

***Discussion of “The Importance of
Default Options for Retirement
Saving Outcomes”***

James Poterba

MIT and NBER

26 October 2006

DOES FINDING DEFAULT EFFECTS MEAN SAVERS ARE IRRATIONAL?

- What Effect Do “Saving Errors” Have on Lifetime Utility? Stake of Decision Matters
- How Persistent Are Default Effects?
- Consider Balance Sheet Beyond 401(k) Account
- Heterogeneous Effects: Defaults Affect Some but not All Households

WHY DO DEFAULTS AFFECT CHOICES?

- Households Lack Information to Make Decisions: Can We Provide Education?
- Households Lack Capacity to Process Information: Can We Train Them?
- Households Exhibit Decision-Making Biases: Can We Use “De-Biasing” Techniques?
- Households Think Defaults Represent Advice: Can We Decouple the Advice?

LIFECYCLE FUNDS

- Increasingly Popular Default Option in 401(k) Plans
- < \$10 Billion in Funds at End of 2000; Now > \$125 Billion
- Automate Choice of Asset Allocation
- “One Size Fits All” Product

ASSET ALLOCATION IN LIFECYCLE FUNDS

| Target Ret. Yr. | Stocks | Bonds | Cash | Other |
|-----------------|--------|-------|------|-------|
| 2010 | 49 | 39 | 11 | 2 |
| 2015 | 58 | 35 | 6 | 1 |
| 2020 | 61 | 31 | 7 | 2 |
| 2025 | 76 | 21 | 3 | 1 |
| 2030 | 74 | 20 | 4 | 1 |
| 2035 | 86 | 11 | 2 | 1 |
| 2040 | 83 | 12 | 4 | 1 |
| | | | | |
| | | | | |

DIFFERENCES IN LIFECYCLE FUND ASSET ALLOCATION PATTERNS

| Ret.Yr. | Fund Name | Stock | Bonds | Cash |
|---------|-------------------------|-------|-------|------|
| 2015 | Fidelity | 65 | 34 | 1 |
| 2015 | T. Rowe Price | 70 | 23 | 6 |
| 2015 | Vanguard | 65 | 34 | 1 |
| 2030 | Fidelity | 71 | 23 | 4 |
| 2030 | Principal Investment | 67 | 23 | 6 |
| 2030 | T. Rowe Price | 88 | 8 | 4 |
| | | | | |

FACTORS THAT AFFECT AGE-SPECIFIC DEMAND FOR EQUITIES

- Risk Tolerance
- Correlation of Shocks to Labor Income and Shocks to Equity Values
- Background Risk
- Flexibility of Future Labor Supply
- RESULT: Heterogeneity in Preferred Equity Allocation

HOW SHOULD DEFAULTS BE CHOSEN?

- “Asymmetric Paternalism”: Help Those Who Make Poor Choices without Affecting Choices of Others
- Consider Short-Run and Long-Run Effects
- Recognize that Some Agents Who Make Good Decisions Without the Default May Choose the Default
- Costs of Un-doing the Default are Key