Policy Issues for Retirement Investing

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A new economic landscape

Two major changes

Major changes that shift decisions to the individual

- **Shift from DB to DC pensions**
  - Workers are in charge of making decisions about their pensions

- **Changes in consumer credit**
  - More opportunities to borrow & in large amounts
  - Individuals are in charge of deciding how much to borrow
Some important features of DC pensions

Workers have to make many decisions

- **Voluntary contributions**
  - Sometimes incentivized by employer matches

- **Investment decisions**
  - Menu of options

- **Borrowing opportunities**
  - Loans and hardship withdrawals

- **Withdrawals after retirement**
  - Can take pensions as lump sums
New data to understand decisions about pensions

The 2009 & 2012 National Financial Capability Study (NFCS)
How well-equipped are individuals to make decisions about pensions?

These decisions are very complex

- Very low levels of financial literacy
  - Individuals lack knowledge of basic financial concepts
- Risk and risk diversification are what people know the least
  - Prevalence of “do not know” responses
- Lack of financial literacy is particularly severe among some demographic groups
  - Young, old, women
- Very limited use of financial advisors
  - Those who consult advisors have high financial literacy
Household finances

The financial fragility of American families

- Little or no precautionary savings and liquidity
  - 40% of families cannot come up with $2,000 in 30 days

- Large amount of debt, even close to retirement
  - Both short-term and long-term debt

- Lack of financial planning
  - A minority (37%) has ever tried to calculate how much they need to save for retirement

- Borrowing against retirement accounts
  - Many, including the young, borrow against their pensions
The increase in debt across older cohorts (age 56-61). Source: Health and Retirement Study (HRS)

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<tbody>
<tr>
<td><strong>Total debt/Total assets &gt; 0.5</strong></td>
<td>9.6%</td>
<td>16.0%</td>
<td>22.9%</td>
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<tr>
<td><strong>Home loans/home value &gt; 0.5</strong></td>
<td>17.0%</td>
<td>26.4%</td>
<td>29.3%</td>
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<td><strong>Respondents with &lt; $25,000 in savings (in $2012)</strong></td>
<td>18.0%</td>
<td>16.4%</td>
<td>24.3%</td>
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Most relevant initiatives for DC pensions

Workers have to make many decisions

Simplify some of these decisions

- Voluntary contributions. **Automatic enrollment**
  - Very low contribution rates. One size fits all approach

- Investment decisions. **Life-cycle funds**
  - No-one knows the composition of their portfolios. Fees?

- Possibility to borrow. **Try to limit that?**
  - Workers will rely on other (expensive) borrowing

- Withdrawals after retirement. **Automatic enrollment into annuities?**
  - It is costly to un-enroll
Some questions

Problems with the current system

- Should individuals be pushed into long-term investments when they have little or no liquidity?
  - When shocks occur, they borrow against pensions

- How about Millennials?
  - They start their economic life in debt.
  - Problems with debt will translate into poor FICO scores

- Preparing for the future (and future decisions)
  - How can we explain annuities?
  - Doing calculations about how much is needed for retirement
  - How to support a 30-year retirement with a 40-year career?
Building a more robust pension system

New directions for policy

- **Equip people to make financial decisions**
  - More financial education programs in the workplace
  - Need financial education programs in school

- **More targeted programs**
  - One size does not fit all

- **Holistic approach**
  - Not only saving and investing but also debt management
  - Precautionary savings in addition to retirement savings
Building long-term financial security

Best practices

How employers can help new hires save for retirement: Best practices that build long-term financial security

We prepared a report documenting best practices for improving financial decision making in the workplace.

- Based on studies of many employer-provided financial education programs
- Goal of the report is to help employers improve retirement saving choices of newly hired workers
NYSE Workplace Financial Fitness Toolkit

A program for any company

- Ten steps divided into 3 stages: Basic, Intermediate, and Advanced
- Customize the program for employees
  One size does not fit all
- The Employee Checklist
  Ten guidelines with implementation tips to improve employees’ financial fitness
“An investment in knowledge pays the best interest.”

Benjamin Franklin, *The Way to Wealth*, 1758
Contact and further information

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