



BeFi

BeFi Conference Topic 1

Improving Choices with Gentle Persuasion: The Power of Nudges

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Joint research with:

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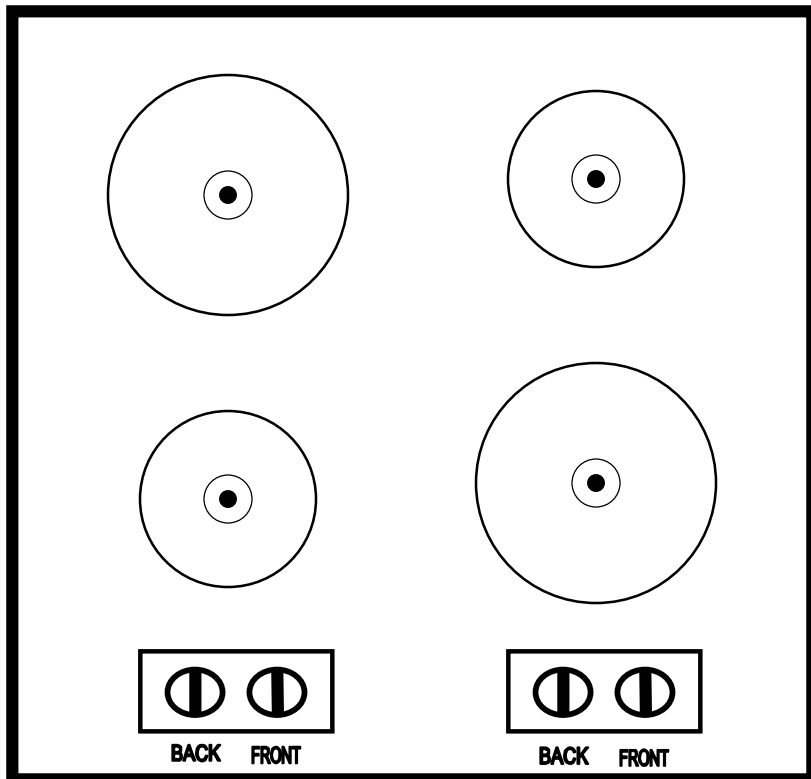
One Approach to Policy: Libertarian Paternalism

- Both terms are currently unpopular (at least in the US), and seemingly contradictory.
- But, neither concept should be controversial:
 - Libertarian: protect the individual's right to choose
 - Paternalism: do what you can to improve the welfare of people
- And it is possible to achieve both goals.
- Libertarian Paternalism policies are designed to improve and guide choices without coercion or the elimination of freedoms.
- Achieve these goals with better **choice architecture**.

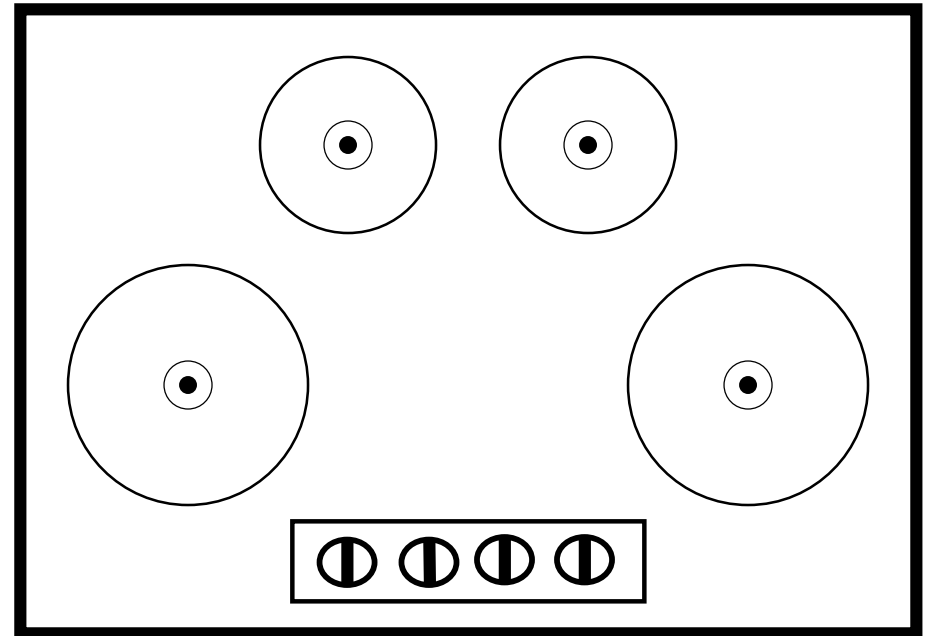
Design Matters

- Stove Example

Bad Design



Good Design



Don Norman's Principles of Good Design

- Visibility: By looking, the user can tell the state of the device and the alternatives for action
- Conceptual Model: The designer provides a good conceptual model for the user, with consistency in the presentation of operations and results and a coherent, consistent system image.
- Mapping: It is possible to determine the relationships between actions and results, between the controls and their effects, and between the system state and what is visible.
- Feedback: The user receives full and continuous feedback about the results of actions.
- Fail save: if the consumer does nothing, does that lead to a good or bad outcome?

Are Savings Systems Well Designed?

- Visibility: Can a user tell what is going on just by looking at their quarterly report?
- Conceptual Model: Does the user understand what problem they are solving?
- Mapping: Does the user know what happens if they change funds or asset allocations?
- Feedback: Do consumers get useful feedback on how they are meeting their goals?
- Fail Safe? Does doing nothing produce something good?

Choice overload

- When lots of fund choices are included, participants can get flustered (Iyengar)
 - They can be slower to join
 - They are less likely to invest in stocks
- So?
 - For plans with many options, have simplified structures.

Simplified Choice Structure

- Opt out
- Good Default
- First level options for those who want them—levels of risk in lifestyle funds.
- Second level—choices of many funds
- Advances level: mutual fund “window”.

Pension Reform Act

- Good libertarian paternalism legislation
- Firms that match, auto-enroll, and escalate get a free pass on non-discrimination rules.
- Something for everyone. Wide bipartisan support.

How Not to Do It: Medicare Part D

- 40-60 plans in each state.
- Plans vary across states.
- Formularies are not known and can be changed.
- Participant has to type in (possibly long) list of drugs. (No spell checker!)
- No default options except for dual eligibles.

Recent Progress

- Automatic Enrollment
- Automatic Escalation (e.g., Save More Tomorrow)
- Better default investment options (e.g., life-style or age-based funds)
- What Else Can We Do to Help?

Company Stock

- Even post Enron, many employees have substantial holdings in company stock.
- Some prescriptions
 - Education
 - Caps
 - Automatic Rebalancing—Sell More Tomorrow

Realize the Everything Matters

- Fact: very few Vanguard participants have more than 4 funds.
- Conjecture: Vanguard has a rule. No.
- Survey at U of C: most have 4 funds.
- The solution. The enrollment form has 4 lines!

Experiment on Morningstar.com

- Participants are told to imagine that their employer has the following 8 funds available and were asked how they would allocation their funds.
- The first group was presented with a form with four lines on it, though the participants could easily select additional funds by clicking on a highlighted link with these instructions: “Based solely on the above, please indicate how you would allocate your retirement contributions. You may choose up to four funds. (If you would like to elect more than four funds, please [click here.](#))”
- The second group of participants was shown an election form with eight lines on it.
- Despite the ease of simply clicking on the link, only 10 percent of the subjects with the four-line form selected more than four funds. In contrast, 40 percent of those viewing the eight-line form picked more than four funds.

Focal Points

- Rather than match 50% of contributions up to 6% why not match 30% up to 10%?
- Social Security: the first age at which one can collect retirement benefits is 62. More people retire at that age than any other. How to get people to work longer?
- One solution: raise the minimum retirement age.
- Another: lower the minimum! Make 62 less focal.

Important Research Initiatives

- Does increasing savings rates increase wealth?
- What is needed:
 - Large sample of employers with varying features (auto enrollment, SMarT, etc.)
 - Careful net worth assessment before and after.
 - At least 3 year horizon.



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