Individual Savings Behavior: Lessons from Economic Research and Implications for Public Policy

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The Changing Composition of Employer Sponsored Retirement Plans

- Defined Contribution Plan Participants:
  - 3.4 DC participants for each DB participant

- Defined Benefit Plan Participants:
  - 2.4 DB participants for each DC participant

Graph showing the number of active plan participants from 1975 to 2005.
Are employees prepared for a defined contribution world?

  - 38% of respondents report that they have little or no financial knowledge
    - 40% of respondents believe that a money market fund contains stocks
    - Two-thirds of respondents don’t know that it is possible to lose money in government bonds
    - Respondents on average believe that employer stock is less risky than a stock mutual fund
  - Two-thirds report that they would be better off working with an investment advisor than managing investments solo
Implications

- Savings outcomes heavily influenced by small changes in plan design
  - Savings plan participation
  - Contribution rate
  - Asset allocation
- Mistakes—potentially large ones
Automatic Enrollment for New Hires and Savings Plan Participation

Fraction ever participated

Tenure (months)

Before automatic enrollment

After automatic enrollment (6% default)

After automatic enrollment (3% default)

Source: Beshears, Choi, Laibson and Madrian (2008)
Automatic enrollment and savings plan participation

- Sizeable benefits to 401(k) participation
  - Tax benefits
  - Employer match (100% match up to 6% contribution for company above)

- Striking difference in participation rates before and after automatic enrollment

- Striking similarity in participation rates under automatic enrollment at 3% and 6% default contribution rates
Automatic enrollment and savings plan participation—explaining the results

☐ Are individuals indifferent?
☐ Unlikely....
  ■ Big financial implications: nothing vs. 12%
  ■ Opt-out rate from automatic enrollment low
  ■ Opt-out rate before automatic enrollment high
  ■ When required to choose, participation rates high (Carroll et al. 2007)
  ■ Individuals state a preference to save more

☐ Collectively, evidence suggests that most individuals prefer savings plan participation to non-participation

☐ Complexity of decision task leads to delay in the absence of automatic enrollment
Simplification and Savings Plan Participation

Fraction of Employees Participating at 3 Months

Month of Hire

Source: Beshears, Choi, Laibson and Madrian (2009)
Automatic Enrollment and the Distribution of Savings Plan Contribution Rates

- **3% default under AE**
  - Hired before automatic enrollment: 2, 1, 3
  - Hired during automatic enrollment (3% default): 21
  - Hired during automatic enrollment (4% default): 20

- **4% default under AE**
  - Hired before automatic enrollment: 9
  - Hired during automatic enrollment (3% default): 31
  - Hired during automatic enrollment (4% default): 20

- **Match threshold**
  - Hired before automatic enrollment: 49
  - Hired during automatic enrollment (3% default): 13
  - Hired during automatic enrollment (4% default): 11

Source: Choi, Laibson, Madrian and Metrick (2006)
Before Automatic Enrollment

- Money Market: 7%
- Bonds: 18%
- Stocks: 75%

After Automatic Enrollment

Money Market Default Fund

- Stocks: 81%
- Bonds: 3%

Source: Madrian and Shea (2001)
Research Impact

- On design of employer-sponsored savings plans
- On regulation of employer-sponsored savings plans
- On savings policy more generally
- In other domains
Research Impact: Employer-Sponsored Savings Plans

- Plans rethinking importance of plan design
- Fairly rapid adoption of “Autosave” plan features
  - In 2009, about half of participants are in plans using automatic enrollment
Research Impact: Savings Policy

- Motivation behind the “Autosave” features of the Pension Protection Act of 2006
- Motivation behind the “Auto IRA” proposal currently under legislative consideration
- Kiwisaver plan in New Zealand
- Pensions reform in the U.K.
Research Impact: Other Domains

- Regulation of consumer financial markets
  - New banking reforms require consumers to opt-in to overdraft protection

- Health

- Education
  - FAFSA form (financial aid)