



# IMPROVING RETIREMENT INCOMES IN THE CONTEXT OF BEHAVIOURAL BIASES

Behavioural economics applied to pensions

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Individuals are not well prepared to take more responsibility for their retirement

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- Changing pension landscape
  - Low financial literacy
  - Behavioural biases
- ➡ Turn behavioural **biases** into behavioural **solutions**



# Participate in a retirement savings plan?

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## **Behavioural biases**

- Inertia
  - Present bias
  - Overconfidence
- Procrastination
  - Complexity
- Tendency to respond to immediate gratification

## **Behavioural solutions**

- Automatic enrolment of formal employees
- Financial incentives
  - Tax incentives, matching contributions, fixed nominal subsidies
  - Nudge self-employed and informal employees into the same scheme
- Make it easy to save by using defaults



# How much to contribute?

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## **Behavioural biases**

- Lack of self-control
- Loss aversion
- Inertia
- Projection bias

## **Behavioural solutions**

- Low initial default contribution rates
  - Reduce opt-out rates
- Automatic escalation of contributions
  - Up to a pre-set level with possibility to stop
  - Linked to pay rises



# How to choose the pension provider?

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## **Behavioural biases**

- Procrastination and inertia
  - Stick with existing providers
  - Not shopping around
  - Not switching to better providers
- Framing, persuasion and simplistic rules of thumb
  - Comparisons not based on most critical characteristics

## **Behavioural solutions**

- Default provider(s) for those not choosing their own
- Selected through a tender mechanism based on a range of criteria, not just fee levels
- Combined with enhanced fee disclosure, education, and price regulation



# How to invest?

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## **Behavioural biases**

- Choice overload
- Time-inconsistent preferences
- Naïve diversification strategies
- Framing
- Overconfidence and over-extrapolation
- Loss aversion

## **Behavioural solutions**

- Reduce the number of investment options
- Establish a life-cycle investment strategy as a default



# How to choose the post-retirement product?

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## **Behavioural biases**

- Loss aversion
- Overconfidence
- Framing
- No good rule of thumb for drawdown programmes

## **Behavioural solutions**

- Promote product innovation combining flexibility and protection against longevity risk
- Consider introducing a default
- Facilitate shopping around by using a platform to compare all options and bids



## Conclusion: Nudge and inform

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- Automatic features
  - Default options
  - Incentives
  - Simplification of information and choice
  - Education and information to increase engagement with respect to pensions
- ➔ Improve retirement incomes