

TIAA Institute Fellows Symposium

A Force for Good: Using Behavioral Finance to Improve Retirement Outcomes

A research forum co-hosted with the Pension Research Council

Research Summaries Report

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TIAA Institute Fellows Symposium

Dear Colleagues:

Welcome to **A Force for Good: Using Behavioral Finance to Improve Retirement Outcomes**, a TIAA Institute Fellows Symposium focused on how behavioral factors and biases can affect financial decisions, co-hosted with the Pension Research Council/Boettner Center at Wharton School of the University of Pennsylvania.

In the context of the coronavirus pandemic and resulting economic crisis, financial security has, sadly, taken on renewed importance. The health and economic ramifications of the virus will play out for years, and creative approaches on all fronts are needed to blunt the impact. To that end, today we will review six innovative studies that explore ways to enhance Americans' lifelong financial security:

- **Using Behavioral Prompts to Improve Saving and Investment Decisions**
Vickie Batjelsmit and Jennifer Coats, Colorado State University
- **The Role of Affect and Social Norms in Preferences for Guaranteed Income Streams in Retirement**
Helen Colby, Indiana University, and Suzanne B. Shu, UCLA
- **Impact of Automatic Enrollment in Retirement Savings Plan for Public Employees**
Robert Clark and Denis Pelletier, North Carolina State University
- **Do Mandatory Retirement Contributions Crowd Out Voluntary Contributions?**
Leora Friedberg and Adam Leive, University of Virginia, and Wenqiang Cai, PWC
- **Understanding Debt Among the Older Population**
Olivia S. Mitchell, University of Pennsylvania
- **Moving the Goalposts**
Jordan Nickerson, Boston College

On the pages that follow, you'll find brief summaries of the studies, including key findings. Biographies of the presenters are provided in a separate document.

Our organizations are proud to support original research that explores how people make important financial decisions, so plan sponsors and policymakers can use this knowledge to enhance retirement outcomes. We hope you glean new insights from this research—and we are eager to hear your thoughts on the findings and implications.

Sincerely,



David P. Richardson
Managing Director of Research, TIAA Institute



Olivia S. Mitchell
Executive Director, Pension Research Council

Table of Contents

Using Behavioral Prompts to Improve Saving and Investment Decisions	3
The Role of Affect and Social Norms in Preferences for Guaranteed Income Streams in Retirement	4
Impact of Automatic Enrollment in Retirement Savings Plan for Public Employees	5
Do Mandatory Retirement Contributions Crowd Out Voluntary Contributions?	6
Understanding Debt Among the Older Population	7
Moving the Goalposts	8

Using Behavioral Prompts to Improve Saving and Investment Decisions

Vickie Batjelsmit and Jennifer Coats

Behavioral biases may adversely impact younger generations' retirement savings decisions and financial outcomes. Previous research suggests that differences in overconfidence, financial literacy, risk preferences, and present bias all affect saving and investment behavior. In an incentivized laboratory experiment, the authors study participants' investment and asset allocation choices over a meaningful time horizon and test the efficacy of alternative behavioral prompts to motivate saving decisions. The prompts considered include setting goals in advance of saving decisions, receiving investment advice tailored to stated goals, and invoking the future self.

Key findings:

- Individual risk tolerance and discount rates each have a persistent and significant impact on saving and investment decisions. Financial literacy is also an important driver of investment decisions.
- Higher levels of financial literacy, higher levels of risk tolerance, and lower discount rates increase the rate of saving and expected return.
- Behavioral prompts that encourage reflection on goals and future needs have significant effects on allocation decisions and expected returns, after controlling for risk tolerance, discount rates, and financial literacy.
- Behavioral prompts increase expected returns for women and people with lower levels of financial literacy.

The Role of Affect and Social Norms in Preferences for Guaranteed Income Streams in Retirement

Helen Colby and Suzanne B. Shu

Decumulation decisions require individuals to consider a range of factors, including not only financial outcomes, but also family needs and retirement goals. An underexplored factor in these decisions is the role of positive and negative affect—or, more explicitly, the emotional content of retirement messages delivered to consumers and that consumers bring to the decisions. This paper describes a series of empirical analyses and experimental studies to explore the role of affect in behavioral retirement insurance decisions (e.g., annuitization) and examines the role of social norms messaging in encouraging interest in annuity uptake.

Key findings:

- While consumers appear to bring a lot of emotions and experiences around retirement financial planning to the annuity decision, making manipulation of affect and anxiety through messaging difficult, positive affect reliably predicts greater interest in annuity product uptake.
- Using a high-social-norms framing also significantly increases interest in life annuity products.
- Individuals who are experiencing higher levels of financial distress, regardless of household income, report more interest in lifetime annuities.
- Interventions and messaging that make better use of these factors may be able to help consumers make long-term financial decisions better aligned with their retirement goals.

Impact of Automatic Enrollment in Retirement Savings Plan for Public Employees

Robert Clark and Denis Pelletier

Numerous studies suggest that automatic enrollment increases participation in retirement saving plans. But virtually all of this research pertains to private sector firms that offer only a 401(k) plan. In contrast, no major study to date has looked at how automatic enrollment affects participation in supplemental retirement plans offered by state governments, which tend to provide richer retirement benefits than those typically offered in the private sector. This paper adds to the literature by examining the effects of automatic enrollment on the state of South Dakota's supplemental retirement saving plan (SRP). The authors were granted access to administrative records of all South Dakota public employees hired between 2005 and 2016. Using these data, they determined and compared SRP enrollment rates for workers hired before and after automatic enrollment was introduced in 2010.

Key findings:

- Career public employees covered by a pension and Social Security often receive at retirement a life annuity equal to 70%-80% of their final salary, so participation in supplemental retirement plans is generally low.
- Before automatic enrollment, less than 3% of newly hired South Dakota government workers contributed to the SRP in their first year of employment.
- After the state introduced automatic enrollment, over 90% of newly hired employees participated in the plan.
- Automatic enrollment tends to equalize plan participation rates across age, gender, and income level.
- The typical South Dakota employee follows the usual pattern of remaining at the default contribution.

Do Mandatory Retirement Contributions Crowd Out Voluntary Contributions?

Leora Friedberg, Adam Leive, and Wenqiang Cai

A high contribution rate to employer-provided defined contribution (DC) pension plans is important for employees to maintain their standard of living during retirement. Yet these plans differ in whether employee or employer contributions are mandated, leaving a critical role for voluntary contributions. This study examines how employees respond to a shift in required contribution rates at a large public university. Starting in 2010, the university's DC plan enacted two key changes: the employer contribution rate fell by 1.5 percentage points (pp) and a new mandatory employee contribution rate of 5% was established. Economic theory predicts that required contributions will "crowd out" voluntary contributions by up to 5 pp. The authors find evidence of incomplete crowd-out by comparing saving decisions of new employees who joined after the change to those of new employees who joined before the change.

Key findings:

- There is a small and often statistically insignificant reduction of 3-6 pp in the share of employees who make any voluntary contributions to the DC plan.
- The reduction is modest in comparison to the 50% of employees who contributed more than zero but less than 5% before the policy change and thus are prone to be crowded out.
- Among those who continue to make voluntary contributions, such contributions dropped by about 2.25 pp.
- The resulting crowd-out rate is only about 45%, falling well short of predicted crowd-out of up to 5 pp.
- The results suggest a high prevalence of passive saving and highlight the importance of salience in an increasingly complicated choice environment.

Understanding Debt Among the Older Population

Olivia S. Mitchell, Annamaria Lusardi, and Noemi Oggero

Older Americans are increasingly likely to carry debt into retirement, and older households' debt to income ratios are rising. This trend has prompted concerns about retirement security, since a higher debt burden can affect how much older persons can contribute to their retirement accounts and how they manage their retirement drawdowns. Also, when interest rates rise, older Americans will need to spend more of their incomes to service their debts. This study analyzes debt among the elderly using two new data sources: a debt module in the 2018 U.S. Health and Retirement Study and the 2018 National Financial Capability Study. The authors examine older persons' attitudes toward and comprehension of debt, including how older persons perceive their financial situations and how debt influences their financial circumstances.

Key findings:

- Many older Americans believe their debt is excessive, feel financially distressed, are contacted by debt collectors, and are unsatisfied with their financial situation.
- Many people close to retirement carry debt, including unpaid medical debt and student loans, and few older persons had given any thought 10 years previously to debt they might accrue today.
- Having dependent children contributes to feelings of being overindebted, as does having a negative income shock.
- Women, African Americans, and lower-income individuals are more financially stressed than their male, white, and higher-income counterparts.
- Financial literacy contributes to positive financial perceptions and behaviors among older adults, including reporting better credit records and planning for retirement.

Moving the Goalposts

Jordan Nickerson

Individuals participating in the workforce face a complex trade-off between either consuming more now and working longer until retirement, or saving more now and being able to retire earlier. This trade-off is exacerbated when workers suffer an unanticipated reduction in their future retirement benefits. This paper examines how people who experienced such a reduction responded along two dimensions: how long they kept working until retiring and how much additional debt they took on. The author exploits a provision in a 2005 Texas pension reform act that “grandfathered” some workers into the former retirement benefit program, while reducing the benefits of other workers. To gauge the effects of a shock to retirement benefits, he compared public school employees who narrowly missed qualifying for the grandfather provision to those who just barely qualified for it.

Key findings:

- Workers who experience a reduction in retirement benefits are apt to delay retirement by about three months.
- Such workers also are likely to increase their outstanding debt balances by roughly \$1,600. The debt increase is due almost exclusively to an increase in auto-related debt and installment loans.
- The additional debt may represent a worker's attempt to make up for the delayed leisure of retirement by spending more on durable goods while still working.
- While workers are likely to offset a reduction in benefits by working longer, the associated increase in debt may lead to lower consumption in retirement.



About the TIAA Institute

Since 1998, the TIAA Institute has helped advance the ways individuals and institutions plan for financial security and organizational effectiveness. The Institute conducts in-depth research, provides access to a network of thought leaders and enables those it serves to anticipate trends, plan future strategies and maximize opportunities for success. To learn more, visit www.tiaainstitute.org.

About the Pension Research Council

For over 65 years, the Pension Research Council/Boettner Center at Wharton School of the University of Pennsylvania has sponsored research on the entire range of private pension and Social Security programs, as well as related benefit plans in the U.S. and worldwide. Learn more at www.pensionresearchcouncil.wharton.upenn.edu