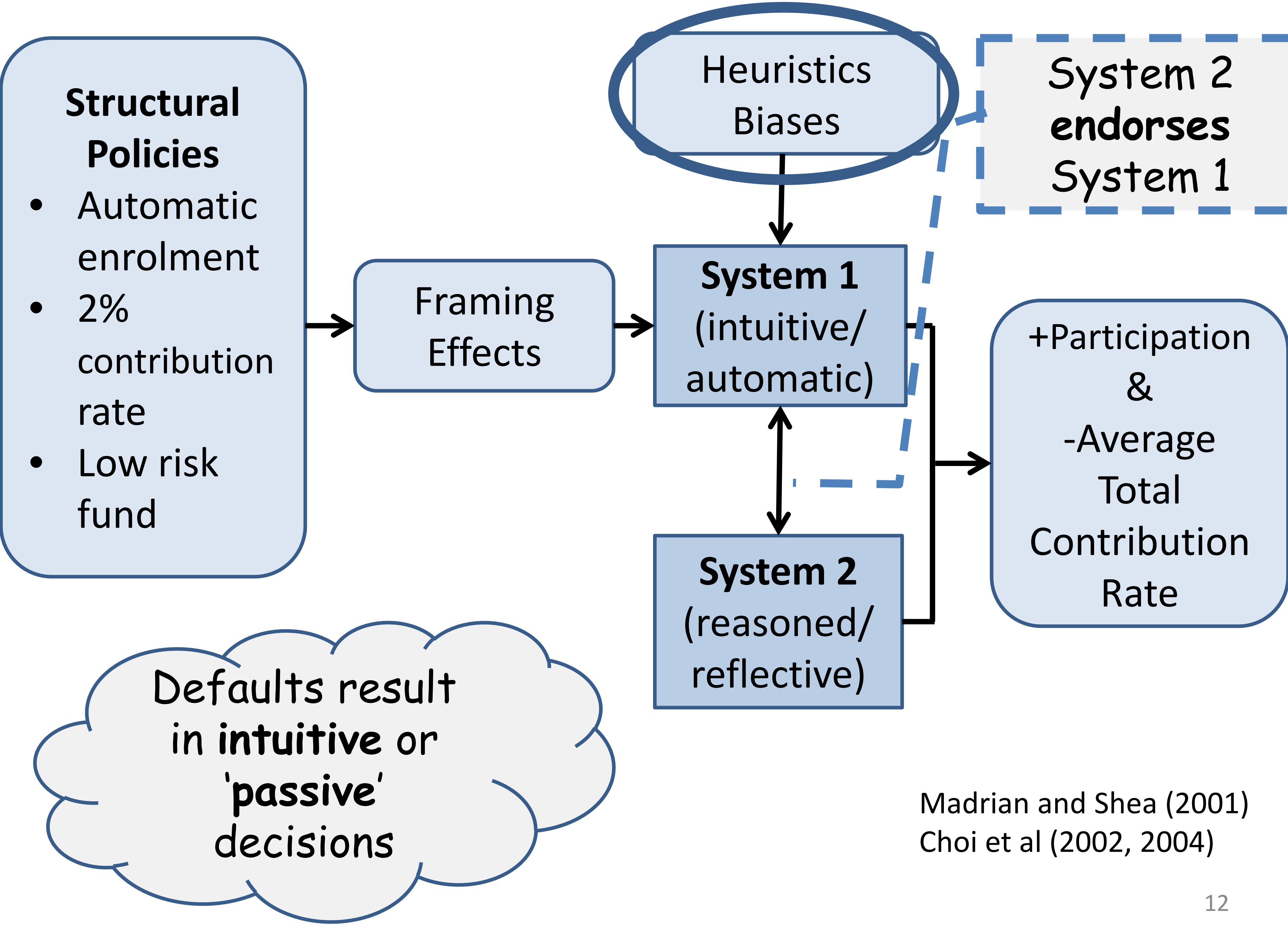
National	Organisational	Personal
Pension coverage - % of people in the labour force, contributing to an occupational or personal pension scheme	**Participation rate** – % of work force who are members of the occupational pension scheme	Amy **joins** her company's DC scheme
Pension adequacy - income required to maintain an individual's pre-retirement lifestyle	**Average contribution rate** – average contribution rate of pension scheme members	Amy saves enough for '**adequate**' income during her retirement years

Bounded rationality

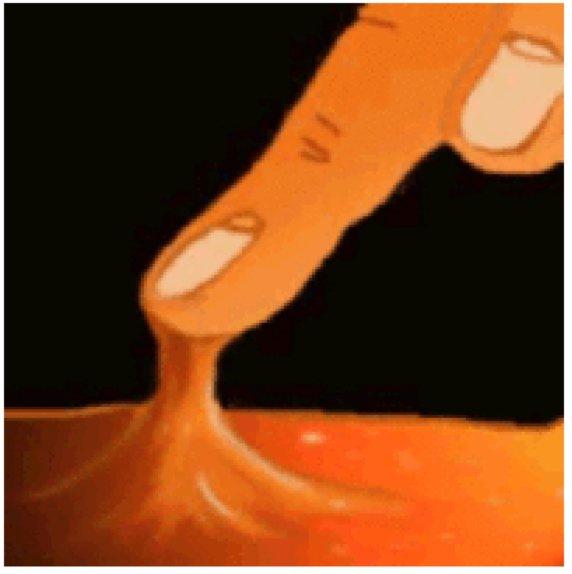
- People are limited in their ability to understand and to calculate
- “Although Humans are not irrational, they often need help to make more accurate judgements and better decisions, and in some cases policies and institutions can provide that help.” (Kahneman 2011, p. 411).
- The choice architect can ‘nudge’ people to make better decisions if they understand how people think (Thaler and Sunstein 2003)

Bounded rationality framework for **defined contribution** schemes





Madrian and Shea (2001)
Choi et al (2002, 2004)



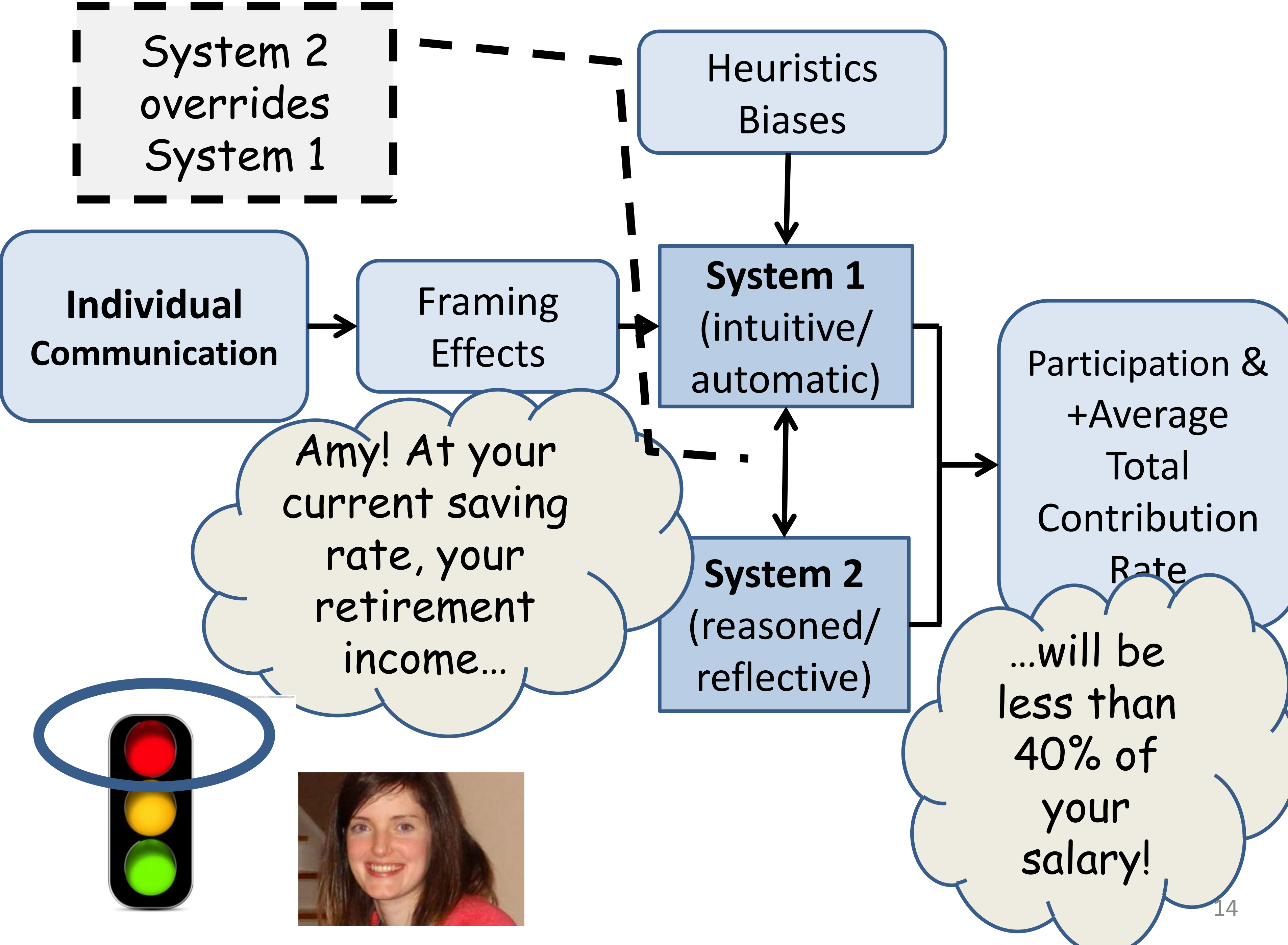
Very ‘sticky’ defaults

- Automatic enrolment
- Investment fund

Fairly ‘sticky’ defaults

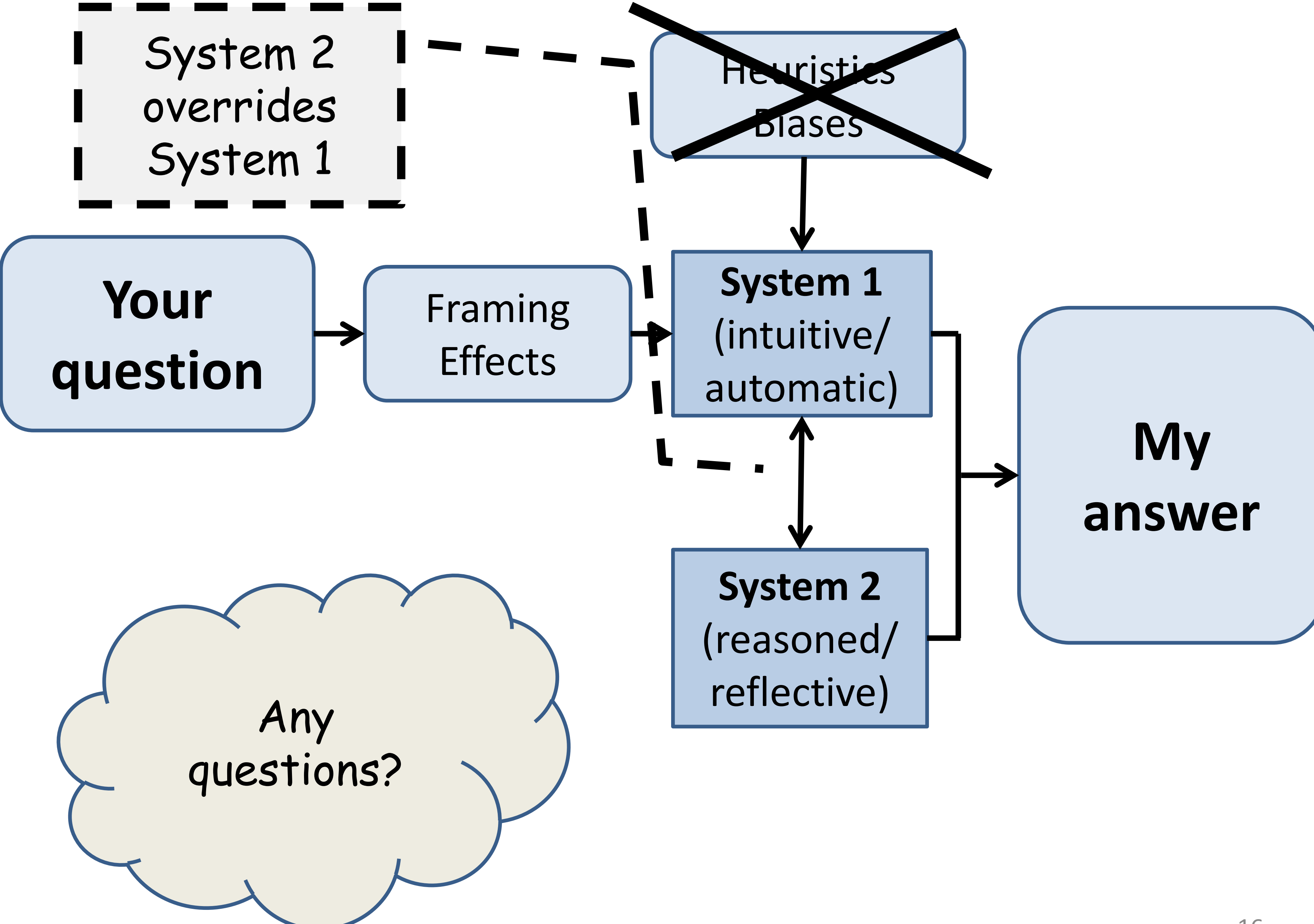
- Contribution rate

- Research suggests that structural policies, particularly defaults, powerfully impact behaviour
- Little research has been conducted to evaluate the impact of communication policies on either decision making or behaviour


System 2 overrides System 1
Heuristics Biases
Individual Communication
Framing Effects
System 1 (intuitive/ automatic)
System 2 (reasoned/ reflective)
Participation & +Average Total Contribution Rate
Amy! At your current saving rate, your retirement income…
…will be less than 40% of your salary!

Conclusion

- Pension adequacy requires ‘good’ structure combined with ‘good’ communication policies
  - Understandable to people with leaving cert
- Structure and communication policies should be developed at the same time
- Developing pension communication policies requires the cooperation of stakeholders around agreed objectives
- Communication policies should be tested and evaluated
  - Focus on young, old, women, low paid, less educated


System 2 overrides System 1
~~Heuristics~~
~~Biases~~
Your question
Framing Effects
System 1 (intuitive/ automatic)
System 2 (reasoned/ reflective)
My answer
Any questions?