



LABOR AND POPULATION

***Retirement Savings:
New Realities for Consumers***

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Center on Financial Decision Making

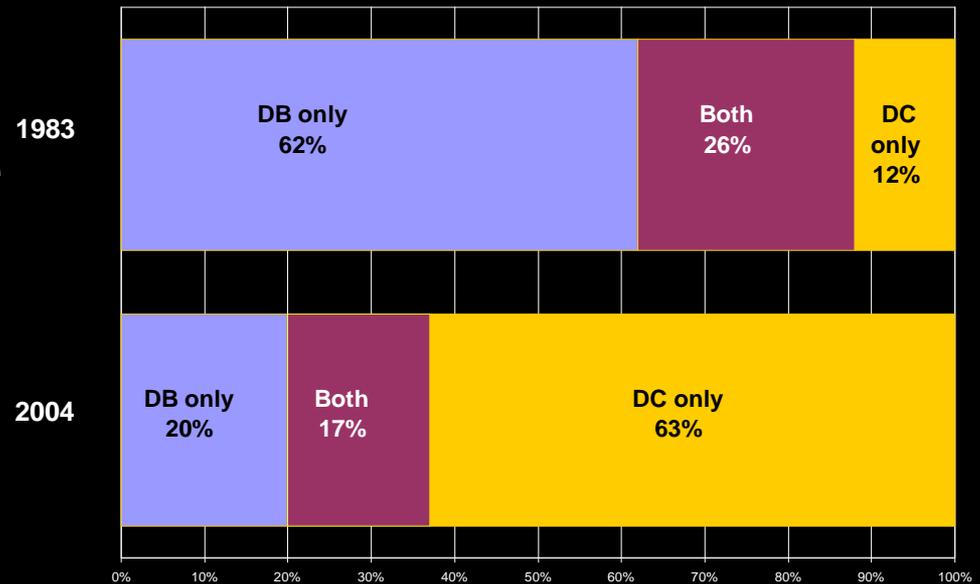
RAND Corporation

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Transition from DB to DC Pensions

- **Defined-contribution plans have become the dominant form of pensions over the past quarter-century in US**

– Munnell & Sunden (2006)

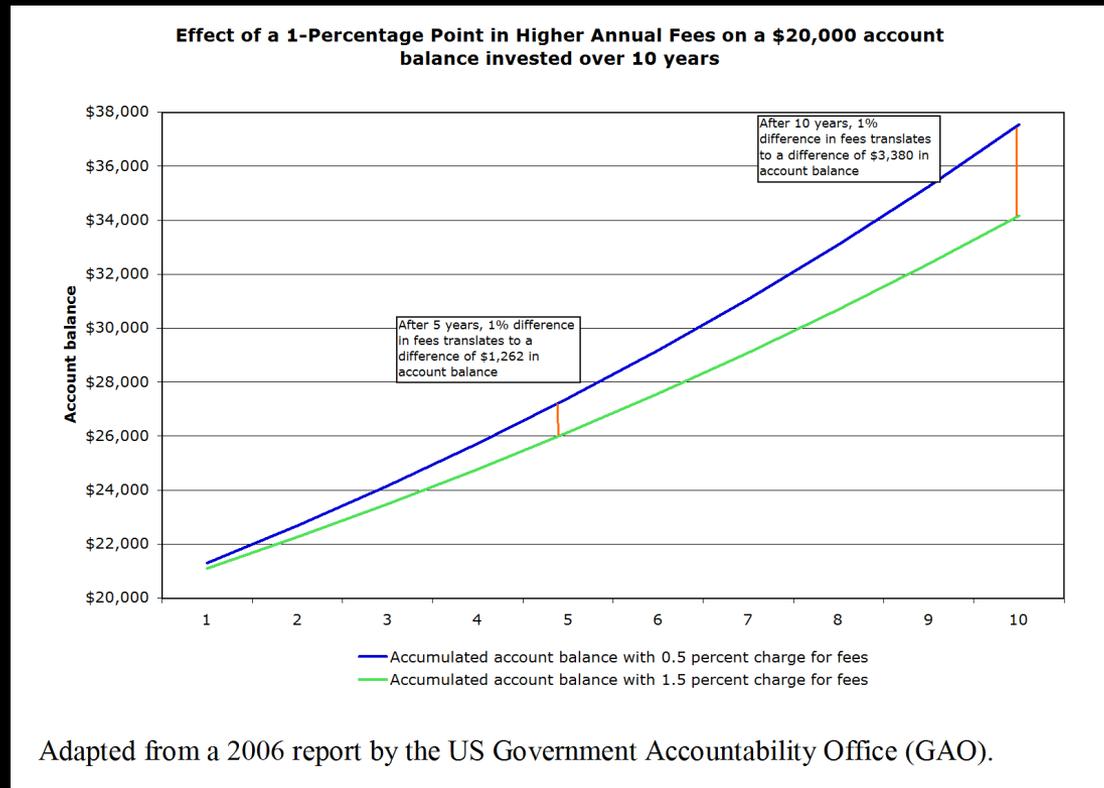


- **DC plans place burden of financial decision making on the individual, who must also bear the investment risk**
 - *What kinds of choices do individuals make?*
 - *What do they know about the choices they face?*
 - *Where do they get information & advice?*
 - *What information & advice are they given?*

Research on DC Plan Decision Making

- **Participation and Contribution Decisions**
 - Opt-in versus opt-out enrollment
 - Response to employer match
 - Role of default options
- **Allocation Decisions**
 - “1/n-rule”
 - Impact of expanded choice set
 - Limited rebalancing
- **Policy proposals**
 - Automatic enrollment
 - Life-cycle funds as default investment
 - Save More Tomorrow™

The Impact of Fees and Expenses



- **What do individuals know about fees & expenses?**
 - Often, not much, according to survey evidence
 - RAND American Life Panel
 - AARP survey of 401(k) participants

The Impact of Fees and Expenses

- *How do mutual fund fees & expenses affect behavior?*
- Evidence from mutual fund flows (Barber et al. 2005)
 - Purchases are sensitive to salient fees, such as loads and commissions
 - Less sensitive to expense ratios
- Evidence from choice experiments
 - RAND American Life Panel (ALP)
 - Loads vs. expense ratios
 - Front-end vs. back-end loads
 - Expected holding period
 - Role of financial literacy
 - Other studies (Choi et al., 2006; Wilcox, 2003)
 - Fees vs. past performance

Findings from RAND-SEC Study:

Individual and Industry Perspectives on Investment Advisers and Broker-Dealers

- ***Do investors understand differences between IAs and BDs?***
 - ***Especially legal obligations***
- **IA-BD Business Practices**
 - **Firms offer multiple services, either directly or via affiliates**
 - **Affiliations not always obvious**
 - **Large multi-service or affiliated firms dominate market**
 - **“We do it all” advertisements**
 - **Financial professionals use generic titles**
- **Investor Confusion**
 - **Almost half of ALP survey respondents reported using financial service providers, but often:**
 - **Don’t understand IA-BD differences**
 - **Don’t know whether provider is IA or BD**
 - **Don’t know fees or even method of payment**

Findings from RAND-SEC Study:

Individual and Industry Perspectives on Investment Advisers and Broker-Dealers

- **Investor Satisfaction**

- Despite confusion about job titles, legal obligations, and fees, investors are generally quite satisfied with their own providers
- Satisfaction typically arises from the personal service given
 - No evidence on how financial returns vary with advice

- **Need for advice**

- Individuals often recognize need for advice
 - Especially concerning retirement savings

Conclusions

- **Research indicates that investors and non-investors often do not behave optimally**
 - **One part of the problem seems to be a lack of information/education about the choices they face**
 - **Suboptimal behavior may persist even after key information is highlighted**
- **Individuals often recognize their own confusion and need for advice**
- **Pension Protection Act of 2006 attempts to remove impediments to**
 - **Participation**
 - **Diversification**
 - **Provision of financial advice**



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